Corporate Governance and Standards Report

Ward(s) affected: All

Report of Managing Director

Author: Vicky Worsfold

Tel: 01483 444834

Email: victoria.worsfold@guildford.gov.uk

Lead Councillor responsible: Nigel Manning

Tel: 01252 665999

Email: nigel.manning@guildford.gov.uk

Date: 26 November 2015

Treasury management activity half-year monitoring report 2015-16

Executive Summary

We are required to report on treasury management activity to Councillors for the first six months of the year.

We had £153 million invested and £245 million borrowed, and net borrowing of £92 million at 30 September 2015.

Our borrowing is made up of £193.7 million for the HRA borrowed from the Public Works Loans Board (PWLB) due to the HRA subsidy reform debt settlement, £10 million medium-term borrowing from other local authorities for the general fund, and short-term borrowing for cash flow purposes of £42 million.

Our budgeted interest receipt was £1.13 million and we are projecting £1.56 million, generating an additional £430,000 interest income. We estimated our interest payable to be £5.45 million and our outturn is estimated to be £5.33 million. A reduction of £120,000.

Our temporary loan portfolio has increased from the start of the year by £27 million. We have further increased the diversification in our investment portfolio by using more bonds and secured instruments, in line with the Council's 2015-16 approved treasury management strategy.

The advice from Arlingclose has been to increase the duration of some of our counterparty investment durations, which has meant we can increase the yield on some of our new investments. To do this we have undertaken some short-term borrowing for cash flow purposes.

Borrowing from other local authorities still represents very good value for money.

The Council has complied with its prudential indicators during the first half of the year.

Recommendation to Council

That the Corporate Governance and Standards Committee notes the detail in the report, and makes any comments it feels appropriate to full Council

Reason for Recommendation:
To allow the Corporate Governance and Standards Committee to review the mid-year performance as required by the treasury management code of practice

1. Purpose of Report

1.1 Treasury management activity is underpinned by the adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (The Code), which includes the requirement to determine a treasury strategy on the likely financing and investment activity for the forthcoming year.

1.2 The Code recommends that Councillors are informed of treasury management activities at least twice a year. This report therefore ensures the Council is embracing best practice in accordance with CIPFA's recommendations by reporting quarterly to Councillors. We have included a commentary on the national Economic Outlook, counterparty updates and future outlook in **Appendix 1**.

1.3 In addition to reporting on risk management related to treasury activities, the Treasury Management Code, also requires the Council to report on any financial instruments entered into to manage treasury risks.

2. Strategic Priorities

2.1 Treasury management is a key function in enabling the Council to achieve financial excellence and value for money. This monitoring report, demonstrates how we are performing against our approved strategy and budgets and proves compliance with our prudential indicators. Treasury management supports all aspects of the Corporate Plan.

3. Background

3.1 Treasury management is defined as "the management of the local authority'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".

3.2 We invest and borrow substantial sums of money and are therefore exposed to financial risks, including the loss of invested funds and the revenue effect of changing interest rates. This report covers treasury activity and the associated monitoring and control of risks.

3.3 **Appendix 1** provides further information on the economic background and future outlook of the UK and global economies.

Counterparty update

3.4 All three credit rating agencies have reviewed their ratings in the last six months to reflect the loss of government support for most financial institutions and the potential for varying loss given defaults as a result of the new bail-in regimes in many countries. Despite reductions in government support many institutions have seen upgrades due to an improvement in their underlying strength and an assessment that the level of loss given default is low.

3.5 At the end of July, Arlingclose advised an extension of recommended durations for unsecured investments in certain UK and European institutions following improvements in the global economic situation and the receding threat of another Eurozone crisis. A similar extension was advised for some non-European banks in September, with the Danish Danske Bank being added as a new recommended counterparty and certain non-rated UK building societies also being extended.

3.6 In September, Volkswagen was found to have been cheating emissions test over several years in many of their diesel vehicles. This scandal is still playing out and the full extent of the financial implications yet to become clear. Arlingclose recommended suspending VW (as a non-financial corporate bond counterparty) for new investments whilst the situation is monitored. The ratings of the VW group were placed on Rating Watch Negative by Fitch, CreditWatch with negative implications by S&P and the outlook revised to negative by Moody's. Moody's also revised the outlook on VW Financial Services to negative.

3.7 At the 20 September 2015, we were holding a VW bond, which has now matured. Arlingclose advised to maintain the holding to maturity, despite the negative press about the company. We received our investment back in full plus the interest that was due to us.

3.8 Further information on the impact of the global economy on counterparties is contained within **Appendix 1**.

4 Debt management

4.1 We have a substantial long-term debt portfolio for the Housing Revenue Account (HRA), and a small amount for the General Fund (GF).

4.2 We have also borrowed for short-term cash flow purposes in the period from other local authorities.

4.3 Our chief objective when borrowing is to strike an appropriate risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate deals should our plans change, being a secondary objective.

4.4 The PWLB is an attractive source of medium to long-term borrowing for the Council, as it offers flexibility and control. Affordability and the "cost of carry" remained important influences on our borrowing strategy, alongside the consideration that, for any borrowing undertaken ahead of need, the proceeds would have to be invested at interest rates significantly lower than the cost of borrowing.

4.5 The use of internal resources for the GF, in lieu of borrowing, has continued to be the most cost effective means of funding capital expenditure. This has lowered overall treasury risk by reducing the need for external debt as we have used investments. However, we acknowledge that this position will not be sustainable over the medium term and we expect to borrow for capital purposes for current commitments. We will continue to assess borrowing options and the timing of such borrowing in conjunction with the Arlingclose.

4.6 We qualify for borrowing at the 'Certainty Rate' (0.20% below the PWLB standard rate).

4.7 We also qualify for £6 million borrowing at the PWLB Project Rate (0.40% below standard PWLB rates) for the Clay Lane Link road project, and have approval for borrowing for the SARP project. We applied for the rate via our Local Enterprise Partnerships (LEP), Enterprise M3, and the Homes and Community Agency (HCA) in respect of a housing zone application for SARP.

4.8 The following table summaries our current borrowing position and the activity in the first half of the year.

Loan type		Balance 01 April 15 £000	New loans £000	Loans repaid £000	Balance 30 Sept 15 £000	Weighted average rate of interest
PWLB						3.15%
Variable		45,000	0	0	45,000	
Fixed	Maturity	147,435	0	0	147,435	
	EIP	1,380	0	(115)	1,265	
Local authorities		5,000	5,000	0	10,000	1.35%
Total long-term Loans		**198,815**	**5,000**	**(115)**	**203,700**	
Temporary Loans		15,000	71,000	(44,000)	42,000	0.42%
Total Loans		**213,815**	**76,000**	**(44,115)**	**245,700**	

4.9 Our overall borrowing balance has remained stable with that of quarter one.

5 Investment activity

5.1 The Guidance on Local Government Investments in England gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles.

5.2 Security of capital remains the Council's main investment objective. We have maintained this by following the Council's counterparty policy as set out in our Treasury Management Strategy Statement for 2015-16, approved by Council in February 2015.

5.3 Counterparty credit quality is assessed and monitored with reference to:

- Credit Ratings across rating agencies Fitch, Standard & Poors and Moody's
- credit default swaps
- financial statements
- information on potential government support
- reports in the quality financial press

Credit risk

5.4 Counterparty credit quality as measured by credit ratings is summarised below

	01-Apr-15	30-Apr-15	31-May-15	30-Jun-15	31-Jul-15	31-Aug-15	30-Sep-15
Value Weighted Average	4.30	4.68	4.60	4.47	4.38	4.18	4.07
expressed as a credit rating	AA-	A+	A+	AA-	AA-	AA-	AA-
Time Weighted Average	2.21	3.00	2.62	2.48	2.40	2.41	2.55
expressed as a credit rating	AA+	AA	AA	AA+	AA+	AA+	AA
Weighted avg no. days to maturity	189	247	311	305	290	287	288

5.5 The value-weighted average reflects the credit quality of investments according to the size of the deposit and the time-weighted average reflects the credit quality of investments according to the time to maturity for the deposit.

5.6 AAA is the highest credit quality score and D is the lowest with a score of 27. The aim is A- or higher (as per the approved strategy), which attracts a score of seven, to reflect the current investment approach with the focus being on security.

5.7 The credit risk scores have remained fairly stable in the last quarter. The scores above are well within the approved limits.

5.8 In the last quarter, Arlingclose have extended the duration for some of our counterparties. This is a reflection of the stabilisation of the markets.

5.9 Giving the increasing risk and continued low returns from short-term unsecured bank investments, we have further diversified our investment portfolio, into more secure and / or higher yielding asset classes, such as covered bonds, and pooled funds.

Budgeted Investment Income and Outturn

5.10 The Council's budgeted investment income for the 2015-16 financial year was estimated at £1.13 million; the projected outturn is £1.56 million. The gross cash balances representing the Council's reserves and working balances at 30

September 2015 available for investment were £153.517 million, net of short-term borrowing £111.517 million.

5.11 The Council's budgeted external interest cost, which relates to long and short-term borrowing, for the year is £5.334 million.

5.12 Net interest receivable was budgeted at £851,000 and is projected to be £1.31 million representing a net increase of £459,000.

5.13 The UK Bank Rate has been 0.50% since March 2009 and is not expected to rise until 2016. The Council's annualised weighted return on investments for the period to 30 September 2015 was 1.15%, against a full year estimate of 1.21%. This is partly lower because the money we have invested in the two new external funds, are currently showing in the annualised return as zero because we have not yet had a dividend payment and therefore cannot estimate the likely return.

Investment	Balance 01 April 15 £000	New investments £000	Investments matured £000	Change in capital value £000	Balance 30 Sept 15 £000	Weighted average rate of interest
Investment Funds						
Payden & Rygel	5,010	0	0	(15)	4,995	0.44%
CCLA	6,182	0	0	253	6,435	2.98%
SWIP	1,860	0	0	(34)	1,826	1.06%
M&G	2,164	0	0	(375)	1,789	1.84%
Schroders	965	0	0	(146)	819	3.97%
Funding Circle	408	225	0	(0)	633	4.58%
UBS	0	2,500	0	(143)	2,357	0.00%
City Financial	0	2,500	0	(75)	2,425	0.00%
In- House Investments:						
Call Accounts	3,034	14,603	(13,566)	0	4,071	0.58%
Money Market Funds	6,042	149,492	(152,698)	0	2,836	0.67%
Notice Accounts	16,075	5,031	(3,100)	0	18,005	0.47%
Temporary Fixed Deposits	50,500	60,000	(65,000)	0	45,500	0.63%
Certificates of Deposit	8,000	15,500	(14,000)	0	9,500	0.67%
Short term bonds	3,500	36,383	(11,482)	0	28,401	0.84%
Long Term Covered Bonds	10,147	4,279	0	0	14,426	0.88%
Long Term Fixed Deposits	0	9,500	0	0	9,500	1.78%
Total Investments	**113,888**	**300,012**	**(259,847)**	**(536)**	**153,517**	

Externally Managed Funds

5.14 The Council invests in a number of external funds, as shown in the table above.

5.15 All funds are performing well in terms of their income distributions, but with a varying performance on the capital value. This reflects movements on the wider financial market during the period. These investments are held for long-term purposes and are invested to generate income for the Council over the longer-term. Any loss in investment value will not be realised unless the investment is sold and the Council has an earmarked reserve available to utilise in the event of a loss thus minimising the impact on the general fund.

5.16 Officers would not normally sell external investments at a loss unless there were very exceptional circumstances. It is expected that the value of external investments will increase in line with the market in the medium-term and generate a positive return for the Council.

5.17 CCLA continues to perform well for us giving us good returns and capital growth.

5.18 We set an investment limit in externally managed pooled funds of £10 million per fund.

5.19 We have a view to monitor these funds on a rolling three to five year period to allow for fluctuations in the capital value.

In-house investments

5.20 We have been using Money Market Funds for liquidity cash flow purposes. We have been investing more in bonds to increase the diversification in our portfolio. The use of certificates of deposits and the brokers for fixed deposits and bonds has enabled us to access high quality counterparties that would not otherwise be possible.

6 Compliance with Prudential Indicators

6.1 Officers confirm that the Council has complied with its Prudential Indicators in the first half of 2015-16, which were set in February 2015 as part of the Council's Treasury Management Strategy Statement.

Authorised Limit and Operational Boundary for External Debt

6.2 The Local Government Act 2003 requires the Council to set an Affordable Borrowing Limit, irrespective of their indebted status. This is a statutory limit, which we should not breach.

6.3 The Council's Authorised Borrowing Limit was set at £435 million for 2015-16.

6.4 The Operational Boundary is based on the same estimates as the Authorised Limit but reflects the most likely, prudent but not worst-case scenario without the additional headroom included within the Authorised Limit.

6.5 The Operational Boundary for 2015-16 was set at £404 million.

6.6 The Chief Financial Officer confirms that there have been no breaches to the Authorised Limit and the Operational Boundary during the year. Borrowing, at its peak was £252 million in the period.

Interest Rate Exposures

6.7 This indicator is set to control the Council's exposure to interest rate risk. They are targets rather than absolute limits.

6.8 The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on our portfolio of investments.

6.9 The limits allow for 100% of total debt and total investments to be at a fixed rate, and a smaller percentage to be at a variable rate to minimise the potential volatility of interest rate risk.

	2015-16 approved (£000)	2015-16 actual to date (£000)
Net debt		
Upper limit on fixed interest rates	312,340	101,930
Upper limit on variable interest rates	(22,790)	(26,150)

6.10 We have more variable rate investments than debt because we have invested in a number of floating rate note bonds, where the interest is reset at regular intervals.

Maturity Structure of Fixed Rate Borrowing

6.11 This indicator is set to control our exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

Time period	Limit	Actual	Variance
Under 12 months	100%	21%	-79%
1 to 2 years	100%	0%	-100%
2 to 5 years	100%	5%	-95%
5-10 years	100%	5%	-95%
10 years and above	100%	68%	-32%

6.12 The table shows the split of the principal repayments of the fixed rate loans of the Council.

Principal sums invested for periods longer than 364 days

6.13 This indicator aims to control the Councils exposure to the risk of incurring losses by seeking early repayment of its investments. The 2015-16 limit was set at £50 million and we had £23.9 million longer term investments, of which £14.4 million was in covered bonds.

7 Consultations

7.1 Not applicable

8 Equality and Diversity Implications

8.1 Not applicable

6. Financial Implications

6.1 These are discussed in the main body of the report

7. Legal Implications

7.1 There are no legal implications

8. Human Resource Implications

8.1 There are no human resource implications

9. Summary of Options

9.1 Not applicable

10. Conclusion

10.1 In compliance with the requirements of the CIPFA Code of Practice, this report provides Councillors with a summary of the treasury management activity for the first quarter of 2015-16. We have not breached the Prudential Indicators and a prudent approach has been taking in relation to investment activity with priority being security and liquidity over yield

11. Background Papers

None

12. Appendices

Glossary
Appendix 1 – Economic background, counterparty information and future outlook
Appendix 2 – Money market data and PWLB rates

Glossary

Authorised Limit – the maximum amount of external debt at any one time in the financial year

Bank Rate - the Bank of England base rate

Capital Financing Requirement (CFR) – financing needs of the Council – i.e. the requirement to borrow

CIPFA - the Chartered Institute of Public Finance and Accountancy. The institute is one of the leading professional accountancy bodies in the UK and the only one which specialises in the public sector. It is responsible for the education and training of professional accountants and for their regulation through the setting and monitoring of professional standards. Uniquely among the professional accountancy bodies in the UK, CIPFA has responsibility for setting accounting standards for a significant part of the economy, namely Local Government. CIPFA's members work, in public service bodies, in the national audit agencies and major accountancy firms.

Cost of Carry – costs incurred as a result of an investment position, for example the additional cost incurred when borrowing in advance of need, if investment returns don't match the interest payable on the debt.

Counterparty – the organisation the Council is investing with.

Creditworthiness – a measure of the ability to meet debt obligations

EIP – Equal Instalments of Principal. A repayment method whereby a fixed amount of principal is repaid with interest being calculated on the principal outstanding.

Gilts – long term fixed income debt security (bond) issued by the UK Government and traded on the London Stock Exchange

ILO Unemployment Rate – percentage of economically active people who are unemployed by ILO standard

LIBID – London Interbank BID Rate – the interest rate at which London banks are willing to borrow from one another

LIBOR – London Interbank Offer Rate – the interest rate at which London banks offer one another

Minimum Revenue Provision – the minimum amount which must be charged to an authority's revenue account each year and set aside towards repaying borrowing

Money Market - the market in which institutions borrow and lend

Money Market Rates – interest rates on money market investments

Operational Boundary – the most likely, prudent but not worst case scenario of external debt at any one time

Pooled funds - investments are made with an organisation who pool together investments from other organisations and apply the same investment strategy to the portfolio. Pooled fund investments benefit from economies of scale, which allows for lower trading costs per pound, diversifications and professional money management.

Prudential Code – a governance procedure for the setting and revising of prudential indicators. Its aim is to ensure, within a clear framework, that the capital investment plans of the Council are affordable, prudent and sustainable and that treasury management decisions are taken in accordance with good practice

Prudential Indicators – indicators set out in the Prudential Code that calculates the financial impact and sets limits for treasury management activities and capital investment

PWLB (Public Works Loans Board) – a central government agency which provides long and medium term notes to local authorities at interest rates only slightly higher than those at which the Government itself can borrow. Local authorities are able to borrow to finance capital spending from this source

Sovereign – the countries the Council are able to invest in

Stable Net Asset Value money market funds – the principle invested remains at its invested value and achieves a return on investment

Treasury Management – the management of the Council's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risk associated with those activities and the pursuit of optimum performance and those risks.

Variable Net Asset Value money market funds – the principle invested may fluctuate below that invested

Appendix 1

Economic background, Counterparty information and Future Outlook

1.1 As the year began, economic data was largely overshadowed by events in Greece. Markets' attention centered on the never-ending Greek issue stumbled from turmoil to crisis, running the serious risk of a disorderly exit from the Euro. The country's politicians and the representatives of the 'Troika' of its creditors - the European Commission (EC), the European Central Bank (ECB) and the International Monetary Fund (IMF) – barely saw eye to eye. Greece failed to make a scheduled repayment to the IMF on 30 June, in itself not a default until the IMF's Managing Director declares it so. Prime Minister Tsipras blindsided Greece's creditors by calling a referendum on 5 July on reform proposals which by then were off the table anyway. The European Central Bank froze liquidity assistance provided to Greek banks and capital controls within the country severely restricted individuals' and corporates' access to cash.

1.2 On 12 July, following a weekend European Union Summit, it was announced that the terms for a third bailout of Greece had been reached. The deal amounting to €86 billion was agreed under the terms that Greece would see tax increases, pension reforms and privatisations; the very reforms Tsipras had vowed to resist. This U-turn saw a revolt within the ruling Syriza party and on 27 August, Alexis Tsipras resigned from his post as Prime Minster of Greece after just eight months in office by calling a snap election, held on 20 September. This gamble paid off as Tsipras led his party to victory once again, although a coalition with the Independent Greeks was needed for a slim parliamentary majority. That government must now continue with the unenviable task of guiding Greece through the continuing economic crisis – the Greek saga is far from over.

1.3 The summer also saw attention shift towards China as the Shanghai composite index (representing China's main stock market), which had risen a staggering 50%+ since the beginning of 2015, dropped by 43% in less than three months with a reported $3.2 trillion loss to investors, on the back of concerns over growth and after regulators clamped down on margin lending activity in an effort to stop investors borrowing to invest and feeding the stock market bubble. Chinese authorities intensified their intervention in the markets by halting trading in many stocks in an attempt to maintain market confidence. They surprised global markets in August as the People's Bank of China changed the way the yuan is fixed each day against the US dollar and allowed an aggressive devaluation of the currency. This sent jitters through Asian, European and US markets impacting currencies, equities, commodities, oil and metals. On 24 August, Chinese stocks suffered their steepest one-day fall on record, driving down other equity markets around the world and soon becoming known as another 'Black Monday'. Chinese stocks have recovered marginally since and are trading around the same level as the start of the year. Concerns remain about slowing growth and potential deflationary effects.

UK Economy:

1.4 The economy has remained resilient over the last six months. Although economic growth slowed in Q1 2015 to 0.4%, year/year growth to March 2015 was a relatively healthy 2.7%. Q2 2015 GDP growth bounced back and was confirmed at 0.7%, with year/year growth showing slight signs of slowing, decreasing to 2.4%. GDP has now increased for ten consecutive quarters, breaking a pattern of slow and erratic growth from 2009. The annual rate for consumer price inflation (CPI) briefly turned negative in April, falling to -0.1%, before fluctuating between 0.0% and 0.1% over the next few months. In the August Quarterly Inflation Report, the Bank of England projected that GDP growth will continue around its average rate since 2013. The Bank of England's projections for inflation remained largely unchanged from the May report with them expecting inflation to gradually increase to around 2% over the next 18 months and then remain there in the near future. Further improvement in the labour market saw the ILO unemployment rate for the three months to July fall to 5.5%. In the September report, average earnings excluding bonuses for the three months to July rose 2.9% year/year.

1.5 The outcome of the UK general election, largely fought over the parties' approach to dealing with the consequences of the structural deficit and the pace of its removal, saw some very big shifts in the political landscape and put the key issue of the UK's relationship with the EU at the heart of future politics.

1.6 The US economy slowed to 0.6% in Q1 2015 due to bad weather, spending cuts by energy firms and the effects of a strong dollar. However, Q2 GDP showed a large improvement at a twice-revised 3.9% (annualised). This was largely due to a broad recovery in corporate investment alongside a stronger performance from consumer and government spending and construction and exports. With the Fed's decision on US interest rate dependent upon data, GDP is clearly supportive. However, it is not as simple as that and the Fed are keen to see inflation rise alongside its headline economic growth and also its labour markets. The Committee decided not to act at its September meeting as many had been anticipating but have signalled rates rising before the end of the year.

Market reaction:

1.7 Equity markets initially reacted positively to the pickup in the expectations of global economic conditions, but were tempered by the breakdown of creditor negotiations in Greece. China led stock market turmoil around the globe in August, with the FTSE 100 falling by around 8% overnight on 'Black Monday'. Indices have not recovered to their previous levels but some improvement has been seen. Government bond markets were quite volatile with yields rising (i.e. prices falling) initially as the risks of deflation seemingly abated. Thereafter yields fell on the outcome of the UK general election and assisted by reappraisal of deflationary factors, before rising again. Concerns around China saw bond yields dropping again through August and September. Bond markets were also distorted by the size of the European Central Bank's QE programme, so large that it created illiquidity in the very markets in which it needed to acquire these bonds, notably German government bonds (bunds) where yields were in negative territory.

Counterparty Update

1.8 All three credit ratings agencies have reviewed their ratings in the six months to reflect the loss of government support for most financial institutions and the potential for varying loss given defaults as a result of new bail-in regimes in many countries. Despite reductions in government support many institutions have seen upgrades due to an improvement in their underlying strength and an assessment that that the level of loss given default is low.

1.9 Fitch reviewed the credit ratings of multiple institutions in May. Most UK banks had their support rating revised from 1 (denoting an extremely high probability of support) to 5 (denoting external support cannot be relied upon). This resulted in the downgrade of the long-term ratings of Royal Bank of Scotland (RBS) to BBB+ from A, Deutsche Bank to A from A+, Bank Nederlandse Gemeeten to AA+ from AAA and ING to A from A+. JP Morgan Chase and the Lloyds Banking Group however both received one notch upgrades.

1.10 Moody's concluded its review in June and upgraded the long-term ratings of Close Brothers, Standard Chartered Bank, ING Bank, Goldman Sachs International, HSBC, RBS, Coventry Building Society, Leeds Building Society, Nationwide Building Society, Svenska Handelsbanken and Landesbank Hessen-Thueringen.

1.11 S&P reviewed UK and German banks in June downgrading Barclays' long-term rating to A- from A, RBS to BBB+ from A- and Deutsche Bank to BBB+ from A. As a result of this the Authority has made the decision to temporarily suspend Deutsche Bank as a counterparty for new unsecured investments. S&P has also revised the outlook of the UK as a whole to negative from stable, citing concerns around a planned referendum on EU membership and its effect on the economy.

1.12 National Australia Bank (NAB) announced its plans to divest Clydesdale Bank, its UK subsidiary. NAB is looking to list Clydesdale on the London Stock Exchange and transfer ownership to NAB's current shareholders. Fitch placed the long- and short-term ratings of the bank on rating watch negative which the agency is expected to resolve once the transaction has been completed. S&P has also placed the long-term rating of Clydesdale Bank on CreditWatch negative following the announcement.

1.13 At the end of July, the council's treasury advisors Arlingclose advised an extension of recommended durations for unsecured investments in certain UK and European institutions following improvements in the global economic situation and the receding threat of another Eurozone crisis. A similar extension was advised for some non-European banks in September, with the Danish Danske Bank being added as a new recommended counterparty and certain non-rated UK building societies also being extended.

1.14 In September, Volkswagen was found to have been cheating emissions test over several years in many of their diesel vehicles. This scandal is still playing out and the full extent of the financial implications yet to become clear. Arlingclose recommended suspending VW (as a non-financial corporate bond counterparty) for new investments whilst the situation is monitored. The ratings of the VW group were placed on Rating Watch Negative by Fitch, CreditWatch with negative implications by S&P and the outlook revised to negative by Moody's. Moody's also revised the outlook on VW Financial Services to negative.

<u>Outlook for Q3 and Q4 2015-16</u>

1.15 Arlingclose's expectation for the first rise in the Bank Rate (base rate) remains the second calendar quarter of 2016. The pace of interest rate rises will be gradual and the extent of rises limited. The appropriate level for Bank Rate for the post-crisis UK economy is likely to be lower than the previous norm. We would suggest this is between 2.0% and 3.0%. There is also sufficient momentum in the US economy for the Federal Reserve to raise interest rates in 2015, although risks of issues from China could possibly push this back.

1.16 The weak global environment and resulting low inflation expectations are likely to dampen long term interest rates. We project gilt yields will follow a shallow upward path in the medium term, with continuing concerns about the Eurozone, and other geo-political events, weighing on risk appetite, while inflation expectations remain subdued. The uncertainties surrounding the timing of UK and US interest rate rises, and the Chinese stock market-led turmoil, are likely to prompt short term volatility in gilt yields.

	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Average
Official Bank Rate														
Upside risk			0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.32
Arlingclose Central Case	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.50	1.75	1.75	1.08
Downside risk				-0.25	-0.25	-0.50	-0.50	-0.75	-0.75	-1.00	-1.00	-1.00	-1.00	-0.70

Appendix 2

Money Market Data and PWLB Rates

The average, low and high rates correspond to the rates during the financial year rather than those in the tables below.

Please note that the PWLB rates below are Standard Rates. Authorities eligible for the Certainty Rate can borrow at a 0.20% reduction.

Table 1: Bank Rate, Money Market Rates

Date		Bank Rate		O/N LIBID	7-day LIBID	1-month LIBID	3-month LIBID	6-month LIBID	12-month LIBID	2-yr SWAP Bid	3-yr SWAP Bid	5-yr SWAP Bid
01/04/2015		0.50		0.35	0.46	0.43	0.51	0.76	0.97	0.87	1.05	1.32
30/04/2015		0.50		0.35	0.48	0.43	0.52	0.74	0.98	1.00	1.21	1.51
31/05/2015		0.50		0.43	0.50	0.43	0.52	0.75	0.98	0.97	1.18	1.49
30/06/2015		0.50		0.35	0.45	0.43	0.52	0.79	0.99	1.09	1.35	1.68
31/07/2015		0.50		0.32	0.43	0.43	0.53	0.79	1.01	1.10	1.33	1.66
31/08/2015		0.50		0.42	0.40	0.43	0.54	0.82	1.02	1.03	1.24	1.61
30/09/2015		0.50		0.37	0.41	0.43	0.54	0.74	1.00	0.93	1.11	1.41
Average		**0.50**		**0.40**	**0.46**	**0.43**	**0.53**	**0.76**	**0.99**	**1.03**	**1.25**	**1.58**
Maximum		**0.50**		**0.48**	**0.58**	**0.56**	**0.65**	**0.86**	**1.02**	**1.17**	**1.44**	**1.82**
Minimum		**0.50**		**0.17**	**0.40**	**0.43**	**0.51**	**0.55**	**0.97**	**0.87**	**1.04**	**1.29**
Spread		**--**		**0.31**	**0.18**	**0.13**	**0.14**	**0.31**	**0.05**	**0.30**	**0.40**	**0.53**

Table 2: PWLB Borrowing Rates – Fixed Rate, Maturity Loans

Change Date	Notice No	1 year	4½-5 yrs	9½-10 yrs	19½-20 yrs	29½-30 yrs	39½-40 yrs	49½-50 yrs
01/04/2015	128/15	1.32	2.07	2.66	3.21	3.34	3.30	3.28
30/04/2015	166/15	1.41	2.27	2.90	3.44	3.55	3.50	3.48
29/05/2015	204/15	1.44	2.26	2.90	3.44	3.54	3.48	3.45
30/06/2015	248/15	1.48	2.44	3.13	3.65	3.72	3.64	3.60
31/07/2015	294/15	1.54	2.45	3.07	3.56	3.62	3.54	3.49
28/08/2015	334/15	1.47	2.30	2.92	3.47	3.54	3.44	3.40
30/09/2015	379/15	1.44	2.19	2.79	3.42	3.50	3.42	3.39
	Low	1.31	2.02	2.60	3.16	3.28	3.23	3.21
	Average	1.46	2.32	2.96	3.51	3.59	3.52	3.49
	High	1.55	2.55	3.26	3.79	3.87	3.80	3.78

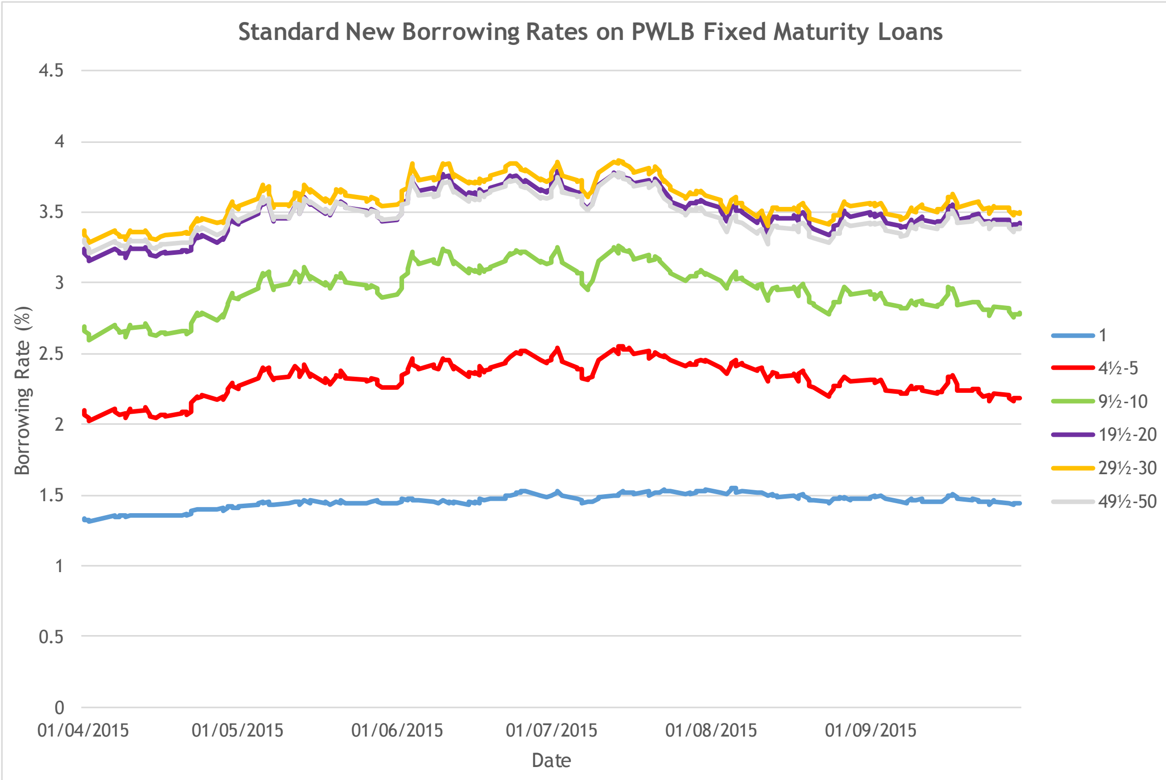

Table 3: PWLB Borrowing Rates – Fixed Rate, Equal Instalment of Principal (EIP) Loans

Change Date	Notice No	4½-5 yrs	9½-10 yrs	19½-20 yrs	29½-30 yrs	39½-40 yrs	49½-50 yrs
01/04/2014	127/15	1.63	2.11	2.68	3.00	3.22	3.32
30/04/2014	166/15	1.79	2.31	2.92	3.24	3.45	3.54
29/05/2014	204/15	1.78	2.30	2.93	3.26	3.45	3.53
30/06/2014	248/15	1.90	2.49	3.15	3.47	3.65	3.72
31/07/2014	294/15	1.96	2.50	3.09	3.39	3.57	3.63
28/08/2014	334/15	1.83	2.34	2.94	3.27	3.48	3.55
30/09/2014	379/15	1.76	2.23	2.82	3.19	3.43	3.51
	Low	1.60	2.06	2.62	2.94	3.16	3.26
	Average	1.84	2.37	2.99	3.31	3.51	3.59
	High	1.99	2.60	3.28	3.61	3.79	3.87

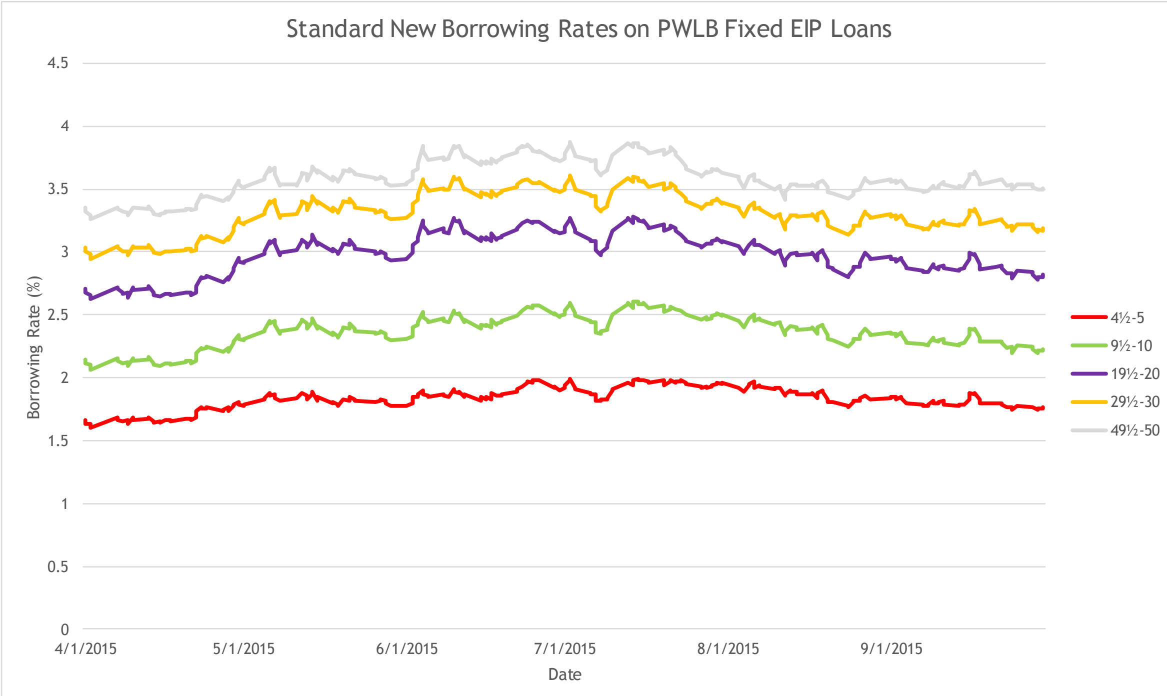

Table 4: PWLB Variable Rates

	1-M Rate	3-M Rate	6-M Rate	1-M Rate	3-M Rate	6-M Rate
	Pre-CSR	Pre-CSR	Pre-CSR	Post-CSR	Post-CSR	Post-CSR
01/04/2015	0.62	0.63	0.66	1.52	1.53	1.56
30/04/2015	0.62	0.64	0.67	1.52	1.54	1.57
29/05/2015	0.62	0.65	0.68	1.52	1.55	1.58
30/06/2015	0.62	0.66	0.70	1.52	1.56	1.60
31/07/2015	0.62	0.66	0.72	1.52	1.56	1.62
28/08/2015	0.62	0.66	0.70	1.52	1.56	1.60
30/09/2015	0.66	0.67	0.76	1.56	1.57	1.66
Low	0.62	0.61	0.66	1.52	1.51	1.56
Average	0.63	0.65	0.70	1.53	1.55	1.60
High	0.66	0.69	0.78	1.56	1.59	1.68