APPENDIX 1
2016/17 TREASURY MANAGEMENT STRATEGY

1. INTRODUCTION

1.1 The Local Government Act 2003 (the Act) and supporting regulations requires the Authority to 'have regard to' the Chartered Institute of Public Finance and Accountancy's (CIPFA) Prudential Code and the CIPFA Treasury Management Code of Practice to set prudential indicators for the next three years to ensure that its capital investment plans are affordable, prudent and sustainable.

1.2 The Act therefore requires the Authority to set out its Treasury Management Strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act). This sets out the Authority's policies for managing its investments and for giving priority to the security and liquidity of those investments.

1.3 The Authority's strategy has regard to the Department of Communities and Local Government (CLG) Guidance on Local Government Investments ("the Guidance"), which came into effect from 1 April 2010.

1.4 The strategy also includes the Authority's 2016/17 Minimum Revenue Provision strategy.

1.5 The CIPFA Code of Practice on Treasury Management (revised November 2009) was adopted by this Authority on 14 April 2010. CIPFA issued revisions to the Prudential Code, Treasury Management Code and Treasury Guidance Notes in mid November 2011 (although there was little material change in the revisions, mainly in relation to HRA).

1.6 The primary requirements of the Code are as follows:

(i) Creation and maintenance of a Treasury Management Policy Statement, which set out the policies and objectives of the Authority's treasury management activities.

(ii) Creation and maintenance of Treasury Management Practices, which set out the manner in which the Authority will seek to achieve those policies and objectives:

- Reporting Requirements – the Authority is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of polices, estimates and actuals.

    - **Prudential and treasury indicators and treasury strategy** – the first, and most important report covers:
        1. The capital plans (including prudential indictors);
        2. A minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);

3. The treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
4. An investment strategy (the parameters on how investments are to be managed).

- **A mid-year treasury management report** – this will update members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision.
- **An annual treasury report** – this provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

(iii) Delegation by the Authority of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

(iv) Delegation by the Authority of the role of scrutiny of the Treasury Management Strategy and policies to a specific named body. For this Authority, the delegated body is the Policy Committee.

1.7 Warrington Borough Council act as the Authority's advisor on Treasury Management. The suggested strategy for 2016/17 in respect of the following aspects of the treasury management function is based upon Warrington Borough Council treasury officers' views on interest rates, supplemented with leading market forecasts provided by Warrington Borough Council's treasury advisor (Capita). The strategy covers two main areas:

Capital Issues

- The capital plans and the prudential indicators;
- The minimum revenue provision (MRP) policy.

Treasury management issues

- Prudential and Treasury Indicators in force that will limit the treasury risk and activities of the Authority;
- the current treasury position;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling opportunities;
- the investment strategy;
- creditworthiness policy;
- policy on use of external service providers;
- the minimum revenue provision strategy; and
- future developments.

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, the CLG MRP Guidance, the CIPFA Treasury Management Code and the CLG Investment Guidance.

1.8 In particular, Section 32 of that Act requires the Authority to calculate its budget requirement for each financial year to include the revenue costs which flow from capital financing decisions. This means that increases in capital expenditure must be limited to a level where any increases in charges to revenue are from:

- Increases in interest charges caused by increased borrowing to finance additional capital expenditure, or
- Any increases in running costs from new capital projects are limited to a level, which is affordable within the projected income of the Authority for the foreseeable future.

1.9 The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny.

2. TREASURY LIMITS FOR 2016/17

2.1 It is a statutory duty, under Section 3 of the Local Government Act 2003 and supporting regulations, for the Authority to determine and keep under review how much it can afford to borrow. The amount so determined is termed the 'Affordable Borrowing Limit'. In England and Wales the Authorised Limit represents the legislative limit specified in the Act.

2.2 The Authority must have regard to the Prudential Code when setting the Authorised Limit. This essentially requires it to ensure that total capital investment remains within sustainable limits and in particular, that the impact upon its future Authority tax is 'acceptable'.

2.3 Whilst termed an "Affordable Borrowing Limit", capital plans to be considered for inclusion include corporate financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set on a rolling basis, for the forthcoming financial year and two successive financial years.

2.4 Prudential and Treasury Indicators are relevant for the purposes of setting an integrated Treasury Management Strategy. These are contained in Appendix 7 to the Budget report at item 2 on the agenda.

2.5 The Authority is also required to indicate if it has adopted the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management in Local Authorities (the Treasury Management Code). The original Treasury Management Code was adopted in 2004 at a full meeting of the Authority, and the 2009 revised Treasury Management Code was adopted at a full meeting of the Authority on 14 April 2010.

3. CURRENT PORTFOLIO POSITION

3.1 The Authority's treasury portfolio position as at 31st December 2015 comprised of:

Current Portfolio Position	Principal £m	Average Interest Rate %
Fixed Rate Funding - Public Works Loans Board - SALIX	 2,214 38	 4.59 0
TOTAL BORROWING	2,252	4.51
Authority Investments - Fixed Rate	 (26,750)	 0.075
TOTAL INVESTMENTS	(26,750)	0.075
NET	**(24,498)**	

BORROWING REQUIREMENT

3.2 The capital expenditure plans provide details of the service activity of the Authority. The treasury management function ensures that the Authority's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury/prudential indicators, the current and projected debt positions and the annual investment strategy. The Authority's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in prudential indicators, which are designed to assist Member's overview and confirm capital expenditure plans.

3.3 The table below sets out the Authority's future borrowing requirement (current and previous years are shown for comparison) based on current commitments and plans.

2014/15 Actual £000	2015/16 Estimate £000	Capital Expenditure	2016/17 Estimate £000	2017/18 Estimate £000	2018/19 Estimate £000	TOTAL 3 Years £000
2,264	5,593	Capital Expenditure	14,999	2,256	2,056	19,311
		Financed By:				
2,139	2,751	Capital Grants & Reserves	2,745	0	0	2,745
95	43	Capital Receipts	110	110	55	275
30	2,799	Authority Revenue Funding	12,144	2,146	2,001	16,291
2,264	**5,593**	**Financing need for year**	**14,999**	**2,256**	**2,056**	**19,311**

4. PROSPECTS FOR INTEREST RATES

4.1 Warrington Borough Council, who advise the Authority on treasury management, has appointed Capita Asset Services to assist and advise the Council and the Authority to formulate a view on interest rates.

4.2 The Bank Base Rate is forecast to remain unchanged at 0.5%, before starting to rise in 2016/17. Capita's central view for bank rate forecasts for financial year ends (March) are as follows:

- 2015/16 0.50%
- 2016/17 0.75%
- 2017/18 1.25%
- 2018/19 1.75%

There are downside risks to these forecasts (i.e. start of increases in Bank Rate occurs later) if economic growth weakens. However, should the pace of growth quicken, there could be upside risk.

Capita Asset Services' interest rate forecast

The following table gives their central view:

	Bank Rate	**PWLB Borrowing Rates**		
		5 year	**25 year**	**50 year**
Mar-16	0.50%	2.00%	3.40%	3.20%
Jun-16	0.50%	2.10%	3.40%	3.20%
Sep-16	0.50%	2.20%	3.50%	3.30%
Dec-16	0.75%	2.30%	3.60%	3.40%
Mar-17	0.75%	2.40%	3.70%	3.50%
Jun-17	1.00%	2.50%	3.70%	3.60%
Sep-17	1.00%	2.60%	3.80%	3.70%
Dec-17	1.25%	2.70%	3.90%	3.80%
Mar-18	1.25%	2.80%	4.00%	3.90%
Jun-18	1.50%	2.90%	4.00%	4.30%
Sep-18	1.50%	3.00%	4.10%	4.30%
Dec-18	1.75%	3.10%	4.10%	4.30%
Mar-19	1.75%	3.20%	4.10%	4.40%

4.3 These assumptions have been used to determine the treasury management budget projections, included as part of the 2016/17 revenue budget and future year projections.

Other forecasts

4.4 The data below shows a variety of forecasts published by a number of institutions. The forecast includes Capital Economics (an independent forecasting consultancy). The forecast within this strategy statement has been drawn from these diverse sources.

Capital Economics interest rate forecast

	Bank Rate	PWLB Borrowing Rates			
		5 year	**10 year**	**25 year**	**50 year**
Mar-16	0.50%	2.60%	3.35%	3.35%	3.40%
Jun-16	0.75%	2.70%	3.45%	3.45%	3.50%
Sep-16	0.75%	2.80%	3.45%	3.45%	3.50%
Dec-16	1.00%	3.00%	3.55%	3.55%	3.60%
Mar-17	1.00%	3.10%	3.65%	3.65%	3.70%
Jun-17	1.25%	3.20%	3.75%	3.75%	3.80%
Sep-17	1.25%	3.30%	3.85%	3.85%	3.90%
Dec-17	1.50%	3.50%	3.95%	3.95%	4.00%

5. ECONOMIC BACKGROUND

5.1 **The UK economy** – UK GDP growth rates in 2013 of 2.2% and 2.9% in 2014 were the strongest growth rates of any G7 country; the 2014 growth rate was also the strongest UK rate since 2006. Whilst the 2015 growth rate is likely to be a leading rate in the G7 again, it looks likely to disappoint previous forecasts and come in at about 2%. Quarter 1 of 2015 was weak at +0.4% (+2.9% y/y) though there was a rebound in quarter 2 to +0.5% before weakening again to +0.4% (2.1% y/y) in quarter 3. The November Bank of England Inflation Report included a forecast for growth to remain around 2.5% - 2.7% over the next three years. For this recovery, however, to become more balanced and sustainable in the longer term, it needs to move away from dependence on consumer expenditure and the housing market to manufacturing and investment expenditure. The strong growth since 2012 has resulted in unemployment falling quickly to a current level of 5.1%.

5.2 Since the August Inflation report was issued, most worldwide economic statistics have been weak and financial markets have been particularly volatile. The November Inflation Report flagged up particular concerns for the potential impact of these factors on the UK. Bank of England Governor Mark Carney has set three criteria that need to be met before he would consider making a start on increasing Bank Rate. These criteria are patently not being met at the current time (as he confirmed in a speech on 19 January 2016):

- *Quarter-on-quarter GDP growth is above 0.60% i.e. using up spare capacity. This condition was met in Q2 2015, but Q3 came up short and Q4 looks likely to also fall short;*
- *Core inflation (stripping out most of the effect of decreases in oil prices), registers a concerted increase towards the MPC's 2% target. This measure was on a steadily*

decreasing trend since mid-2014 until November 2015 @ 1.2%. December 2015 saw a slight increase to 1.4%.

- *Unit wage costs are on a significant increasing trend. This would imply that spare capacity for increases in employment and productivity gains are being exhausted, and that further economic growth will fuel inflationary pressures.*

5.3 The MPC has been particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of CPI inflation in order to underpin a sustainable recovery. It has, therefore, been encouraging in 2015 to see wage inflation rising significantly above CPI inflation which has been around zero since February. However, it is unlikely that the MPC would start raising rates until wage inflation was expected to consistently stay over 3%, as a labour productivity growth rate of around 2% would mean that net labour unit costs would still only be rising by about 1% year on year (y/y). The Inflation Report was also notably subdued in respect of the forecasts for CPI inflation; this was expected to barely get back up to the 2% target within the 2-3 year time horizon. The increase in the forecast for inflation at the three year horizon was the biggest in a decade and at the two year horizon it was the biggest since February 2013. However, the first round of falls in oil, gas and food prices over late 2014 and also in the first half 2015, will fall out of the 12 month calculation of CPI during late 2015 / early 2016 but only to be followed by a second, subsequent round of falls in fuel and commodity prices which will delay a significant tick up in inflation from around zero. CPI inflation is now expected to get back to around 1% in the second half of 2016 and not get near to 2% until the second half of 2017, though the forecasts in the Report itself were for an even slower rate of increase.

5.4 However, with the price of oil having fallen further in January 2016, and with sanctions having been lifted on Iran, enabling it to sell oil freely into international markets, there could well be some further falls still to come in 2016. The price of other commodities exported by emerging countries could also have downside risk and several have seen their currencies already fall by 20-30%, (or more), over the last year. These developments could well lead the Bank of England to lower the pace of increases in inflation in its February 2016 Inflation Report. On the other hand, the start of the national living wage in April 2016 (and further staged increases until 2020), will raise wage inflation; however, it could also result in a decrease in employment so the overall inflationary impact may be muted.

5.5 Confidence is another big issue to factor into forecasting. Recent volatility in financial markets could dampen investment decision making as corporate take a more cautious view of prospects in the coming years due to international risks. This could also impact in a slowdown in increases in employment. However, consumers will be enjoying the increase in disposable incomes as a result of falling prices of fuel, food and other imports from emerging countries, so this could well feed through into an increase in consumer expenditure and demand in the UK economy. Also the UK will not be affected as much as some other western countries by a slowdown in demand from emerging countries, as the EU and US are our major trading partners.

5.6 There is, therefore, considerable uncertainty around how quickly pay and CPI inflation will rise in the next few years and this makes it difficult to forecast when the MPC will decide to make a start on increasing Bank Rate. There are also concerns around the fact that the central banks of the UK and US currently have few monetary policy options left to them given that central rates are near to zero and huge QE is already in place. There are, accordingly, arguments that rates ought to rise sooner and quicker, so as to have some options available for use if there was another major financial crisis in the near future. But it is unlikely that either would aggressively raise rates until they are sure that growth was securely embedded and that no inflation was not a significant threat.

5.7 The forecast for the first increase in Bank Rate has, therefore, been pushed back progressively over the last year from Q4 2015 to Q4 2016. Increases after that are also likely to be at a much slower pace, and to much lower final levels than prevailed before 2008, as increases in Bank Rate will have a much bigger effect on heavily indebted consumers and householders than they did before 2008. There has also been an increase in momentum towards holding a referendum on membership of the EU in 2016, rather than 2017, with Q3 2016 being the current front runner in terms of timing; this could impact on MPC considerations to hold off from a first increase until the uncertainty caused by it has passed.

5.8 The Government's revised Budget in July eased the pace of cut backs from achieving a budget surplus in 2018/19 to achieving that in 2019/20 and this timetable was maintained in the November Budget.

5.9 **USA** – GDP growth in 2014 of 2.4% was followed by Q1 2015 growth, which was depressed by exceptionally bad winter weather, at only +0.6% (annualised). However, growth rebounded remarkably strongly in Q2 to 3.9% (annualised) before falling back to +2.0% in Q3.

5.10 Until the turmoil in financial markets in August, caused by fears about the slowdown in Chinese growth, it had been strongly expected that the Fed. would start to increase rates in September. The Fed. pulled back from that first increase due to global risk which might depress US growth and put downward pressure on inflation, as well as a 20% appreciation of the dollar which has caused the Fed. to lower its growth forecasts. Although the non-farm payrolls figures for growth in employment in August and September were disappointingly weak, the October figure was strong while November was also reasonably strong (and December was outstanding); this, therefore, opened up the way for the Fed. to embark on its first increase in rates of 0.25% at its December meeting. However, the accompanying message with this first increase was that further increases will be at a much slower rate, and to a much lower ultimate ceiling, than in previous business cycles, mirroring comments by our own MPC.

5.11 **Eurozone** – in the Eurozone (EZ), the European Central Bank (ECB) released €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it is intended to run initially to September 2016. At the ECB's December meeting, this programme was extended to March 2017 but was not increased in terms of the amount of monthly purchases. The ECB also cut its deposit facility rate by 10bps from -0.2% to -0.3%. This programme of monetary easing has had limited positive effect in helping a recovery in consumer and business confidence and a start to an improvement in economic growth. GDP growth rose to 0.5% in quarter 1 2015 (1.0% y/y) but came in at +0.4% (+1.5% y/y) in quarter 2 and +0.3% in quarter 3. Financial markets were disappointed by the ECB's lack of more decisive action in December and it is likely that it will need to boost its QE programme if it is to succeed in significantly improving growth in the EZ and getting inflation up from the current level of around zero to its target of 2%.

5.12 **Greece** – during July, Greece finally capitulated to European Union (EU) demands to implement a major programme of austerity. An €86bn third bailout package has since been agreed though it did nothing to address the unsupportable size of total debt compared to GDP. However, huge damage has been done to the Greek banking system and economy by the resistance of the Syriza Government, elected in January, to EU demands. The surprise general election in September gave the Syriza government a mandate to stay in power to implement austerity measures. However, there are major doubts as to whether the size of cuts and degree of reforms required can be fully implemented and so a Greek exit from the euro may only have been delayed by this latest bailout.

5.13 **Portugal and Spain** – the general elections in September and December respectively have opened up new areas of political risk where the previous right wing reform-focused pro-austerity mainstream political parties have lost power. A left wing / communist anti-austerity coalition has won a majority seats in Portugal. The general election in Spain produced a complex result where no combination of two main parties is able to form a coalition with a majority of seats. It is currently unresolved as to what bond and equity markets for these countries which has the potential to spill over and impact on the whole Eurozone project.

5.14 **China and Japan** – Japan is causing considerable concern as the increase in sales tax in April 2014 suppressed consumer expenditure and growth. In Q2 2015 quarterly growth shrank by -0.2% after a short burst of strong growth of 1.1% during Q1, but then came back to +0.3% in Q3 after the first estimate had indicated that Japan had fallen back into recession; this would have been the fourth recession in five years. Japan has been hit hard by the downturn in China during 2015 and there are continuing concerns as to how effective efforts by the Japanese government to stimulate growth, and increase the rate of inflation from near zero, are likely to prove when it has already fired the first two of its “arrows” of reform but has dithered about firing the third, deregulation of protected and inefficient areas of the economy.

5.15 As for China, the Government has been very active during 2015 and the start of 2016, in implementing several stimulus measures to try to ensure the economy hits the growth target of about 7% for 2015. It has also sought to bring some stability after the major fall in the onshore Chinese stock market during the summer and then a second bout in January 2016. Many commentators are concerned that recent growth figures could have been massaged to hide a downturn to a lower growth figure. There are also major concerns as to the creditworthiness of much of bank lending to corporates and local government during the post 2008 credit expansion period. Overall, China is still expected to achieve a growth figure that the EU would be envious of. Nevertheless, there are growing concerns about whether the Chinese economy could be heading for a hard landing and weak progress in rebalancing the economy from an over dependency on manufacturing and investment to consumer demand led services. There are also concerns over the volatility of the Chinese stock market, which was a precursor to falls in world financial markets in August and September and again in January 2016, which could lead to a flight to quality bond markets. In addition, the international value of the Chinese currency has been on a steady trend of weakening and this will put further downward pressure on the currencies of emerging countries dependent for earnings on exports of their commodities.

5.16 **Emerging countries** – there are also considerable concerns about the vulnerability of some emerging countries and their corporates. Having borrowed massively in dollar denominated debt since the financial crisis, (as investors searched for yield by channelling investment cash away from western economies with dismal growth, depressed bond yields and near zero test rates into emerging countries), there is now a strong flow back to those western economies with strong growth and a path of rising interest rates and bond yields.

5.17 The currencies of emerging countries have therefore been depressed by both this change in investors' strategy, and the consequent massive reverse cash flow, and also by the expectations of a series of central interest rate increases in the US which has caused the dollar to appreciate significantly. In turn, this has made it much more costly for emerging countries to service their dollar denominated debt at a time when their earnings from commodities are depressed by a simultaneous downturn in demand for their exports and a deterioration in the value of their currencies. There are also likely to be major issues when previously borrowed debt comes to maturity and requires refinancing at much more expensive rates.

5.18 Corporates (worldwide) heavily involved in mineral extraction and / or the commodities market may also be at risk and this could also cause volatility in equities and safe haven flows to bonds. Financial markets may also be buffeted by the sovereign wealth funds of those countries that are highly exposed to falls in commodity prices and which, therefore, may have to liquidate investments in order to cover national budget deficits.

5.19 **Capita Asset Services Forward guidance** – economic forecasting remains difficult with so many external influences weighing on the UK. The Bank Rate forecasts (and Monetary Policy Committee (MPC) decisions) will be liable to further amendment depending on how economic data transpires over time. There is much volatility in rates and bond yields as news ebbs and flows in negative or positive ways. This latest forecast includes a first increase in Bank Rate in quarter 4 of 2016.

5.20 The overall trend in the longer term will be for gilt yields and PWLB rates to rise when economic recovery is firmly established accompanied by rising inflation and consequent increases in Bank Rate, and the eventual unwinding of QE. At some future point in time, an increase in investor confidence in eventual world economic recovery is also likely to compound this effect as recovery will encourage investors to switch from bonds to equities.

5.21 The overall balance of risks to economic recovery in the UK is currently to the downside, given the number of potential headwinds that could be growing on both the international and UK scene. Only time will tell just how long this current period of strong economic growth will last; it also remains exposed to vulnerabilities in a number of key areas.

5.22 However, the overall balance of risks to our Bank Rate forecast is probably to the downside, i.e. the first increase, and subsequent increase, may be delayed further if recovery in GDP growth, and forecasts for inflation increases, are lower than currently expected. Market expectations in January 2016, (based on short sterling), for the first Bank Rate increase are currently around Q1 2017.

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

- Emerging country economies, currencies and corporates destabilised by falling commodity prices and / or Fed. rate increases, causing a flight to safe havens.
- Geopolitical risks in Eastern Europe, the Middle East and Asia, increasing safe haven flows.
- UK economic growth and/or increases in inflation are weaker than currently anticipate.
- Weak growth or recession in the UK's main trading partners – the EU, US and China.
- A resurgence of the Eurozone sovereign debt crisis.
- Recapitalisation of European banks requiring more government financial support.
- Monetary policy action failing to stimulate sustainable growth and combat the threat of deflation in western economies, especially the Eurozone and Japan.

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

- Uncertainty around the risk of a UK exit from the EU.
- 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 than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

6. BORROWING STRATEGY

6.1 The capital expenditure plans provide details of the service activity of the Authority. The treasury management function ensures that the Authority's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

6.2 In general, the Authority will borrow for one of two purposes – to finance cash flow in the short-term or to fund capital investment over the longer term. The Authority is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Authority's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is high.

6.3 The Authority's estimated treasury portfolio position at 31 March 2016, with forward projections is summarised below. The actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement (CFR)), highlights an underlying need to borrow £14,999k in 2016/17, £2,256k in 2017/18 and £2,056k in 2018/19.

6.4 A key aim of the Treasury Management Strategy is to minimise the cost of the Authority's loan portfolio whilst ensuring that the obligation to repay the loan is spread over a period of time. This reduces the impact on the revenue budget of interest payments.

6.5 Currently the average rate of interest on the Authority's loan portfolio is 4.51%.

6.6 The Authority is not projecting a borrowing requirement during the strategy period. If it were to become necessary, the Authority will borrow from either the Public Works Loans Board (PWLB), the bond market or other Local Authorities during the strategy period. PWLB rate forecasts are given in the table below.

	PWLB Borrowing Rates		
	5 year	**25 year**	**50 year**
Mar-16	2.00%	3.40%	3.20%
Jun-16	2.10%	3.40%	3.20%
Sep-16	2.20%	3.50%	3.30%
Dec-16	2.30%	3.60%	3.40%
Mar-17	2.40%	3.70%	3.50%
Jun-17	2.50%	3.70%	3.60%
Sep-17	2.60%	3.80%	3.70%
Dec-17	2.70%	3.90%	3.80%
Mar-18	2.80%	4.00%	3.90%
Jun-18	2.90%	4.00%	3.90%
Sep-18	3.00%	4.10%	4.00%
Dec-18	3.10%	4.10%	4.00%
Mar-19	3.20%	4.10%	4.00%

6.7 These forecasts are based around an expectation that there will normally be variations of +/-25bp during each quarter around these average forecasts in normal economic and political circumstances. However, greater variations can occur should there be any unexpected shocks to financial and/or political systems.

6.8 The Authority is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Authority's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is relatively high.

6.9 Against this background and the risks within the economic forecast, caution will be adopted with the 2016/17 treasury operations. The Head of Finance will monitor interest rates in financial markets in conjunction with Warrington Borough Council and adopt a pragmatic approach to changing circumstances, should any borrowing become required:

- If it was felt that there was a significant risk of a sharp fall in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

- If it was felt that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still lower than they will be in the next few years.

6.10 Any decisions will be reported to Policy Committee at the next available opportunity.

6.11 The Authority's policy for 2016/17 will be to run down investments to maximise returns and minimise risks. However, an assessment of the opportunity for borrowing will be made on the cost of borrowing long-term dependent on the interest rate movements.

7. POLICY ON BORROWING IN ADVANCE OF NEED

7.1 The Authority will not borrow more than or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure value for money can be demonstrated and that the Authority can ensure the security of such funds.

7.2 In determining whether borrowing will be undertaken in advance of need the Authority will:

- ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio, which supports the need to take funding in advance of need;
- ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered;
- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow;
- consider the merits and demerits of alternative forms of funding;
- consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use;
- consider the impact of borrowing in advance on temporarily (until required to finance capital expenditure) increasing investment cash balances and the consequent increase in exposure to counterparty risk, and other risks, and the level of such risks given the controls in place to minimise them. Any risks will be reported through the mid-year or annual reporting mechanism.

8. DEBT RESCHEDULING

8.1 The introduction by the PWLB in 2007 of a spread between the rates applied to new borrowing and repayment of debt (which has now been compounded since 20 October 2010 by a considerable further widening of the difference between new borrowing and repayment rates) has meant that PWLB to PWLB debt restructuring is now much less attractive than before these events. In particular, consideration would have to be given to the large premiums, which would be incurred by prematurely repaying existing PWLB loans and it is very unlikely that these could be justified on value for money grounds if using replacement PWLB refinancing. However, some interest savings may still be achievable through using lenders option borrowers option (LOBO's) loans and other market loans in rescheduling exercises rather than using PWLB borrowing as the source of replacement financing.

8.2 As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

8.3 The reasons for any rescheduling to take place will include:

(a) The generation of cash savings and / or discounted cash flow savings;

(b) Help fulfil the borrowing strategy outlined above;

(c) Enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

8.4 Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

8.5 All rescheduling will be reported to Policy Committee at the earliest meeting following this action.

8.6 It is likely that the Municipal Bond Agency, currently in the process of being set up, will be offering loans to local authorities in the near future. It is also hoped that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). This Authority intends to make use of this new source of borrowing as and when appropriate.

APPENDIX 2

2016/17 AUTHORITY'S ANNUAL INVESTMENT STRATEGY

9. INTRODUCTION

9.1 The aim of our investment strategy is to:

- Maintain capital security;
- Maintain policy flexibility.

9.2 The Head of Finance, under delegated powers, will undertake the most appropriate form of investments depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast above.

9.3 The Authority invests surplus cash balances only with certain approved organisations, as security of funds is of primary importance. All investments will be made in accordance with the Authority's investment policies and prevailing legislation and regulations.

10. INVESTMENT POLICY

10.1 The Authority will have regard to the CLG's Guidance on Local Government Investments ("the Guidance") issued in March 2004, any revisions to that guidance, the Audit Commission's report on Icelandic investments and the 2009 and revised 2011 CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Authority's investment priorities are: -

(a) The security of capital and;

(b) The liquidity of its investments.

10.2 The Authority will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Authority is low in order to give priority to security of its investments.

10.3 In accordance with guidance from CLG and CIPFA, and in order to minimise the risk to investments, the Authority has stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list, which also enable diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

10.4 Furthermore, the Authority's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Authority will engage with Warrington Borough Council and its advisors to maintain and monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings. This is integrated into the credit methodology provided by the Warrington Borough Council's advisors, Capita Asset Services in producing its colour coding which show the varying degrees of suggested creditworthiness.

10.5 Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

10.6 The aim of the strategy is to generate a list of highly creditworthy counterparties, which will also enable diversification and thus avoidance of concentration risk. The intention of the strategy is to provide security of investment and minimisation of risk.

10.7 Investment instruments identified for use in the financial year are listed below under the 'Specified' and 'Non-Specified' investments categories. Counterparty limits will be as set through the Authority's Treasury Management Practices Statement.

11. SPECIFIED INVESTMENTS (MATURITIES UP TO ONE YEAR)

- Bank and Building Society Term Deposits
- Other Local Authority Term Deposits
- Debt Management Agency Deposit Facility
- Money Market Fund
- Government Liquidity Fund

12. NON-SPECIFIED INVESTMENTS (MATURITIES OVER ONE YEAR)

- Bank and Building Society Term Deposits
- Other Local Authority Term Deposits
- Money Market Funds

OTHER NON SPECIFIED INVESTMENTS

- Fixed term deposits with variable rate and variable maturities
- Local Authority Mortgage Schemes

13. COUNTERPARTY LIMITS

	Maximum Limit
1. Specified Investments (limit per counterparty)	
UK Government	Unlimited
Local Authorities	£10.0m
Money Market Funds with a minimum rating AAA	£10.0m
Institutions with a minimum rating of AAA/A1	£10.0m
Pooled Fund Institution with a minimum rating of AAA/A1	£10.0m
Institutions with a minimum rating of AA-/A2	£7.5m
Institutions with a minimum rating of A-/A2	£5.0m
Building Societies – assets greater than £5,000 million	£2.5m
Building Societies – assets greater than £1,000 million	£1.75m

Building Societies – assets greater than £250 million	£1.0m
2. Non-specified Investments (limit per counterparty)	
Investments for more than 365 days	£5.0m
Other non specified investments	£5.0m
3.Other limits (on day of investment)	
Aggregate value of non specified investments	£10.0m

14 CREDITWORTHINESS POLICY

14.1 The Authority uses the creditworthiness service provided by Capita Asset Services on behalf of Warrington Borough Council. This service employs a sophisticated modelling approach utilising credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors. The credit ratings of counterparties are supplemented with the following overlays:

- Credit watches and credit outlooks from credit rating agencies;
- Credit Default Swap (CDS) spreads to give early warning of likely changes in credit ratings;
- Sovereign ratings to select counterparties from only the most creditworthy countries.

14.2 The main rating agencies (Fitch, Moody’s and Standard & Poor’s) have, through much of the financial crisis, provided some institutions with a ratings “uplift” due to implied levels of sovereign support. Commencing in 2015, in response to the evolving regulatory regime, all three agencies have begun removing these “uplifts” with the timing of the process determined by regulatory progress at the national level. The process has been part of a wider reassessment of methodologies by each of the rating agencies. In addition to the removal of implied support, new methodologies are now taking into account additional factors, such as requlatory capital levels. In some cases, these factors have “netted” each other off, to leave underlying ratings either unchanged or little changed. A consequence of these new methodologies is that they have also lowered the importance of the (Fitch) Support and Viability ratings and have seen the (Moody’s) Financial Strength rating withdrawn by the agency.

14.3 In keeping with the agencies’ new methodologies, the rating element of Capita’s credit assessment process now focuses solely on the Short and Long Term ratings of an institution. While this is the same process that has always been used for Standards & Poor’s, this has been a change in the use of Fitch and Moody’s ratings. It is important to stress that the other key elements to the process, namely the assessment of Rating Watch and Outlook information as well as the Credit Default Swap (CDS) overlay have not been changed.

14.4 The evolving regulatory environment, in tandem with the rating agencies’ new methodologies also means that sovereign ratings are now of lesser importance in the assessment process. The new regulatory environment is attempting to break the link between sovereign support and domestic financial institutions. The Authority consider there is a relationship between the underlying domestic and where appropriate, international, economic and wider political and social background will still have an influence on the ratings of a financial institution.

14.5 It is important to stress that these rating agency changes do not reflect any changes in the underlying status or credit quality of the institution. They are merely reflective of a reassessment of rating agency methodologies in light of enacted and future expected changes to the regulatory environment in which financial institutions operate. While some banks have received lower credit ratings as a result of these changes, this does not mean that they are suddenly less credit worthy than they were formerly. Rather, in the majority of cases, this mainly reflects the fact that implied sovereign government support has effectively been withdrawn from banks. They are now expected to have sufficiently strong balance sheets to be able to withstand foreseeable adverse financial circumstances without government support. In fact, in many cases, the balance sheets of banks are now much more robust than they were before 2008 financial crisis when they had higher ratings than now. However, this is not universally applicable, leaving some entities with modestly lower ratings than they had through much of the “support” phase of the financial crisis.

14.6 The Capita modelling approach combines credit ratings, credit watches, and credit outlooks in a weighted scoring system, which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands that indicate the relative creditworthiness of counterparties. These colour codes are also used by the Authority to determine the duration for investments. The Authority is satisfied that this service now gives a much improved level of security for its investments. It is also a service that the Authority would not be able to replicate using in-house resources.

14.7 The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions down to a minimum durational band within Capita’s weekly credit list of worldwide potential counterparties. The Authority will therefore use counterparties within the following durational bands:

- Yellow – 5 years*
- Dark pink – 5 years for Enhanced money market funds (EMMFs) with a credit score of 1.25
- Light pink – 5 years for Enhanced money market funds (EMMFs) with a credit score of 1.50
- Purple - 2 years
- Blue - 1 year (only applies to nationalised/semi nationalised UK Banks)
- Orange - 1 year
- Red - 6 months
- Green – 100 days
- No Colour - not to be used

**The yellow colour category is for UK Government debt, or its equivalent, money market funds and collateralised deposits where the collateral is UK Government debt.*

14.8 This Authority will not use the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties. This is because Moody's are currently very much more aggressive in allocating low ratings than the other two agencies. This would leave the Authority with few banks on its approved lending list and would be unworkable.

14.9 The creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue weight to just one agency's ratings.

14.10 Typically the minimum credit ratings criteria the Authority use will be a short term rating (Fitch or equivalents) of short term rating F1, long term rating A-, viability rating of a-, and a support rating of 1. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

14.11 All credit ratings will be monitored weekly by Warrington Borough Council, which is alerted to changes to ratings of all three agencies through its use of the Capita creditworthiness service:

- If a downgrade results in the counterparty/investment scheme no longer meeting the Authority's minimum criteria, its further use as a new investment will be withdrawn immediately;
- In addition to the use of Credit Ratings the Authority will be advised of information in movements in Credit Default Swap (CDS) against the iTraxx (CDS product brand name) benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Authority's lending list.

14.12 Sole reliance will not be placed on the use of this external service. In addition this Authority will also use market data and information, information on government support for banks and the credit ratings of that government support.

15. COUNTRY LIMITS

15.1 The Authority has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent from other agencies if Fitch does not provide them). The list will be added to, or deducted from by officers should ratings change in accordance with this policy.

16. INVESTMENT STRATEGY

16.1 Prudence will drive the Authority's investment strategy in 2016/17 due to the volatility and uncertainty that exists in the world's financial markets. Lending will only take place to institutions at the higher end of the credit rating spectrum. Due to interest rates being historically low and to maximise liquidity investments will be of a short term nature. In order to minimise risk, the Authority will look to diversify its investment portfolio by investing in other investment vehicles such as money market funds. The driving force of our strategy will be maintaining the security of capital and investment liquidity. The Authority will use a combination of credit ratings, sovereign ratings and guarantees to assess the credit quality of financial institutions before placing investments.

17. INTEREST RATE OUTLOOK

17.1 The Bank Rate is forecast to remain unchanged at 0.50% before starting to rise from quarter 2 of 2016. Bank Rate forecasts for financial year ends (March) are as follows:-

- 2016/17 0.75%
- 2017/18 1.25%
- 2018/19 1.75%

17.2 There are downside risks to these forecasts (i.e. start of increases in Bank Rate occurs sooner) if economic growth weakens. However, should the pace of growth quicken, there could be upside risk.

17.3 The suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year for the next few years are as follows:

- 2016/17 0.50%
- 2017/18 1.25%
- 2018/19 1.75%
- 2019/20 2.25%
- 2020/21 2.50%
- 2021/23 2.75%
- 2022/23 2.75%
- 2023/24 3.00%
- Later years 3.00%

17.4 For 2016/17 the Authority will budget for an investment return of 0.50% on investments placed during the financial year.

18. LIQUIDITY OF INVESTMENTS

18.1 The maximum period of investment of Authority money will be ten years.

18.2 There will be no more than £10m committed for a period over 5 years.

19. POLICY ON THE USE OF EXTERNAL SERVICE PROVIDERS

19.1 The Authority uses Warrington Borough Council as its external treasury management advisers. They in turn use Capita Services to advise them.

19.2 The Authority recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

19.3 It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Authority will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

20. TREASURY MANAGEMENT SCHEME OF DELEGATION

20.1 The scheme of delegation is in the Authority's Treasury Management Practices statement which will be reported to the Policy Committee on an annual basis.

21. MINIMUM REVENUE PROVISION (MRP) STRATEGY

21.1 The Authority is required to make an annual provision from revenue to contribute towards the repayment of borrowing. This requirement arises under the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008, which simplifies earlier MRP requirements by placing a duty on the Authority to determine each year an amount of minimum revenue provision, which it considers to be prudent. In order to assist the Authority with this determination, guidance for assessing what would represent a prudent provision has been issued under S.21 (1A) of the Local Government Act 2003 (The Guidance). The Authority is required to have regard to the Guidance when considering the amount of their annual "prudent" MRP.

It is proposed that the MRP for 2016/17 will continue to be charged at the rate of 6.7% of the opening Capital Financing Requirement. It is officers' professional opinion that this approach continues to meet the statutory duty to make prudent revenue provision.

Based on the current projected capital outturn position for 2015/16, it is expected that this will equate to a charge of approximately £549k for 2016/17.

The policy will be reviewed on an annual basis. If it is proposed to vary the strategy during the year, a revised statement will be submitted to the Policy Committee.

22. CAPITAL PROGRAMME

22.1 The Authority is proposing a capital programme of £2.6m in 2016/17. This will be funded from revenue, capital reserves and capital receipts.