Manchester City Council
Report for Information

Report to: Audit Committee – 30 November 2017

Subject: Treasury Management Interim Report 2017-18

Report of: City Treasurer

Summary

To report the Treasury Management activities of the Council during the first six months of 2017-18.

Recommendations

The Audit Committee is asked to note the contents of the report

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Wards Affected:

Not Applicable

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Background documents (available for public inspection):

Treasury Management Strategy Statement and Borrowing Limits and Annual Investment Strategy Report 2017-18

(Executive – 8 February 2017, Resource and Governance Scrutiny Committee – 20 February 2017, Council – 3 March 2017)

1 Introduction and Background

1.1 Treasury Management in Local Government is regulated by the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management in Local Authorities. The City Council has adopted the Code and complies with its requirements. A primary requirement of the Code is the formulation and agreement by full Council of a Treasury Policy Statement which sets out Council, Committee and Chief Financial Officer responsibilities, and delegation and reporting arrangements.

1.2 CIPFA amended the CIPFA Treasury Management in the Public Services Code of Practice in late 2009, and the revised Code recommended that local authorities include, as part of their Treasury Management Strategy Statement, the requirement to report to members at least twice a year on the activities of the Treasury Management function. The recommendation was included within the Treasury Management Statement Strategy approved by the Executive on the 17th February 2016, and by Council on the 4th March 2016. This report therefore ensures that the Council meets the requirements of the Strategy, and therefore the Code.

1.3 The Code was revised in November 2011, acknowledging the effect the Localism Bill could have on local authority treasury management, however there were no major changes to the Code. This report has been prepared in accordance with the revised November 2011 Code.

1.4 Treasury Management in this context is defined as:

"The management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks".

1.5 This interim report covers:

Section 1: Introduction and Background
Section 2: The Council's Portfolio Position as at 30th September 2017
Section 3: Review of Economic Conditions
Section 4: External Borrowing in 2017-18 to date
Section 5: Progress with MCC Stock Redemption
Section 6: Compliance with Treasury Limits and Prudential Indicators
Section 7: Investment Strategy for 2017-18 to date
Section 8: Temporary Borrowing and Investment for 2017-18 to date
Section 9: Implications of MIFID II - The second Markets in Financial Instruments Directive
Section 10: Proposed changes to the CIPFA Prudential and Treasury Management Codes
Section 11: Conclusion

Appendix A: Public Works Loans Board (PWLB) Interest Rates
Appendix B: Treasury Management Prudential Indicators
Appendix C: Review of Economic Conditions, provided by advisors

Appendix D: Glossary of Terms

2 Portfolio Position as at 30th September 2017

2.1 As outlined in the approved Treasury Management Strategy for 2017-18 it was anticipated that there would be a need to undertake some permanent borrowing in 2017-18 to fund the capital programme and to replace some of the internal funds. However with the receipt of £106m from the DCLG for the Housing Investment Fund cash balances during the year to date have been relatively high. As it remains the policy to keep cash low and minimise temporary investments, no further borrowing activity has been undertaken. The Council's debt position at the beginning of the financial year and at the end of September for comparison was as follows:

Loan Type	31-Mar-17		30-Sep-17	
	Principal	Average Rate	Principal	Average Rate
	£m	%	£m	%
PWLB	0.0	0.00	0	0.00
Temporary Borrowing	2.4	0.33	0.7	0.25
Market Loans	458.2	4.82	458.2	4.85
Stock	7.4	3.37	4.5	3.29
Government Funding	68.0	0.00	173.5	0.00
Gross Total	**536.0**	4.17	**636.9**	2.73
Temporary Deposits	-83.7	0.27	-322.4	0.20
Net Total	**452.3**		**314.5**	

2.2 The temporary borrowing and deposit figures fluctuate daily to meet the daily cash flow requirements of the Council. The figures for these categories in the table above are therefore only a snapshot at a particular point in time.

2.3 Total debt increased by £100.9m during the period 31st March 2017 to 30th September 2017. The increase was mainly due to the receipt of £105.5m in further advances from the DCLG for the Housing Investment Fund, (HIF). For accounting purposes the HIF advances are treated as central government borrowing. This was offset in the period by a £2.9m reduction in the value of stock following the redemption initiative, together with a reduction in temporary borrowing of £1.7m

2.4 An assumed borrowing need of £296m was identified in the budget for 2017-18 and based on current cashflow this has reduced substantially. Given the cash deposit levels the Council is currently holding, and based on our experience of previous years, it is anticipated there will be no borrowing need during the remainder of the year.

2.5 There could potentially be further advances of Government funding such as for the Housing Investment Fund and from Salix Financing Ltd. Financing from Salix provides interest free Government loan funding which can be applied for to fund public sector energy efficiency and carbon reduction initiatives.

3 Review of Economic Conditions: April to date 2017

3.1 In August 2016 the Bank of England cut the key lending rate to a record low of 0.25%, the first change in rate since March 2009. This cut was reversed in November 2017. Concerns expressed in past reports about many banks being reluctant to lend, thereby limiting opportunities for the Council to borrow from the market, continue to exist.

3.2 Officers remain concerned that the bank liquidity regime pursued by the FSA may further impact the ability of the Council to achieve interest rates above the base rate on short term deposits. The Treasury Management function is actively researching alternative options which may protect the average rate achieved on deposits.

3.3 Appendix C provides a more detailed review of the economic situation.

4 Treasury Borrowing in 2017-18 to date

4.1 PWLB interest rates during the first 6 months of the year are illustrated in the table below and the graph at Appendix A.

PWLB Borrowing Rates 2016-17 to date for 1 to 50 years					
	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.00%	1.34%	1.98%	2.72%	2.45%
Date	03/05/2017	15/06/2017	15/06/2017	08/09/2017	08/09/2017
High	1.36%	1.82%	2.42%	3.03%	2.77%
Date	28/09/2017	28/09/2017	28/09/2017	28/09/2017	28/09/2017
Average	1.14%	1.50%	2.15%	2.85%	2.59%

4.2 Manchester is on the approved list of authorities that can access the PWLB Certainty Rate going forward, giving the Council access to a 20 basis points reduction on the published PWLB rates.

4.3 The Council has discussed a £100m facility with the European Investment Bank (EIB) which will form part of the Council's future overall borrowing strategy. The EIB's rates for sterling borrowing continue to be favourable compared to PWLB, allowing for existing planned future borrowing from PWLB to be replaced by cheaper funding from the EIB. The facility is due to expire in November 2017 and the Council is seeking an extension of 12 months, with an expectation that the facility will start to be drawn down at the start of 2018-19. Whilst the EIB appraises its funding plans against individual schemes, particularly around growth and employment and energy efficiency, any monies borrowed are part of the Council's overall pooled borrowing. There has not been any advice from the EIB post Brexit that these arrangements will change.

5 Progress with MCC Stock Redemption

5.1 An exercise to redeem three classes of stock issued by the Council between 1874 and 1891 has been approved. The required 12 month's notice of redemption was given to stockholders in February 2017, however stockholders were also given the option of redeeming their stock earlier if they wished. This has been taken up by a number of stockholders and to the 30th September 2017 £3.6m of stock has been redeemed. The remaining holding at that date was valued at:

	30/09/2017		31/03/2017	
Class	No. of Stockholders	Value £	No. of Stockholders	Value £
Q 3% Redeemable	21	553,113	46	768,338
S 3% Redeemable	65	2,716,839	98	4,346,123
I 4% Irredeemable	35	1,199,942	76	2,968,828
Total	121	4,469,894	220	8,083,289

5.2 The remaining balances of the Q and S classes of stock at 30th September 2017 will be fully redeemed by 22nd February 2018 following expiration of the 12 month notice period. This will leave a potential remaining balance at 31st March 2018 for only the irredeemable I stock. This will reflect the extent that I class stockholders have not taken up the redemption offer by that date.

6 Compliance with Treasury Limits and Prudential Indicators

6.1 During the first half of the financial year, the Council operated within the Treasury Limits and the Prudential Indicators set out in the Treasury Management Strategy Statement. This is with the exception of eight breaches of the daily current account limit which are described below. Performance against the Prudential Indicators is shown in Appendix B.

6.2 During the period 1st April to 30th September 2017 there were eight breaches of the daily £0-400k limit on the Barclays current account. The causes of the

breaches fall into three categories. On four occasions there were late receipts that Treasury Management staff had not been previously advised of. On two occasions receipts did not arrive that Treasury Management had been advised were due. On two occasions issues at Barclays bank caused breaches of the limit; Barclays had difficulties with the availability of its on-line system meaning Treasury Management had no access to any banking information and on another occasion Barclays had not previously advised how they were applying a conversion factor to funds held as Euros.

6.3 Following this experience internal procedures have been reviewed and strengthened, whilst there have been discussions with Barclays about service levels and contingency arrangements.

7 Investment Strategy for 2017-18 to date

7.1 The Treasury Management Strategy Statement (TMSS) for 2017-18 was approved by Executive on 8th February 2017. The Council's Annual Investment Strategy, which is incorporated in the TMSS, outlines the Council's investment priorities as:
(a) the security of capital, and (b) the liquidity of investments.

7.2 In light of credit rating changes the Council needed to spread its counterparty risk by identifying more counterparties that can be utilised for investments; therefore included in the 2017-18 Treasury Management Strategy are a number of measures to broaden the basis of lending:

- Utilise UK banks / building societies and local authorities.
- Utilise non-UK banks / building societies in countries with an AAA rating.
- Diversify the investment portfolio into more secure UK Government and Government-backed investment instruments such as Treasury Bills.
- Utilise Certificates of Deposit and Covered Bonds with high quality counterparties, i.e. those that are AAA rated.
- Utilise Money Market Funds which are Constant Net Asset Value (CNAV) and AAA rated.
- Although the current investment strategy allows investments for up to 364 days, restrict deposits to less than 3 months unless the case can be made for investing for longer (i.e. to match a future commitment) apart from deposits with other Local Authorities or the Debt Management Office (DMO).

These measures were approved as part of the 2017-18 Strategy, but because of the changes in regulatory and economic environments they have not all yet been pursued.

- Investment in banks and building societies are now exposed to bail-in risk (where depositors' funds will be used to support a bank at risk). In view of this the Council is now depositing less cash with banks and building societies. This is apart from Barclays bank, the Council's main

banker which is the investment destination of last resort for the close of daily trading.

- Account and custodian facilities for trading in Treasury Bills have been opened. The intention is to bid in the weekly HM Treasury auction at times when the Council has temporary surplus cash and when Treasury Bill returns have improved compared to their current rates.
- Money Market Funds will also avoid bail-in risk and the Council is currently reviewing the products offered by a number of financial firms. This is to identify the Funds that are preferred and which meet the Council's requirements in regard to credit rating and liquidity requirements.

7.3 The current strategy means that a significant proportion of the Council's investments are with the Government (via the Debt Management Office, DMO) or with other Local Authorities. This highlights the relatively low rate of credit risk that the Council takes when investing.

7.4 It should be noted that, whilst seeking to broaden the investment base, officers will seek to limit the level of risk taken by the Council. It is not expected that the measures considered above will have a significant impact on the rates of return the Council currently achieves.

7.5 During the financial year to date the Council's temporary cash balances were managed by the City Treasurer in-house and invested with those institutions listed in the Council's Approved Lending List. Officers can confirm these institutions meet the security criteria set out in the Annual Investment Strategy.

8 Temporary Borrowing and Investment 2017-18 to date

8.1 Investment rates available in the market continue to be at an historic low point. The average level of funds available for investment purposes in the first six months of 2017-18 was £224m. These funds were available on a temporary basis and the level of funds available was mainly dependent on the timing of precept payments, the receipt of grants, and progress on the capital programme.

8.2 At the 30th September 2017 £178m was held on temporary deposit with the Greater Manchester Combined Authority to assist their temporary lending to the GM Waste Disposal Authority. The GMCA lending to the WDA was to support the latter funding the termination of its 25 year PFI contract. As of 1st April 2017 the WDA responsibilities transfer to the Combined Authority. The deposit with the GMCA has been made in accordance with the Council's treasury management policy and the rate of interest applied has been evidenced by reference to an independent investment broker. £78m of the deposit is on a Call basis where the Council can immediately recover the funds if they are required. To comply with the Council's treasury limits £100m of the advance has been deposited for a month and is reviewed on a monthly basis. If the funds are not required on the maturity of each monthly deposit the advance is renewed for a further month. This arrangement is intended to continue until the end of December 2017.

8.3 The temporary investment and borrowing undertaken by the Council is detailed below. As illustrated, the Council over performed the benchmark by 6 basis points on investments due to the inter local authority market being relatively buoyant.

8.4 The temporary borrowing consists of funds the Council holds for Manchester organisations that work closely with the Council. It was agreed the Council would pay interest on their funds in line with the base rate.

	Average temporary investment/borrowing	Net Return/Cost	Benchmark Return / Cost *
Temporary Investments	£223.6m	0.17%	0.11%
Temporary Borrowing	£2.1m	0.24%	0.24%

* *Average 7-day LIBID/LIBOR rates*

8.5 None of the institutions in which investments were made had any difficulty in repaying investments and interest in full during the period. The list of institutions in which the Council invests is kept under continuous review.

9 Implications of MIFID II - The second Markets in Financial Instruments Directive

9.1 MIFID II is now UK law and takes effect from 3rd January 2018. It has implications for all Local Authorities and their dealings in Financial Markets. The legislation originates from the European Commission and seeks to provide a European wide framework for regulation of EU financial markets. The legislation requires firms offering products and services in Financial Markets and external advisors to classify their clients as either Retail or Professional.

9.2 There are key differences between the Retail and Professional classifications. Professional classification will assume the client has a higher level of internal treasury expertise and experience and it is unlikely that financial firms will be willing to conduct business with Retail status organisations. Professional status will afford fewer protections, though eligibility for compensation from the Financial Services Compensation Scheme will not affected.

9.3 The default MIFID II classification is Retail and this applies to Local Authorities. There is a discretionary option where a client can elect to adopt Professional status. This will be granted if the client can demonstrate to the financial firm that it meets the criteria required and can pass the requirements of a qualitative test.

9.4 In order to continue trading with its existing Investment Brokers from the 3rd January 2018 the Council will have to have applied for and have been granted MIFID II Professional status by each firm. MIFID II classification will not apply to cash deposits the Council places with the Bank of England or in its Call accounts held with banks. Not applying for Professional status will severely

restrict the Council's ability to place funds with a diverse range of counterparties and is also likely to significantly dampen the investment return possible.

9.5 The Council meets the criteria required to evidence Professional status; this is in respect of the size and volume of its treasury transactions, and the qualifications and experience of its key treasury management officers. Therefore to maintain existing financial market relationships into 2018, application for professional status is being pursued as a matter of priority. Any future new relationships with financial firms will also be approached on the basis of the Council evidencing its Professional status.

9.6 Applications are being progressed via the procedures advised by individual financial firms, and also using an online portal developed by CIPFA. The latter may make the application process more efficient for the Council by avoiding duplication in the presentation of its supporting evidence.

9.7 MIFID II also requires Professional status organisations to hold a Legal Entity Identifier, (LEI) if they wish to participate in financial instruments that are traded on an Exchange, e.g. these include Certificates of Deposit, Corporate Bonds, Treasury Bills, Gilts, etc. The LEI is a 20 digit code specific to each legal entity which is issued following application to the London Stock Exchange. There is a £115 application fee and £70 annual maintenance fee. Trading in these instruments is approved as part of the Treasury Management Strategy therefore the Council intends to apply for an LEI.

9.8 The risks associated with Professional Status are mainly that the protections given to Retail status clients will not be available, moreover there will be greater emphasis on internal decision making with limited reliance on advice and guidance provided by the financial firms. These risks are acknowledged, however it is believed that the existing risk framework for treasury management, including the Prudential Code and Treasury Management Code, will enable the Council to manage these risks. Without Professional Status the Council will be unable to continue trading in financial markets using current arrangements.

10 Proposed changes to the CIPFA Prudential and Treasury Management Codes

10.1 The first version of the CIPFA Treasury Management Code in the Public Services was published in 2001 and provides a framework for effective treasury management in public sector organisations. The Code was last updated in 2011 and further revision has now been proposed in response to a sustained period of reduced public spending and development of the localism agenda.

10.2 The suggested changes include:

- responses to practical issues public sector bodies have expressed there are with three existing indicators; principal invested for longer than 364 days, interest rate exposures and the maturity structure of borrowing.
- a proposal to introduce a new requirement for capital strategy to be formally reported and for the chief financial officer to report explicitly on the risks associated with the capital strategy.

- an initiative to delete the Council Tax indicator.
- clarification that the Code should cover all investments held primarily for financial returns. This implies there will be no differentiation between investments held for treasury purposes and investments held for commercial purposes.

10.3 CIPFA have operated a consultation with public sector bodies on the suggested changes, however confirmation is currently awaited regarding the final form of the changes and whether they will be implemented for the 2018-19 financial year.

10.4 The Treasurer in conjunction with the Treasury Management Team is actively reviewing the Council's Treasury Management and Capital strategies to determine how these may be improved to ensure they are fit for purpose under the new arrangements. This is together with ensuring compliance when there is final confirmation of the changes from CIPFA.

11 Conclusion

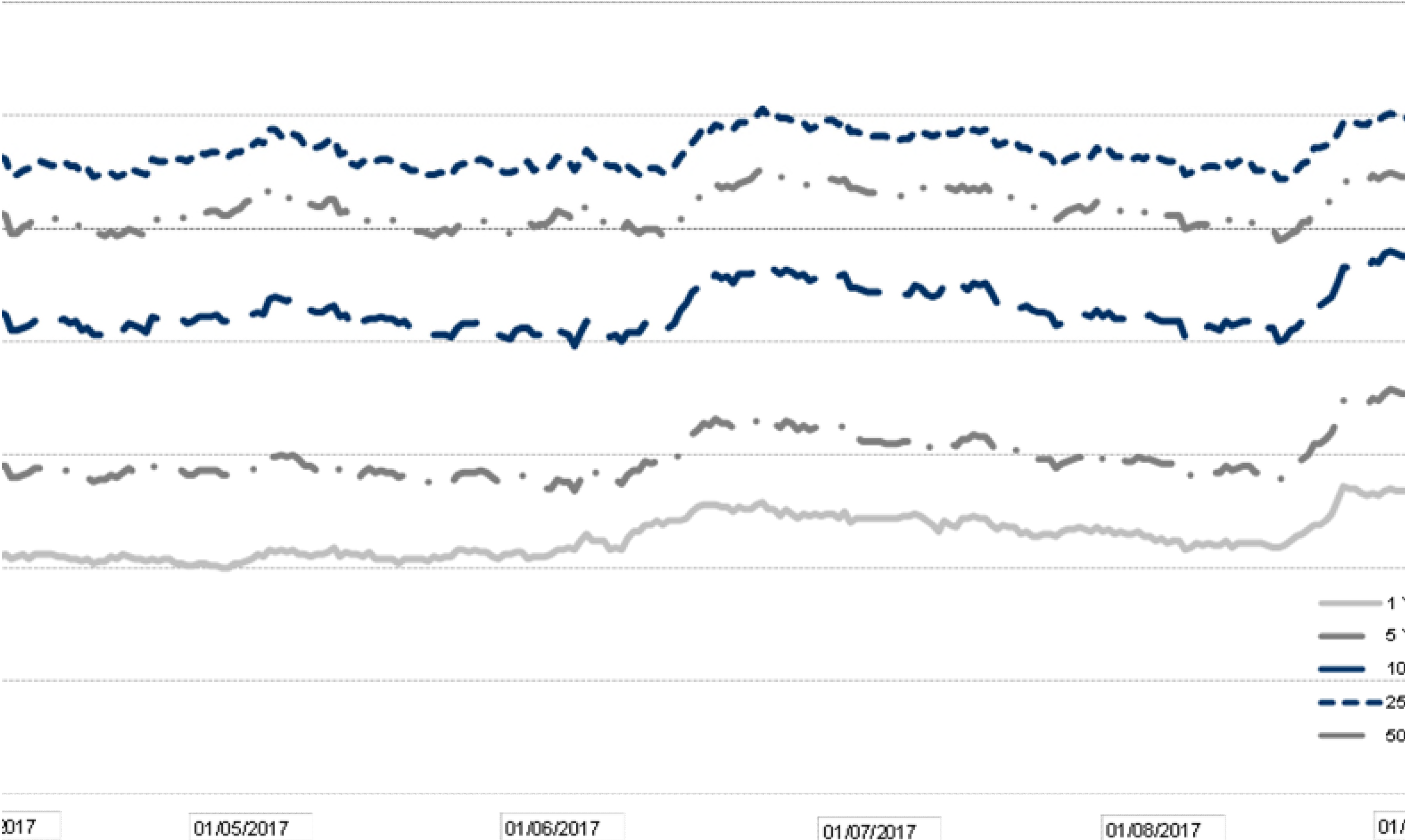
11.1 The current borrowing position reflects the strong balance sheet of the Council. It enables net interest costs to be minimised and reduces credit risk by making temporary use of internal borrowing (reserves, provisions, positive cash flows, etc.) The Council's policy remains to keep cash as low as possible and not to borrow in advance of need for capital purposes. Cash balances have been relatively high and a further borrowing requirement is not expected in 2017-18.

11.2 Proactive treasury management during the year has enabled the Council to achieve an average net return on investments of 0.17%, in excess of the benchmark average 7-day LIBID rate of 0.11% and also higher than the rate offered by the DMO, which is the default option if there are no offers in the inter local authority market.

11.3 Officers will monitor the changes that may result from the downgrading in credit ratings, and take the necessary action to ensure the Council still adheres to its Treasury Management Strategy. This however, will limit the investment options available to the Council.

APPENDIX A

PWLB Rates April 2017 - September 2017



APPENDIX B

Treasury Management Prudential Indicators: 2017-18 to date

	Original	**Minimum In Year to 30 Sept 2017**	**Maximum In Year to 30 Sept 2017**
	£m	**£m**	**£m**
Operational Boundary for External Debt:			
Borrowing	1,159.8	536.0	647.6
Other Long Term Liabilities	216.0	161.6	161.6
Authorised Limit for External Debt:			
Borrowing	1,555.4	536.0	647.6
Other Long Term Liabilities	216.0	161.6	161.6
		Actual as at 30 Sept 2017	
Authority has adopted CIPFA's Code of Practice for Treasury Management in the Public Services	Yes	Yes	
Upper Limits for Interest Rate Exposure:			
Net Borrowing at Fixed Rate as a percentage of Total Net Borrowing	96%	77%	
Net Borrowing at Variable Rate as a percentage of Total Net Borrowing	92%	23%	
Upper Limit for Principal Sums Invested for over 364 days	£0	£0	

Maturity structure of Fixed Rate Borrowing	**Lower Limit 2017-18 Original**	**Upper Limit 2017-18 Original**	**Actual as at 30 Sept 2017**
under 12 months	0%	70%	0%
12 months and within 24 months	0%	100%	56%
24 months and within 5 years	0%	80%	41%
5 years and within 10 years	0%	70%	1%

10 years and above	0%	70%	2%

APPENDIX C

1. REVIEW OF ECONOMIC CONDITIONS APRIL TO SEPTEMBER 2017 AND FUTURE OUTLOOK

This section has been prepared by the Authority's Treasury Advisors, Capita Asset Services and includes their forecast for future interest rates.

1.1 UK

i After the UK surprised on the upside with strong growth in 2016, growth in 2017 has been disappointingly weak; quarter 1 came in at only +0.2% (+2.0% y/y) and quarter 2 was +0.3% (+1.7% y/y). The main reason for this has been the sharp increase in inflation, caused by the devaluation of sterling after the referendum, feeding increases in the cost of imports into the economy. This has caused, in turn, a reduction in consumer disposable income and spending power and so the services sector of the economy, accounting for around 75% of GDP, has seen weak growth as consumers cut back on their expenditure.

ii More recently there have been encouraging statistics from the manufacturing sector which is seeing strong growth, particularly as a result of increased demand for exports. It has helped that growth in the EU, our main trading partner, has improved significantly over the last year. However, this sector only accounts for around 11% of GDP so expansion in this sector will have a much more muted effect on the average total GDP growth figure for the UK economy as a whole.

iii The Monetary Policy Committee (MPC) meeting of 14 September 2017 surprised markets and forecasters by suddenly switching to a much more aggressive tone in terms of its words around warning that Bank Rate will need to rise. The Bank of England Inflation Reports during 2017 have clearly flagged up that they expected CPI inflation to peak at just under 3% in 2017, before falling back to near to its target rate of 2% in two year's time.

iv Inflation actually came in at 2.9% in August, (this data was released on 12 September), and so the Bank revised its forecast for the peak to over 3% at the 14 September meeting MPC. This marginal revision can hardly justify why the MPC became so aggressive with its wording; rather, the focus was on an emerging view that with unemployment falling to only 4.3%, the lowest level since 1975, and improvements in productivity being so weak, that the amount of spare capacity in the economy was significantly diminishing towards a point at which they now needed to take action.

v In addition, the MPC took a more tolerant view of low wage inflation as this now looks like a common factor in nearly all western economies as a result of increasing globalisation. This effectively means that the UK labour faces competition from overseas labour e.g. in outsourcing work to third world countries, and this therefore depresses the negotiating power of UK labour. However, the Bank was also concerned that the withdrawal of the UK from

the EU would effectively lead to a decrease in such globalisation pressures in the UK, and so would be inflationary over the next few years.

vi It therefore looks very likely that the MPC will increase Bank Rate to 0.5% in November or, if not, in February 2018. The big question after that will be whether this will be a one off increase or the start of a slow, but regular, increase in Bank Rate. As at 19 September, short sterling rates are indicating that financial markets do not expect a second increase until November 2018 with a third increase in February 2020. However, some forecasters are flagging up that they expect growth to improve significantly in 2017 and into 2018, as the fall in inflation will bring to an end the negative impact on consumer spending power while a strong export performance will compensate for weak services sector growth.

vii If this scenario were to materialise, then the MPC would have added reason to embark on a series of slow but gradual increases in Bank Rate during 2018. While there is so much uncertainty around the Brexit negotiations, consumer confidence, and business confidence to spend on investing, it is far too early to be confident about how the next two years will pan out.

1.2 EU

Economic growth in the EU, (the UK's biggest trading partner), has been lack lustre for several years after the financial crisis despite the European Central Bank (ECB) eventually cutting its main rate to -0.4% and embarking on a massive programme of QE. However, growth picked up in 2016 and now looks to have gathered ongoing substantial strength and momentum thanks to this stimulus. GDP growth was 0.5% in quarter 1 (2.0% y/y) and 0.6% in quarter (2.3% y/y). However, despite providing massive monetary stimulus, the ECB is still struggling to get inflation up to its 2% target and in August inflation was 1.5%. It is therefore unlikely to start on an upswing in rates until possibly 2019.

1.3 USA

Growth in the American economy has been volatile in 2015 and 2016. 2017 is following that path again with quarter 1 coming in at only 1.2% but quarter 2 rebounding to 3.0%, resulting in an overall annualised figure of 2.1% for the first half year. Unemployment in the US has also fallen to the lowest level for many years, reaching 4.3%, while wage inflation pressures, and inflationary pressures in general, have been building. The Fed has started on a gradual upswing in rates with three increases since December 2016; and there could be one more rate rise in 2017 which would then lift the central rate to 1.25 – 1.50%. There could then be another four more increases in 2018. At its June meeting, the Fed strongly hinted that it would soon begin to unwind its $4.5 trillion Balance Sheet holdings of bonds and mortgage backed securities by reducing its reinvestment of maturing holdings.

1.4 China

Economic growth has been weakening over successive years, despite repeated

rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems.

1.5 Japan

Is struggling to stimulate consistent significant growth to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

1.6 Capita Asset Services Interest rate forecasts

	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Bank rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
5yr PWLB rate	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
10yr PWLB rate	2.10%	2.20%	2.30%	2.30%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
25yr PWLB rate	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%
50yr PWLB rate	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%

i Capita undertook its last review of interest rate forecasts on 9 August after the quarterly Bank of England Inflation Report. There was no change in MPC policy at that meeting. However, the MPC meeting of 14 September revealed a sharp change in sentiment whereby a majority of MPC members said they would be voting for an increase in Bank Rate "over the coming months". It is therefore possible that there will be an increase to 0.5% at the November MPC meeting. If that happens, the question will then be as to whether the MPC will stop at just withdrawing the emergency Bank Rate cut of 0.25% in August 2016, after the result of the EU withdrawal referendum, or whether they will embark on a series of further increases in Bank Rate during 2018.

ii The overall balance of risks to economic recovery in the UK is currently to the downside but huge variables over the coming few years include just what final form Brexit will take, when finally agreed with the EU, and when.

iii Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- UK economic growth and increases in inflation are weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU and US.
- Geopolitical risks in Europe, the Middle East and Asia, which could lead to increasing safe haven flows.
- A resurgence of the Eurozone sovereign debt crisis.

- Weak capitalisation of some European banks.
- Monetary policy action failing to stimulate sustainable growth and to get inflation up consistently to around monetary policy target levels.

iv The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include:

- The pace and timing of increases in the Fed. Funds Rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
- UK inflation returning to significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

APPENDIX D

Glossary of Terms

Authorised Limit - This Prudential Indicator represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable. It is the expected maximum borrowing need, with some headroom for unexpected movements.

Bank Rate – the rate at which the Bank of England offers loans to the wholesale banks, thereby controlling general interest rates in the economy.

Constant Net Asset Value (CNAV) – refers to Funds which use amortised cost accounting to value all of their assets. The aim is to maintain a Net Asset Value (NAV), or value of a share of the Fund at £1.

Counterparty – one of the opposing parties involved in a borrowing or investment transaction

Credit Rating – A qualified assessment and formal evaluation of an institution's (bank or building society) credit history and capability of repaying obligations. It measures the probability of the borrower defaulting on its financial obligations, and its ability to repay these fully and on time.

Discount – Where the prevailing interest rate is higher than the fixed rate of a long-term loan, which is being repaid early, the lender can refund the borrower a discount, the calculation being based on the difference between the two interest rates over the remaining years of the loan, discounted back to present value. The lender is able to offer the discount, as their investment will now earn more than when the original loan was taken out.

Fixed Rate Funding - A fixed rate of interest throughout the time of the loan. The rate is fixed at the start of the loan and therefore does not affect the volatility of the portfolio, until the debt matures and requires replacing at the interest rates relevant at that time.

Gilts - The loan instruments by which the Government borrows. Interest rates will reflect the level of demand shown by investors when the Government auctions Gilts.

High/Low Coupon – High/Low interest rate

LIBID (London Interbank Bid Rate) – This is an average rate, calculated from the rates at which individual major banks in London are willing to borrow from other banks for a particular time period. For example, 6 month LIBID is the average rate at which banks are willing to pay to borrow for 6 months.

LIBOR (London Interbank Offer Rate) – This is an average rate, calculated from the rates which major banks in London estimate they would be charged if they borrowed from other banks for a particular time period. For example, 6 month LIBOR

is the average rate which banks believe they will be charged for borrowing for 6 months.

Liquidity – The ability of an asset to be converted into cash quickly and without any price discount. The more liquid a business is, the better able it is to meet short-term financial obligations.

LOBO (Lender Option Borrower Option) – This is a type of loan where, at various periods known as call dates, the lender has the option to alter the interest rate on the loan. Should the lender exercise this option, the borrower has a corresponding option to repay the loan in full without penalty.

Market - The private sector institutions - Banks, Building Societies etc.

Maturity Profile/Structure - an illustration of when debts are due to mature, and either have to be renewed or money found to pay off the debt. A high concentration in one year will make the Council vulnerable to current interest rates in that year.

Monetary Policy Committee – the independent body that determines Bank Rate.

Operational Boundary – This Prudential Indicator is based on the probable external debt during the course of the year. It is not a limit and actual borrowing could vary around this boundary for short times during the year. It should act as an indicator to ensure the Authorised Limit is not breached.

Premium – Where the prevailing current interest rate is lower than the fixed rate of a long-term loan, which is being repaid early, the lender can charge the borrower a premium, the calculation being based on the difference between the two interest rates over the remaining years of the loan, discounted back to present value. The lender may charge the premium, as their investment will now earn less than when the original loan was taken out.

Prudential Code - The Local Government Act 2003 requires the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

PWLB - Public Works Loan Board. Part of the Government's Debt Management Office, which provides loans to public bodies at rates reflecting those at which the Government is able to sell Gilts.

Specified Investments - Sterling investments of not more then one-year maturity. These are considered low risk assets, where the possibility of loss of principal or investment income is very low.

Non-specified investments - Investments not in the above, specified category, e.g., foreign currency, exceeding one year or outside our minimum credit rating criteria.

Variable Rate Funding - The rate of interest either continually moves reflecting interest rates of the day, or can be tied to specific dates during the loan period. Rates may be updated on a monthly, quarterly or annual basis.

Volatility - The degree to which the debt portfolio is affected by current interest rate movements. The more debt maturing within the coming year and needing replacement, and the more debt subject to variable interest rates, the greater the volatility.

Yield Curve - A graph of the relationship of interest rates to the length of the loan. A normal yield curve will show interest rates relatively low for short-term loans compared to long-term loans. An inverted Yield Curve is the opposite of this.