Corporate Governance and Standards Committee Report

Ward(s) affected: all

Report of Chief Finance Officer

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Treasury management annual report 2015-16

Executive Summary

Treasury management is the control and management of the Council's cash, regardless of its source. It covers management of the daily cash position, investments and borrowing.

It is defined as "the management of the council'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"

The Chartered Institute of Public Finance and Accountancy (CIPFA) publish a 'treasury management code of practice' and a 'Prudential Code for Capital Finance in Local Authorities' which require us to set Prudential and Treasury indicators. CIPFA also requires us to report on treasury management activity and compliance with Prudential Indicators.

The objectives of the prudential code, and the indicators calculated in accordance with it, is to provide a framework for local authority capital finance that will ensure:

- capital expenditure plans are affordable
- all external borrowing is within prudent and sustainable levels
- treasury management decisions are taken in accordance with professional good practice and
- in taking the above decisions, the council is accountable by providing a clear transparent framework.

The Council's cash balances have built up over a number of years, and reflect our strong balance sheet, with considerable revenue and capital reserves. Officers carry out this function within the parameters set by the Council each year in the treasury management strategy statement (TMSS). As at 31 March 2016, the Council held £144 million in investments.

The Council considers, security, liquidity and yield when making investment decisions. The most important part of making investments is the security of capital – ensuring we get our money back. Next, we consider liquidity – getting our money back when we need it. Once we are comfortable with both the security and liquidity of the investment, we review the return on the investment.

For borrowing, we borrow short-term from other local authorities for cash flow purposes and ensure there is no cost of carry on this. We undertake longer-term borrowing in line with our liability benchmark and the capital programme. We took out a small loan from another local authority at the beginning of the year. The Council had £238 million borrowing at 31 March 2016.

This report (section 8) confirms that the Council complied with its prudential indicators, treasury management policy statement and treasury management practices (TMPs) for 2015-16. The policy statement is included and approved as part of the TMSS, and the TMPs are approved under delegated authority.

The treasury management performance over the last year, compared to estimate, is summarised in the table below. The report highlights the factors affecting this performance throughout the report, and in **Appendix 1**.

	Estimate %	**Actual %**	**Estimate (£000)**	**Actual (£000)**
General fund Capital Financing Requirement (CFR)			69,583	39,784
Housing Revenue Account CFR			196,664	196,664
Total CFR			**266,247**	**236,448**
Return on investments	1.21	1.13	1,130	1,739
Interest paid on external debt		2.26	5,519	5,470
Total net interest paid			**4,389**	**3,731**

There was slippage in the capital programme, which resulted in a lower CFR than estimated.

Interest paid on debt was lower than budget, due to the variable loan rate being reset lower than expected.

The yield returned on investments was lower than estimated, but the interest received (return on investments) was higher due to more cash being available to invest in the year – a direct result of the capital programme slippage.

All of the above was included in the projected outturn position when reported to councillors during the year.

For detailed information on the return on investments, and interest paid on external debt can be found in section 7 of the main report.

This report will also be considered by the Executive at its meeting on 28 June 2016.

Recommendation to Council (26 July 2016)

The Committee is asked to comment on the following recommendation to Council:

(1) That the treasury management annual report for 2015-16 be noted.
(2) That the actual prudential indicators reported for 2015-16, as detailed in **Appendix 1** to this report, be approved.

Reason for Recommendation:
To comply with the Council's treasury management policy statement, the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on treasury management and the CIPFA Prudential Code for Capital Finance in Local Authorities.

1. Purpose of Report

1.1 The Local Government Act 2003 states that the Council has a legal obligation to have regard to both the CIPFA code of practice on treasury management and the CLG investment guidance.

1.2 The CIPFA treasury management code of practice required public sector authorities to produce an annual treasury management strategy, and as a minimum, report to councillors on treasury activity mid-year and after the year-end.

1.3 This report covers the activity of the treasury management function in 2015-16. It also covers the requirement to report on the prudential and treasury indicators for the year.

1.4 The Council borrows and invests substantial sums of money and is, 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.

1.5 Treasury management is a highly complex, technical and regulated aspect of local government finance. We have included a glossary of technical terms (**Appendix 8**), to aid the reading of this report.

2. Strategic Priorities

2.1 Treasury management is a key function in enabling the Council to achieve financial excellence and value for money. It underpins the achievement of all the Corporate Plan 2015-2020 themes, in particular Your Council – ensuring long-term financial stability and sound financial governance.

2.2 This report details the activities of the treasury management function and the effects of the decisions taking in the year in relation to the best use of its resources.

3. Background

3.1 Treasury management is defined by CIPFA as:

"the management of the councils' 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 The Council has responsibility for treasury management. Treasury management contains a number of risks. The effective identification and management of those risks are integral to the Council's treasury management objectives, as is ensuring that borrowing activity is prudent, affordable and sustainable.

3.3 The Council has a statutory requirement, under the Local Government Act 2003, to adopt the CIPFA Prudential Code and produce prudential indicators. A requirement of the prudential code is the adoption of the CIPFA treasury management code of practice and the treasury management policy statement (included as an appendix to the annual treasury management strategy statement).

3.4 The objectives of the prudential code are to ensure, within a clear framework, that capital investment plans are affordable, prudent and sustainable, and the treasury management decisions are taken in accordance with good professional practice.

3.5 The council has adopted the revised CIPFA treasury management code of practice. It operates its treasury management function in compliance with this Code and the statutory requirements.

3.6 This annual report, and the appendices attached to it, set out:

- a summary of the economic factors affecting the approved strategy and counterparty updated (sections 4 and 5 with details in **Appendix 4**)
- a summary of the approved strategy for 2015-16 (section 6)
- a summary of the treasury management activity for 2015-16 (section 7 with detail in **Appendix 1**)
- compliance with the treasury and prudential indicators (section 8 with detail in **Appendix 1**)
- risks and performance (section 9)
- Minimum Revenue Provision (MRP) (section 10)
- details of external service providers (section 11)
- details of training (section 12)

4. Economic Environment

4.1 This section includes a summary of the economic environment for 2015-16, to show the treasury management activity in context. **Appendix 4** contains more detail.

4.2 The UK economy slowed with GDP growth falling to 2.3% from a robust 3% the year before.

4.3 CPI inflation hovered around 0% with deflationary spells in April, September and October. Low inflation was due to the extremely low oil prices, the appreciation of sterling since 2013 pushing down import prices and weaker than expected wage growth resulted in subdued unit labour costs.

4.4 The slowdown in the Chinese economy became the largest threat to prospects for global growth. Chinese authorities intervened in the currency and equity markets, and the effects were only temporary which led to high market volatility. There were falls in prices of equities and risky assets and a widening in corporate credit spreads.

4.5 Between February and March 2016, sterling had depreciated by around 3%, a significant proportion of the decline reflecting the uncertainty surrounding the referendum result.

4.6 The Bank of England Monetary Policy Committee (MPC) made no change to policy, maintaining the Bank Rate at 0.50% and asset purchases (Quantitative Easing) at £375 billion.

4.7 The market reaction to the overall economy was that from June 2015, gilt yields were driven lower by a weakening in Chinese growth, the knock on effects of the fall in its stock market, the continuing fall in the price of oil and commodities and acceptance of diminishing effectiveness of central bankers' unconventional policy actions. Added to this was the heightened uncertainty surrounding the outcome of the UK referendum on its continued membership of the EU as well as the US presidential elections which culminated in a significant volatility particularly in equities and corporate bond yields.

5. Counterparty update

5.1 This section details the changes in the counterparties on the Council's lending list during the year.

5.2 Two European Union directives became UK legislation, which placed the burden of rescuing failing UK banks disproportionately onto unsecured institutional investors which include local authorities and pension funds.

5.3 During the year, all three credit rating agencies reviewed their ratings to reflect the loss of government support for most financial institutions and the potential for loss given default as a result of new bail-in regimes in many countries. Despite reductions in government support, many institutions saw upgrades due to an improvement in their underlying strength and an assessment that the level of loss given default is low.

5.4 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), Deutsche Bank, Bank Nederlandse Gemeeten and ING. JP Morgan Chase and the Lloyds Banking Group, however, both received one notch upgrades.

5.5 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 Handlesbanken and Landesbank Hessen-Thuringen.

5.6 S&P reviewed UK and German banks in June, downgrading the long-term ratings of Barclays, RBS and Deutsche Bank. As a result, the Council suspended Deutsche Bank as a counterparty for new unsecured investments. S&P also revised the outlook of the UK as a whole from stable to negative, citing concerns around the EU referendum and its effect on the economy.

5.7 National Australis Bank (NAB) announced its plans to divest Clydesdale Bank, its UK subsidiary. NAB listed Clydesdale on the London Stock Exchange and transferred ownership to NAB's shareholders. Following the demerger, Fitch and Moody's downgraded the long and short-term ratings of the bank.

5.8 At the end of July 2015, 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 being extended.

5.9 In September, Volkswagen (VW) was found to have been cheating emissions tests over several years in many of their diesel vehicles. Arlingclose recommended suspending VW (as a non-financial corporate bond counterparty) for new investments. As issues around the scandal continued, there were credit rating downgrades across the VW group by all rating agencies.

5.10 In December, the Bank of England released the results of its latest stress tests on the seven largest UK banks and building societies which showed that RBS and Standard Chartered were the weakest performers. However, the regulator did not require either bank to submit revised capital plans, since both firms had already improved their capitalisation ratios over the year.

5.11 In January 2016, Arlingclose supplemented its existing investment advice with a counterparty list of high quality bond issuers, including recommended cash and duration limits.

5.12 Interest rates are likely to stay lower for longer, and with large cash balances, it makes long-term bonds an attractive option.

5.13 The first quarter of 2016 was characterised by financial market volatility and a weakening outlook for global economic growth. In March 2016, following the publication of many banks' 2015 full year results, Arlingclose advised the suspension of Standard Chartered Bank for unsecured investments. Standard Chartered has also seen various rating actions taken against it by the rating agencies and a rising CDS level throughout the year.

5.14 The end of bank bail-outs, the introduction of bail-ins, and the preference being given to large numbers of depositors other than local authorities means that the risks of making unsecured deposits continues to be elevated relative to other investment options. The council therefore increasingly favoured secured investment options or diversified alternatives, such as covered bonds and non-bank investments over unsecured bank and building society deposits.

6. Approved strategy for 2015-16 – a summary

6.1 Council approved the treasury management strategy for 2015-16 in February 2015.

6.2 The strategy showed an underlying need to borrow in 2015-16 for the General Fund (GF) capital programme of £149.95 million.

6.3 The strategy set out how we would manage our cash. It allowed for internally managed investments for managing cash flow and externally managed and longer-term investments for our core cash (cash not required in the short or medium term).

6.4 It highlighted the need to further diversify our investment portfolio to reduce credit risk. The approved strategy set the minimum long-term credit rating of A- (or equivalent) for investments in counterparties using the lowest denominator principal for the three main credit rating agencies.

7. Treasury management activity in 2015-16

7.1 The treasury position at 31 March 2016, compared to the previous year is:

		31 March 2015 (£'000)	**Average Rate**	**31 March 2016 (£'000)**	**Average Rate**
Fixed Rate Debt	PWLB	148,815	3.23%	148,585	3.23%
	Market	0	0.00%	0	0.00%
Variable Rate Debt	PWLB	45,000	0.56%	45,000	0.70%
	Market	0	0.00%	0	0.00%
Long-term	LAs	5,000	1.50%	10,000	1.35%
Temporary borrowing	LAs	15,000	0.33%	34,500	0.46%
Total Debt		**213,815**	**2.50%**	**238,085**	**2.26%**
Fixed Investments		(72,146)	0.66%	(88,452)	0.84%
Variable Investments		(25,152)	0.59%	(34,793)	0.61%
Externally managed		(16,590)	3.39%	(21,538)	3.38%
Total Investments		**(113,888)**	**1.03%**	**(144,782)**	**1.13%**
Net Debt / (Investments)		**99,927**		**93,303**	

7.2 PWLB is the Public Works Loans Board and is a statutory body operating as an executive of HM Treasury. Its function is to lend money from the National Loans Fund to local authorities and other prescribed bodies.

7.3 The above table shows investments have increased by £30.89 million and loans by £24.27 million. Therefore, net debt has reduced by £6.6 million. Part of the increase in investments is the increase in short-term borrowing (£19.5 million) and the remainder of £11.39 million is simply due to more cash.

7.4 We budgeted a return of 1.21% for 2015-16 and achieved 1.13%. Our return is lower because we had budgeted for a small increase in investment rates due to a rise in base rate which did not happen.

7.5 The Council's budgeted investment income was £1.13 million, and actual interest was £1.74 million (£610,000 higher). We had been projecting higher interest receipts throughout the financial year. This is because we had more cash available to invest than we had budgeted. Our external funds returned £164,000 more than budgeted, and cash investments the £446,000.

7.6 Our budgeted debt interest payable was £5.519 million. £5.25 million relates to the HRA. The outturn was £5.47 million (5.172 million for the HRA). Higher short-term loan interest of £30,000 was offset by increased investment income.

7.7 All our external funds are distributing funds, and they achieved an overall weighted average return of 3.38%, split as:

Fund	**Balance at 31 March £000**	**Average return**	**Type of fund**
M&G	2,025,718	3.22%	Equity focussed
Schroders	823,518	6.84%	Equity focussed with at least 80% on FTSE all share companies
SWIP	1,797,729	1.36%	Fixed income focussed
Funding Circle	653,109	10.00%	Investments in SMEs up to a max of £2,000
UBS	2,349,432	2.82%	Multi asset
City Financials	2,335,036	0.68%	Multi asset
Payden	4,999,920	0.88%	Cash plus
CCLA	6,553,160	6.13%	Property

7.8 Our external fund portfolio is now very diverse and we invest in a range of products and markets. The capital value of the funds can go up as well as down. Across all funds, there was a capital loss of £52,100. The CCLA property fund increased over the year by £371,000, the rest suffered overall losses for the year due to the difficult global economic conditions.

Capital programme

7.9 The actual underlying need to borrow for the GF capital programme was £9.768 million, which is lower than budgeted of £38.68 million because of slippage in the capital programme. We will continue to support service managers with the scheduling of schemes in the capital programme to ensure it is kept up to date when project timescales change.

7.10 The amount of internal borrowing actually undertaken was £9.768 million. The Council must charge a Minimum Revenue Provision (MRP) on its internal borrowing which is setting aside cash from council tax to repay the internal borrowing. MRP charged to the revenue account in 2015-16 was £294,545, against an original budget of £506,333.

7.11 Our overall underlying need to borrow, as measured by the Capital Financing Requirement (CFR) was £236.448 million.

Benchmarking and performance indicators

7.12 The Council is a member of the CIPFA treasury management benchmarking club.

7.13 Arlingclose also provide benchmarking data across their clients. It highlights the effect of changes in our investment portfolio and compares on the basis of size of investment, length of investment and the amount of credit risk taken.

7.14 The benchmarking shows a snapshot of our average running yield on all investments, also split between internally managed and externally managed. The latest benchmarking data (at 31 March 2016), shows our average rate of investments for our total portfolio as being 0.94% against the client universe of 0.96%. The table shows that we have outperformed our internally managed investments by quite some margin.

	Internally managed	Externally managed	Total portfolio
Guildford	0.90%	2.88%	0.94%
Client Universe	0.71%	3.15%	0.96%

7.15 The difference in our return as part of the benchmarking and our own return is due to a different calculation in the way Arlingclose put the benchmarking return together.

7.16 Arlingclose have commented on our portfolio:

"Guildford has a widely diversified investment portfolio, which has enabled it to reduce its treasury risks at the same time as enhancing returns. Credit risk is below average for our local authority clients, liquidity is adequate but not excessive, and returns are above average. Strategic investments in corporate bonds, covered bonds and pooled funds have added around £100,000 to annual investment income"

7.17 We set our own performance indicators:

Indicator	Target	Actual	Variance
Cashflow investment returns above base rate	0.26%	0.19%	-0.07%
Long-term investment returns above base rate	0.35%	0.74%	0.39%
Externally managed funds above base rate	2.71%	2.88%	0.17%
Combined funds above base rate	0.71%	0.63%	-0.08%
% of daily balances within the range +/- £50,000	70.00%	74.50%	4.50%
The daily current account bal to be +/- £50,000	+/-£50,000	-£2,878	

7.18 Overall performance was just under target in terms of yield.

7.19 The council's daily bank balance target was +/- £50,000 for 70% of days. The average balance in the year was £2,878 overdrawn and 74.5% of days were +/- £50,000, so we were well within our target.

8. Compliance with treasury and prudential indicators

8.1 The CIPFA prudential code and treasury management code of practices require local authorities to set treasury and prudential indicators.

8.2 The objectives of the Prudential Code, and the indicators calculated in accordance with it, provide a framework for local authority capital finance that will ensure

- capital expenditure plans are affordable
- all external borrowing and other long-term liabilities are within prudent and sustainable limits
- treasury management decisions are taken in accordance with professional good practice and
- in taking the above decisions, the council is accountable by providing a clear transparent framework

8.3 The prudential code requires the council to set a number of prudential indicators for the following and two subsequent financial years, and to monitor against the approved indicators during the year. We can revise these indicators during the year but need full Council approval.

8.4 Officers can confirm that the council has complied with its prudential indicators for 2015-16 (see **Appendix 1** for the outturn figures), its treasury management policy statement and its treasury management practices.

8.5 Section 6 outlines the approved treasury management strategy. We have adhered to the strategy by:

- financing of capital expenditure from government grants, usable capital resources, revenue contributions and cash flow balances rather than from external borrowing
- taking a prudent approach in relation to the investment activity in the year, with priority given to security and liquidity over yield
- maintaining adequate diversification between counterparties
- forecasting and managing cash flow to preserve the necessary degree of liquidity

9. Risk and performance

9.1 The Council considers security, liquidity and yield, in that order, when making investment decisions.

9.2 The Council has complied with all the relevant statutory and regulatory requirements, which limit the level of risk associated with its treasury management activities. In particular, its adoption and implementation of both the prudential code and treasury management code of practice means our capital expenditure is prudent, affordable and sustainable, and our treasury practices demonstrate a low risk approach.

9.3 Short-term interest rates and likely movements in these rates, along with our projected cash balances, determine our anticipated investment return. These returns can be volatile and whilst, loss of principal is minimised through the annual investment strategy, accurately forecasting future returns can be difficult.

9.4 We set a target return of 1.21% and returned 1.13%. This shows that we did not increase the level of risk taken over what we had budgeted for.

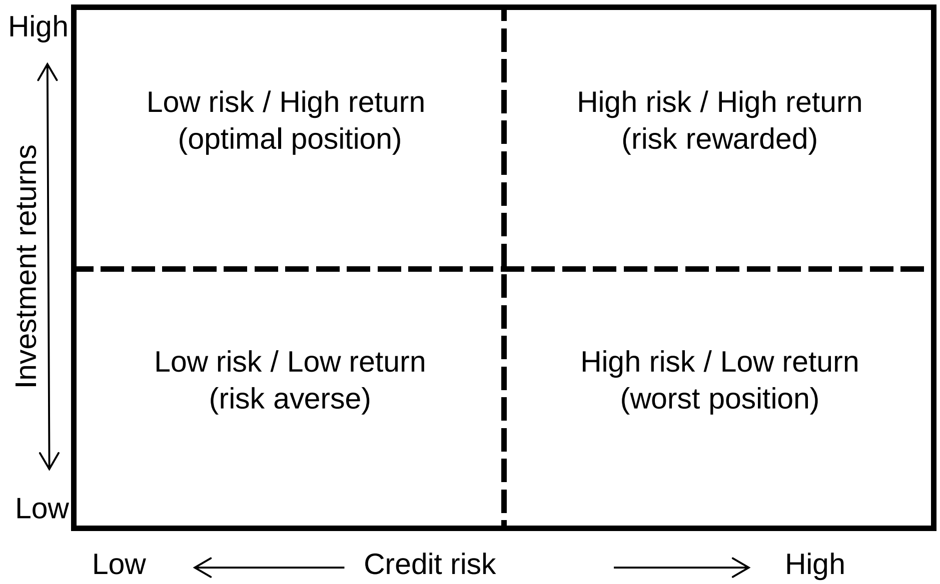
9.5 If the Council were to lose any of its investments, the GF will carry the loss, even if the cash lost is HRA cash. Therefore, to compensate the GF for this, we apply a credit risk adjustment to the rate of interest we apply on the HRA balances and reserves. Therefore, a lower interest rate is applied than the weighted average investment return for the year.

9.6 The Council invests in externally managed funds. These are more volatile than cash investments, but can come with a higher return. Officers continually review our funds to ensure they still have a place in the portfolio. We view most of our funds over a three to five year time horizon to take account of their potential volatility – they are not designed to be short-term investments, despite being able to get the money from them quickly.

Credit developments and credit risk management during the year

9.7 Security of our investments is our key objective when making treasury decisions. We therefore manage credit risk through the limits and parameters we set in our annual treasury management strategy. One quantifiable measure of credit quality we use is to allocate a score to long-term credit ratings. **Appendix 6** explains the scoring in more detail.

9.8 This is a graphical representation used in the Arlingclose benchmarking.



9.9 Typically we should aim to be in the top left corner of the chart where we get a higher return for lower risk. In the actual benchmarking, for average rate versus credit risk (value weighted) we were above the average of all clients and were in the top left box towards the middle vertical line. For time weighted we are well within the top left box (see **Appendix 3** for the two charts).

9.10 We set our definition of high credit quality as a minimum long-term credit rating of A-, which attracts a score of 7. The lower the score, the higher the credit quality of the investment portfolio.

9.11 The table below shows that at each quarter date, the weighted average score of our investment portfolio, on a value weighted and a time weighted basis is well within our definition of high credit quality, ending the year at 4.14 and 2.56.

Date	Value Weighted Avg Credit Risk Score	Value Weighted Avg Credit Rating	Time Weighted Avg Credit Risk Score	Time Weighted Avg Credit Rating	Average Life (days)
31-03-14	4.38	AA-	2.30	AA+	188
30-06-15	4.49	AA-	2.57	AA	306
30-09-15	4.07	AA-	2.46	AA+	286
31-12-15	3.85	AA-	2.65	AA	280
31-03-16	4.14	AA-	2.56	AA	314

9.12 We have maintained our security throughout the year within the portfolio. We also have a lower risk score on both elements than the Arlingclose client universe. We do, however, have a much longer duration and this is due to the addition of covered bonds in the portfolio, which can be sold on the secondary market if required.

10. Minimum Revenue Provision (MRP)

10.1 The Local Authorities (Capital Financing and Accounting) (England) (Amendment) Regulations 2003 (SI No 414) place a duty on local authorities to make a prudent provision for debt redemption. Making an MRP reduces the Capital Financing Requirement (CFR) and leaves cash available to replenish reserves used for internal borrowing or making external debt repayments. There are three options for applying MRP available to us:

- asset life method
- depreciation method
- any other prudent method

10.2 Any other prudent method means we can decide on the most appropriate method depending on the capital expenditure.

10.3 The revised MRP policy was approved by Council in February 2016. It stated that:

- the Council will use the asset life method as its main method, but will use annuity for investment property
- in relation to expenditure on development, we may use the annuity method starting in the year after the asset becomes operational
- where we acquire assets ahead of a development scheme, we will charge MRP based on the income flow of the asset or as service benefit is obtained, and will not charge MRP during construction, refurbishment or redevelopment
- where expenditure is incurred pending receipt of an alternative source of finance we will not charge MRP
- we will use 75-years for freehold land purchased for development purposes, and any new buildings or similar structures on that land
- where loans are made to other bodies for their capital expenditure, no MRP will be charged
- we will apply a 100-year life for investments in shares classed as capital expenditure

10.4 The unfinanced capital expenditure in 2015-16 of £9.768 million related mainly to investment property purchase and MRP will be applied as approved above.

11. External service providers

11.1 The Council reappointed Arlingclose as our treasury management advisors in March 2015. The contract is for a period of 7 years. The Council is clear what services it expects and what services Arlingclose will provide under the contract.

11.2 The Council is clear that overall responsibility for treasury management remains with the Council.

12. Training

12.1 CIPFA's revised treasury management code of practice suggest that best practice is achieved by all councillors tasked with treasury management responsibilities, including scrutiny of the treasury management function, receiving appropriate training relevant to their needs and they that should fully understand their roles and responsibilities.

12.2 The DCLS's revised investment guidance also recommends that a process is in place for reviewing and addressing the needs of the council's treasury management staff for training in investment management.

12.3 Following the revised CIPFA code of practice and the stated requirement that a specified body be responsible for the implementation and regular monitoring of the treasury management policies, we set up a Treasury Management Panel. The panel met in the year to discuss the treasury management strategy report, the treasury and prudential indicators.

12.4 Corporate Governance and Standards Committee will review this annual report at its meeting on 16 June 2016.

12.5 Officer training is undertaken on a regular basis, by attending workshops held by Arlingclose, and seminars or conferences held by other bodies, such as CIPFA. On the job training and knowledge sharing are undertaken when required. Those involved in treasury management are either a fully qualified accountant, or AAT qualified. The main post holder responsible for the treasury management function holds the 'Certificate in International Treasury Management for Public Finance' qualification, which is a joint qualification between the ACT (Association of Corporate Treasurers) and CIPFA.

12.6 Arlingclose undertook training for councillors in September. It was primarily aimed at those councillors sitting on the Corporate Governance and Standards Committee, but it was open to all councillors who wished to attend.

13. Consultations

13.1 Officers have consulted with the Lead Councillor for Finance about the contents of this report.

14. Executive Advisory Board comment

14.1 Treasury management reports are under the remit of Corporate Governance and Standards committee and are not required to be presented to an EAB

15. Equality and Diversity Implications

15.1 There are no equality and diversity implications

16. Financial Implications

16.1 The detailed financial implications are summarised above and in **Appendix 1**.

17. Legal Implications

17.1 A variety of professional codes, statues and guidance regulate the council's treasury management activities. These are:

- the Local Government Act 2003 ("the Act") provides the powers to borrow and invest. It also imposes controls and limits on these activities
- the Act permits the Secretary of State to set limits on either the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken. The HRA debt cap is the only restriction that applied in 2015-16
- statutory instrument 3146 (2003 ("The SI"), as amended, develops the controls and powers within the Act
- the SI requires the council to undertake any borrowing with regard to the prudential code. The prudential code requires indicators to be set – some of which are limits – for a minimum of three forthcoming years
- the SI also requires the council to operate the treasury management function with regard to the CIPFA treasury management code of practice
- under the terms of the Act, the Government issued "investment guidance" to structure and regulate the council's investment activities. The emphasis of the guidance is on the security and liquidity of investments.

18. Human Resource Implications

18.1 There are no human resource implications arising from this report other than the training discussed in section 12, which is already in place.

19. Summary of Options

19.1 We could have invested in lower credit quality investments, but this would have increased our risk exposure.

19.2 We could have borrowed longer-term for our capital programme, but would have suffered a cost of carry due to the slippage in the programme.

20. Conclusion

20.1 The council has complied with the objectives of the CIPFA treasury management code of practice by maintaining the security and liquidity of its investment portfolio.

20.2 We maintained the security of our investment portfolio, and did not borrow long-term in advance of need.

20.3 We have also complied with the requirements of the prudential code by setting, monitoring and staying within the prudential indicators set.

21. Background Papers

- CIPFA Treasury Management in the Public Services – Code of Practice and Cross Sectoral Guidance Notes (2011 edition)
- CIPFA Treasury Management in the Public Services – Guidance Notes for Local Authorities including Police Authorities and Fire Authorities (2011 edition)
- CIPFA the Prudential Code for Capital Finance in Local Authorities (2011 edition)
- CIPFA the Prudential Code for Capital Finance in Local Authorities – Guidance Notes for Practitioners (2013 edition)
- Treasury management annual strategy report 2015-16 and prudential indicators 2016-17 to 2020-21

22. Appendices

Appendix 1: treasury management activity, treasury and prudential indicators 2015-16
Appendix 2: schedule of investments at 31 March 2016
Appendix 3: benchmarking graphs
Appendix 4: economic background – a commentary from Arlingclose
Appendix 5: rates
Appendix 6: credit score analysis
Appendix 7: credit rating equivalents and definitions
Appendix 8: background to externally managed funds
Appendix 9: glossary

Treasury management activity, treasury and prudential indicators 2015-16

1. Introduction

1.1 The treasury management service is an important part of the overall financial management of the council. Whilst the prudential indicators consider the affordability and impact of capital expenditure decisions, the treasury service covers the effective funding of these decisions.

1.2 Strict regulations, such as statutory requirements and the CIPFA treasury management code of practice (the TM Code) govern the council's treasury activities. We adopted the TM Code on 13 June 2002 and adopted the revised treasury management policy statement in February 2012. This adoption meets the requirement of one of the main prudential indicators.

2. Treasury management activity

2.1 The council has an integrated treasury management strategy and manages its cash as a whole in accordance with its approved strategy. Therefore, overall borrowing may arise because of all the financial transactions of the council (for example, borrowing for cash flow purposes) and not just those arising from capital expenditure reflected in the Capital Financing Requirement (CFR).

Investments

2.2 The Department of Communities and Local Government (DCLG) Investment Guidance requires local authorities to focus on security and liquidity rather than yield.

2.3 Security of capital remains our main objective when placing investments. We maintained this during 2015-16 by following our investment policy, as approved in our treasury management strategy 2015-16, which defined "high credit quality" counterparties as those having a long-term credit rating of A- or higher.

2.4 Investments during the year included:

- investments in AAA rates constant net asset money market funds
- call accounts and deposits with banks and building societies systemically important to each country's banking system. We did place some investments with overseas banks
- other local authorities
- corporate bonds

- non-rated building societies
- covered bonds
- pooled funds without a credit rating, but only those subject to an external assessment by Arlingclose

2.5 We divided our investments into three types

- short-term (less than one-year) internally managed cash investments
- long-term internally managed investments
- externally managed funds

2.6 Cash balances consisted of working cash balances, capital receipts, and council reserves.

2.7 The table below shows our investment portfolio, at 31 March 2016, compared to 31 March 2015. **Appendix 2** contains a detail schedule of investments outstanding at the end of the year.

Investment details	**Balance at 31-03-15 £m**	**Weighted Avg Return for Year**	**Balance at 31-03-16 £m**	**Weighted Avg Return for Year**
Internally Managed Investments				
Fixed Investments < 1 year to cover cash flow	50.50	0.64%	47.00	0.68%
Corporate bonds	3.50	0.94%	7.57	0.86%
Certificates of deposit	8.00	0.67%	9.00	0.71%
Notice Accounts	16.08	0.71%	22.00	0.69%
Call Accounts	3.03	0.53%	3.05	0.57%
Money Market Funds	6.04	0.45%	9.74	0.49%
Long term investments > 1 year	10.15	0.91%	24.89	1.24%
Externally Managed Funds				
Payden & Rygel	5.01	0.93%	5.00	0.88%
Funding circle	0.41	2.79%	0.65	10.00%
CCLA	6.18	5.42%	6.55	6.13%
SWIP	1.86	2.12%	1.80	1.36%
M&G	2.16	3.36%	2.03	3.22%
Schroders	0.97	6.96%	0.82	6.84%
UBS	0	0.00%	2.35	2.82%
City Financials	0	0.00%	2.34	0.68%
Total Investments	**113.89**	**1.03%**	**144.78**	**1.13%**

2.8 Our level of investments increased during 2015-16, and we achieved a higher return than last year.

Security of investments

2.9 Counterparty credit quality was assessed and monitored with reference to credit ratings; for financial institutions analysis of funding structure and susceptibility to bail-in, credit default swap prices; financial statements; information on potential government support and reports in the quality financial press.

2.10 We also considered the use of secured investment products that provide collateral in the event that the counterparty cannot meet its obligations for repayment.

2.11 The minimum long-term counterparty credit rating for ‘high quality counterparties’ approved for 2015-16 was A-/A3 across all three main credit rating agencies (Fitch, S&P, and Moody’s).

2.12 The strategy sets different limits for different counterparty credit ratings both in maximum duration and exposure in monetary terms.

Liquidity of investments

2.13 In keeping with the CLG’s Guidance on Investments, the council maintained a sufficient level of liquidity using money market funds, call accounts, the maturity profile of fixed investments and certificates of deposits and short-term borrowing from other local authorities.

2.14 We use treasurynet as our daily cash flow forecasting software to determine the maximum period for which funds may prudently be committed.

Yield of investments

2.15 The council sought to optimise returns commensurate with its objective of security and liquidity. The Bank of England base rate was maintained at 0.50% throughout the year. Short-term money market rates also remained at very low levels, which continued to have an impact on investment returns.

2.16 We invested in corporate bonds during the year which increased returns, and also longer-term covered bonds, which increased the return of the portfolio and the duration. Covered bonds have a secondary market and can be sold should we need the liquidity.

2.17 The council’s budgeted investment income for 2015-16 was £1.13 million and actual interest was £1.79 million. This includes £100,000 income from external funds that were not included in the budget.

Externally managed funds

2.18 We estimate to have substantial cash balances over the medium-term (our “core” cash), and as such we have continued investing in pooled (cash-plus, bond, equity, multi-asset and property) funds. These funds, have allowed us to diversify into asset classes other than cash without the need to own and manage the underlying investments. These funds operate on a variable net asset value (VNAV) basis offer diversification of investment risk, coupled with the services of a professional fund manager; they also offer enhanced returns over the longer term but are more volatile in the short term. All of our pooled funds are in the respective funds distributing share class, which pay out the income generated.

They have no defined maturity date, but are available for withdrawal, some with a notice period.

2.19 We regularly monitor all our external funds' performance and continued suitability in meeting our investment objectives.

Borrowing and debt management

2.20 The council's debt portfolio is detailed in the table below. Our loan portfolio increased by £24.2 million, of which £5 million was long term and £19.5 million taken out for cash flow purposes.

Interest calc	Lender	Repayment method	Principal £'000	Initial loan period (yrs)	Period remaining years	Maturity date	Rate
Long-term							
Fixed	PWLB	EIP	1,150	10	5.0	31/03/2021	3.60%
Variable	PWLB	Maturity	45,000	10	6.0	28/03/2022	0.70%
Fixed	PWLB	Maturity	10,000	12	8.0	28/03/2024	2.70%
Fixed	PWLB	Maturity	10,000	13	9.0	28/03/2025	2.82%
Fixed	PWLB	Maturity	10,000	14	10.0	28/03/2026	2.92%
Fixed	PWLB	Maturity	10,000	15	11.0	28/03/2027	3.01%
Fixed	PWLB	Maturity	25,000	17	13.0	28/03/2029	3.15%
Fixed	PWLB	Maturity	25,000	20	16.0	28/03/2032	3.30%
Fixed	PWLB	Maturity	25,000	25	21.0	28/03/2037	3.44%
Fixed	PWLB	Maturity	15,000	29	25.0	28/03/2041	3.49%
Fixed	PWLB	Maturity	17,435	30	26.0	28/03/2042	3.50%
Fixed	Lancashire Police	Maturity	5,000	3	1.0	23/10/2017	1.50%
Fixed	Slough BC	Maturity	5,000	3	2.0	02/04/2018	1.20%
Short-term							
Fixed	West Midlands PCC	Maturity	5,000	0.16	0.0	05/04/2016	0.52%
Fixed	Manchester CC combined	Maturity	6,500	0.25	0.0	13/04/2016	0.43%
Fixed	Bath & NE Somerset DC	Maturity	2,000	0.25	0.1	21/04/2016	0.38%
Fixed	Basildon DC	Maturity	1,000	0.50	0.1	23/05/2016	0.50%
Fixed	Tameside	Maturity	4,000	0.50	0.1	23/05/2016	0.52%
Fixed	Vale of Glamorgan Council	Maturity	3,000	0.50	0.2	10/06/2016	0.46%
Fixed	Gloucestershire CC	Maturity	5,000	0.99	0.2	20/06/2016	0.55%
Fixed	Basset Law DC	Maturity	3,000	0.50	0.5	21/09/2016	0.50%
Fixed	Derby CC	Maturity	5,000	0.99	0.7	25/11/2016	0.65%
Total			**238,085**				

2.21 All short-term borrowing was from other local authorities, across a variety of periods.

2.22 Our chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should our long-term plans change being a secondary objective.

2.23 The rate on the variable rate loan is the average for the year.

2.24 We also has some short-term loans outstanding at the end of the year which we took out for cash flow purposes. Temporary and short-dated loans borrowed during the year from other local authorities remained affordable and attractive.

2.25 Affordability and the “cost of carry” remained important influences on our long-term borrowing strategy alongside the consideration that, for any borrowing undertaken ahead of need, the proceeds would be invested at rates of interest significantly lower than the cost of borrowing. As short-term interest rates have remained, and are likely to remain at least over the forthcoming two years, lower than long-term rates, the council determined it was more cost effective in the short-term to use internal resources and borrow short-term to medium-term instead.

2.26 The benefits of internal borrowing were monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise. Arlingclose assist the council with this ‘cost of carry’ and break even analysis.

2.27 The PWLB continued to operate a spread of approximately 1% between “premature repayment rate” and “new loan” rates so the premium charge for early repayment of PWLB debt remained relatively expensive for the loans in our portfolio and therefore unattractive for debt rescheduling activity. No rescheduling activity was undertaken as a consequence.

3. Treasury and prudential indicators

3.1 The CFO confirms that we have complied with our prudential indicators for 2015-16, which were approved in February 2015 as part of the treasury management strategy statement. The CFO also confirms that we have complied with our treasury management policy statement and treasury management practices during 2015-16.

3.2 One of the key indicators is the adoption of the CIPFA treasury management code. It demonstrates that the council has adopted the principles of best practice. The council approved the adoption of the CIPFA treasury management code at its full Council meeting on 13 June 2002, and approved the revised treasury management policy on 9 February 2012.

Balance sheet and treasury position prudential indicator

3.3 The capital financing requirement (CFR) measures the council’s underlying need to borrow for a capital purpose. Over the medium-term, borrowing must be only for a capital purpose, although in the short-term, we can borrow for cash flow purposes, which do not affect the CFR.

3.4 The council’s CFR for 2015-16 is shown in the following table

Capital Financing Requirement	2015-16 Approved Estimate £000	2015-16 Revised Estimate £000	2015-16 Actual £000
HRA			
Opening balance (1 Apr 15)	196,664	196,664	196,664
Movement in year: Appropriations	0	0	0
Movement in year: Unfinanced captial expenditure	0	0	0
Movement in year: Voluntary Revenue Provision	0	0	0
Closing balance (31 Mar 16)	196,664	196,664	196,664
General Fund			
Opening balance (1 Apr 15)	31,579	30,311	30,311
Movement in year: Appropriations	0	0	0
Movement in year: Unfinanced captial expenditure	38,681	21,349	9,768
Movement in year: MRP	(677)	(293)	(294)
Closing balance (31 Mar 16)	69,583	51,367	39,785
Total			
Opening balance (1 Apr 15)	228,243	226,975	226,975
Movement in year: Appropriations	0	0	0
Movement in year: Unfinanced captial expenditure	38,681	21,349	9,768
Movement in year: MRP	(677)	(293)	(294)
Movement in year: VRP	0	0	0
Closing balance (31 Mar 16)	266,247	248,031	236,449
Balances and Reserves	(70,332)	(99,878)	(144,782)
Cumulative net borrowing requirement / (investments)	**195,915**	**148,153**	**91,667**

3.5 The GF unfinanced capital expenditure mainly relates to the cost of investment property purchase. This is much lower than budgeted because of the slippage in the capital programme – we projected this slippage during the year, which is shown by the revised estimate (as in the strategy report presented to Council in February 2016).

3.6 We budgeted an underlying need to borrow of £59.3 million for 2015-16, and our actual underlying need to borrow was £9.768 million because of slippage in the capital programme.

Gross debt and the CFR

3.7 We monitor the CFR to gross debt continuously to ensure that, over the medium term, borrowing is only for a capital purpose and does not exceed the CFR. This is a key indicator of prudence. We will report any deviations to the CFO for investigation and appropriate action. The following table shows the council is in a net internal borrowing position and gross debt does not exceed the CFR over the period.

Gross Debt and the CFR	2015-16 Actual £000	2016-17 Estimate £000	2017-18 Estimate £000
General Fund CFR	39,785	132,447	204,873
HRA CFR	196,664	197,024	197,024
Total CFR (at 31 March)	**236,449**	**329,471**	**401,897**
Gross External Borrowing	(238,085)	(203,355)	(198,125)
Net (external) / internal borrowing position	**(1,636)**	**126,116**	**203,772**

3.8 The 2016-17 and 2017-18 estimates are based on what was approved in the treasury management strategy in February 2016.

3.9 Actual debt levels are monitored against the operational boundary and authorised limit for external debt, detailed in section x.

3.10 We are showing as being in an external borrowing position of £1.6 million for the year, this is because we have £34.5 million of short-term borrowing for cash flow purposes. If we only had long-term borrowing, the net internal borrowing position for 2015-16 would be £32.8 million.

Capital expenditure prudential indicator

3.11 This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits, and, in particular, to consider the impact on council tax or housing rent levels for the HRA.

3.12 The following table shows capital expenditure in the year, compared to the original estimate approved by the Executive in January 2015.

Projects	Original Estimate (£'000)	Actual (£'000)	Variance (£'000)
Housing Revenue Account			
HRA Capital Programme	15,972	7,635	(8,337)
Total Housing	**15,972**	**7,635**	**(8,337)**
General Fund			
Affordable Housing	1,355	932	(423)
Investment in Millmead improvements	1,971	3,244	1,273
SARP	112	1	(111)
Asset investment fund	18,000	9,692	(8,308)
North Street development	331	0	(331)
Vehicle replacement	630	1,136	506
Spectrum Roof & CHP	3,638	30	(3,608)
Riverside Route Ph1	708	115	(593)
Provisional schemes	33,043	37	(33,006)
Energy schemes	304	151	(153)
IT renewals	515	743	228
Schemes at Spectrum	243	0	(243)
Other General Fund Projects	3,279	2,466	(813)
Total General Fund	**64,129**	**18,547**	**(45,582)**
Total Capital Programme	**80,101**	**26,182**	**(53,919)**

3.13 The table shows that there was a lot of slippage in the capital programme. This was mainly over a few larger schemes including:

- asset investment fund – re-profiling of expenditure
- spectrum roof and CHP works being carried out at around the same time as the roof – project did not happen as quickly as anticipated and is progressing in 2016-17
- provisional schemes were re-profiled during the year, and include:
  - new burial grounds
  - woodbridge road
  - Guildford park car park
  - North street development
  - Millbrook/Mary road car parks works to increase spaces

3.14 The following table shows the financing of capital expenditure in the year, compared with the original approved estimate.

CAPITAL EXPENDITURE - SUMMARY	Original Estimate (£'000)	Actual (£'000)
General Fund Capital Expenditure		
- Main programme	60,674	16,316
- Reserve & s106 Capital Schemes	2,100	1,299
- General Fund Housing	1,355	932
HRA Capital expenditure		
- Main programme	15,972	7,635
Total Capital Expenditure	**80,101**	**26,182**

CAPITAL EXPENDITURE - SUMMARY	Original Estimate (£'000)	Actual (£'000)
General Fund Capital Expenditure Financed by:		
- Borrowing/Use of Balances	(59,331)	(9,768)
- Capital Receipts	(30)	(4,729)
- Capital Grants/Contributions	(1,588)	(1,071)
- Capital Reserves/Revenue	(3,180)	(2,979)
HRA Capital Expenditure Financed by:		
- Borrowing/Use of Balances	0	0
- Capital Receipts	(5,505)	(1,855)
- Capital Grants/Contributions	0	(808)
- Capital Reserves/Revenue	(10,467)	(4,972)
Financing - Totals	**(80,101)**	**(26,182)**

3.15 GF borrowing was less than budgeted because of slippage in the capital programme, and an increase in the opening of available capital resources which reduced the need for internal borrowing in the year.

Incremental impact of capital investment decisions prudential indicator

3.16 This is an indicator of affordability. It shows the effect on the revenue budget arising from the capital programme, excluding financing costs. The calculation is the loss of interest on funds used for the capital programme (using the average investment rate), plus any ongoing revenue implications of the schemes and MRP.

3.17 Capital investment decisions do not affect the weekly housing rent charge as the council sets its rents in line with the policy laid down by the CLG. There is also no variation to council tax once it has been set. We calculate this prudential indicator on an actual basis for comparative purposes.

	2015-16 Approved £	2015-16 Outturn £
Cost of Capital Programme on Council Tax - Band D	13.25	3.48
Cost of Housing Capital Programme Weekly Housing Rents	0.69	0.28

3.18 The impact for both the GF and HRA is lower than approved because of slippage in the capital programme, detailed above.

Ratio of financing costs to the net revenue stream prudential indicator

3.19 This is an indicator of affordability and highlights the revenue impact of capital expenditure by identifying the proportion of the revenue budget required to meet the financing costs associated with capital spending. Financing costs include interest on borrowing, MRP, premium or discount on loans repaid early, investment income and depreciation where it is a real charge.

3.20 Depreciation is not a real charge to the GF, but has been to the HRA since April 2012.

3.21 The ratio is based on costs net of investment income.

3.22 The net revenue stream for the GF is the total budget requirement and for the HRA is total income. Where the figure is negative, it is because there is a net investment position (more investments than debt). The total budget requirement for the GF used is the 2016-17 budget.

	2015-16 Original Estimate	2015-16 Actual
General Fund	1.80%	-7.08%
HRA	32.96%	34.55%

3.23 The GF is lower than originally budgeted because investment income is higher, and HRA is higher because the depreciation charge is higher.

3.24 The figure for the GF is negative because interest received is higher than financing costs (interest payable, debt management costs and MRP).

The authorised limit prudential indicator

3.25 The Local Government Act 2003 requires the council to set an affordable borrowing limit, irrespective of the indebted status. This is a statutory limit, which we cannot breach.

3.26 The limit is the maximum amount of external debt we can legally owe at any one time. It is expressed gross of investments and includes capital expenditure plans, the CFR and cash flow expenditure. It also provides headroom over and above for unexpected cash movements.

3.27 The limit was set at £435.9 million for the year and the highest level of debt was £252.2 million.

3.28 We measure the levels of debt on an ongoing basis during the year for compliance. The CFO confirms there were no breaches to the authorised limit in 2015-16.

The operational boundary prudential indicator

3.29 The operational boundary, based on the same estimates as the authorised limit, reflects the most likely, prudent but not worst case scenario. It does not allow for additional headroom included in the authorised limit.

3.30 The limit was set at £404.31 million for the year and the highest level of debt was £252.2 million.

Upper limit for fixed and variable interest rate exposures treasury indicator

3.31 This indicator is set to control exposure to interest rate risk. We calculate exposures on a net basis (fixed rate debt net of fixed rate investments). We take fixed rate to be if it was taken out as a fixed rate loan/investment regardless of its duration.

Net Debt / (Investments) on Principal outstanding	2015-16 Approved £000	2015-16 Actual £000
Limits on fixed interest rates	312,340	158,591
Limits on variable interest rates	(22,790)	(42,968)

3.32 The above shows that at its peak fixed interest rates were well within our target. Variable was higher than target, and is negative because we had more variable rate investments than debt. We include our external funds as variable rate investments.

Maturity structure of fixed rate borrowing treasury indicator

3.33 The aim of this indicator is to control our exposure to refinancing risk (large concentrations of fixed rate debt needing refinancing at once). We calculate this as the amount of fixed rate borrowing maturing in each period as a percentage of fixed rate borrowing.

	Upper Limit	Lower Limit	Actual at 31 March 2016	Value of loans maturing
Under 12 months	15%	0%	17.99%	34,730,000
1-2 years	20%	0%	5.30%	10,230,000
3 to 5 years	25%	0%	0.36%	690,000
6 to 10 years	50%	0%	15.54%	30,000,000
11 years and above	100%	0%	60.82%	117,435,000

3.34 The above table shows the amount of debt maturing in each period and its percentage of total fixed rate loans. The targets were set to give us flexibility for drawing down new loans on a fixed or variable rate basis. If a lower upper limit for fixed rate debt were set, the council would be giving itself a greater exposure to interest rate changes by having more variable rate debt. The upper limit for under 12 months was set to cover any short-term borrowing for cash flow purposes and for allowing for the principal loan repayments falling in that period. The limit for that maturing within 12 months is slightly higher due to short-term borrowing levels. Proportionately there is very little fixed rate debt maturing before 10 years, which gives the council stability in its interest payments over that time. The first fixed rate loan matures in 2024. The two longer local authority loans are maturing in the next 1-2 years.

3.35 The actual at March 2016 was higher than target because the upper limit did not allow for as much short-term borrowing as we had at the end of the year.

Actual external debt treasury indicator

3.36 This indicator comes directly from our balance sheet. It is the closing balance for actual gross borrowing (short and long term) plus other deferred liabilities. It is measured in a manner consistent for comparison with the authorised limit and operational boundary.

	External debt as at 31-03-15 £'000	External debt as at 31-03-16 £'000
Borrowing	213,815	238,085
Other long term liabilities	0	0
Total	**213,815**	**238,085**

3.37 Actual external debt increased due to short-term borrowing and a small level of long-term borrowing from other local authorities

HRA limit of indebtedness prudential indicator

3.38 This indicator compares the actual debt of the HRA to the debt cap imposed by the Government.

	2015-16 Actual £'000	2016-17 Estimate £'000	2017-18 Estimate £'000	2018-19 Estimate £'000
HRA CFR	196,664	197,024	197,024	197,024
HRA Debt Cap	196,665	197,024	197,024	197,024
Balance available	**(1)**	**0**	**0**	**0**

3.39 The table shows that the council operated inside the debt cap for 2015-16. We need to review our HRA CFR continually to ensure that, should the need to start increasing the CFR arise, there are balances and reserves to fund the capital expenditure to ensure the debt cap is not breached. The debt cap could stop the council building homes, if we do not have enough reserves to fund our building programme.

Upper limit for total principal sums invested over 364 days

3.40 The purpose of this limit is to contain exposure to the possibility of loss that may arise as a result of the council having to seek early repayment of the sums invested.

3.41 Our limit was set at £50 million, we ended the year with exposure of £x million.

3.42 As mentioned earlier in the report, many of our longer term investments are covered bonds, which can be sold on the secondary market. There could be a price differential if they were sold, but it is unlikely to be material.

Appendix 2

Schedule of investments at 31 March 2016

Counterparty	Principal £	Rate	Start	End
Fixed investments				
Heleba	2,000,000	0.7400%	01-Oct-15	01-Apr-16
NRBS Cumberland BS	1,000,000	0.5400%	15-Jan-16	22-Apr-16
NRBS Loughborough BS	1,000,000	0.5500%	15-Jan-16	22-Apr-16
Close Brothers	1,000,000	0.6500%	30-Oct-15	29-Apr-16
DBS	2,000,000	0.6300%	05-Nov-15	05-May-16
Coventry BS	5,000,000	0.6000%	11-Nov-15	11-May-16
Pohjola	5,000,000	0.7000%	03-Dec-15	03-Jun-16
National Counties BS	1,000,000	0.7500%	04-Dec-15	06-Jun-16
LA - Lancashire CC	2,000,000	0.6500%	02-Jul-15	30-Jun-16
Heleba	2,000,000	0.8000%	11-Jan-16	11-Jul-16
Lloyds	1,000,000	0.9200%	13-Aug-15	13-Jul-16
Lloyds	2,000,000	1.0000%	10-Aug-15	08-Aug-16
Lloyds	2,000,000	1.0000%	08-Sep-15	06-Sep-16
DBS	4,000,000	0.7000%	18-Dec-15	19-Sep-16
LA - North Tyneside MBC	3,000,000	0.7000%	24-Dec-15	22-Dec-16
OCBC	5,000,000	0.8200%	06-Jan-16	04-Jan-17
Bank of Nova Scotia	5,000,000	0.7900%	06-Jan-16	06-Jan-17
NRBS Furness (6mth break cl	1,000,000	1.5500%	18-Sep-15	17-Sep-17
Heleba	2,000,000	0.7400%	04-Feb-16	04-Aug-16
	47,000,000			
Certificates of deposit				
Toronton Dominion	1,000,000	0.6100%	16-Oct-15	19-Apr-16
Standard Chartered	3,000,970	0.7400%	19-Nov-15	03-May-16
Toronton Dominion	5,000,000	0.8900%	30-Nov-15	28-Nov-16
	9,000,970			
Short-term Bonds				
Svenska Handlesbanken	1,000,000	0.8500%	21-Oct-15	26-May-16
Daimler AG	2,000,000	1.2700%	07-Dec-15	02-Dec-16
Daimler AG	766,000	1.1850%	19-Jan-16	02-Dec-16
Wales & West Utility Finance	900,000	1.1750%	21-Jan-16	02-Dec-16
London Stock Exchange plc	1,350,000	1.4980%	02-Feb-16	07-Jul-16
Bank of Scotland	1,550,000	0.8310%	03-Mar-16	08-Nov-16
	7,566,000			
Long-term Covered bonds				
Yorkshire BS	1,107,100	1.2602%	16-Feb-15	12-Apr-18
Bank of Scotland	2,000,000	0.9700%	06-Aug-15	08-Nov-16
Nationwide	907,000	0.7894%	01-Sep-15	17-Jul-17
Leeds BS (3mth LIBOR+27bp	3,000,000	0.8591%	09-Feb-15	09-Feb-18
Nationwide (3m LIBOR + 20bp	1,372,000	0.7894%	27-Apr-15	27-Apr-18
Toronton Dominion (3mLIBOR	1,000,000	1.0709%	03-Feb-16	01-Feb-19
ANZ (3m LIBOR + 47bp)	2,000,000	1.0610%	11-Feb-16	11-Feb-19
Leeds BS (3mth LIBOR+40bp	2,000,000	0.9913%	01-Oct-14	01-Oct-19
Coventry (3mth LIBOR + 30bp	2,000,000	0.8888%	17-Mar-15	17-Mar-20
	15,386,100			

Counterparty	Principal £	Rate	Start	End
Long-term investments				
Fife Council	5,000,000	1.7700%	07-Apr-15	07-Apr-20
Rugby BC	3,000,000	1.8000%	05-May-15	05-May-20
Staffordshire Moorlands	1,500,000	1.7800%	20-May-15	20-May-20
	9,500,000			
Notice Accounts				
Barclays	3,000,000			
Close Brothers	5,000,000			
Handlesbanken	4,000,000			
Santander 120 day	2,000,000			
Santander 180 day	3,000,000			
Goldman Sachs Evergreen	5,000,000			
	22,000,000			
Call accounts				
HSBC Business Reserve	3,052,701			
	3,052,701			
Money market funds				
Aberdeen	200,000			
Standard Life (formerly Ignis)	6,322,000			
Federated	3,218,000			
	9,740,000			
Total internally managed	**123,245,771**			
Externally managed				
Payden	4,999,920			
CCLA	6,553,160			
M&G	2,025,718			
Schroders	823,518			
Aberdeen	1,797,729			
City Financials	2,335,036			
UBS	2,349,432			
Funding Circle	653,109			
Total Externally managed	**21,537,622**			
Total investments	**144,783,394**			

Economic background – a commentary from Arlingclose

Growth, Inflation, Employment: The UK economy slowed in 2015 with GDP growth falling to 2.3% from a robust 3.0% the year before. CPI inflation hovered around 0.0% through 2015 with deflationary spells in April, September and October. The prolonged spell of low inflation was attributed to the continued collapse in the price of oil from $67 a barrel in May 2015 to just under $28 a barrel in January 2016, the appreciation of sterling since 2013 pushing down import prices and weaker than anticipated wage growth resulting in subdued unit labour costs. CPI picked up to 0.3% year/year in February, but this was still well below the Bank of England's 2% inflation target. The labour market continued to improve through 2015 and in Q1 2016, the latest figures (Jan 2016) showing the employment rate at 74.1% (the highest rate since comparable records began in 1971) and the unemployment rate at a 12 year low of 5.1%. Wage growth has however remained modest at around 2.2% excluding bonuses, but after a long period of negative real wage growth (i.e. after inflation) real earnings were positive and growing at their fastest rate in eight years, boosting consumers' spending power.

Global influences: The slowdown in the Chinese economy became the largest threat to the South East Asian region, particularly on economies with a large trade dependency on China and also to prospects for global growth as a whole. The effect of the Chinese authorities' intervention in their currency and equity markets was temporary and led to high market volatility as a consequence. There were falls in prices of equities and risky assets and a widening in corporate credit spreads. As the global economy entered 2016 there was high uncertainty about growth, the outcome of the US presidential election and the consequences of June's referendum on whether the UK is to remain in the EU. Between February and March 2016 sterling had depreciated by around 3%, a significant proportion of the decline reflecting the uncertainty surrounding the referendum result.

UK Monetary Policy: The Bank of England's MPC (Monetary Policy Committee) made no change to policy, maintaining the Bank Rate at 0.5% (in March it entered its eighth year at 0.5%) and asset purchases (Quantitative Easing) at £375bn. In its *Inflation Reports* and monthly monetary policy meeting minutes, the Bank was at pains to stress and reiterate that when interest rates do begin to rise they were expected to do so more gradually and to a lower level than in recent cycles.

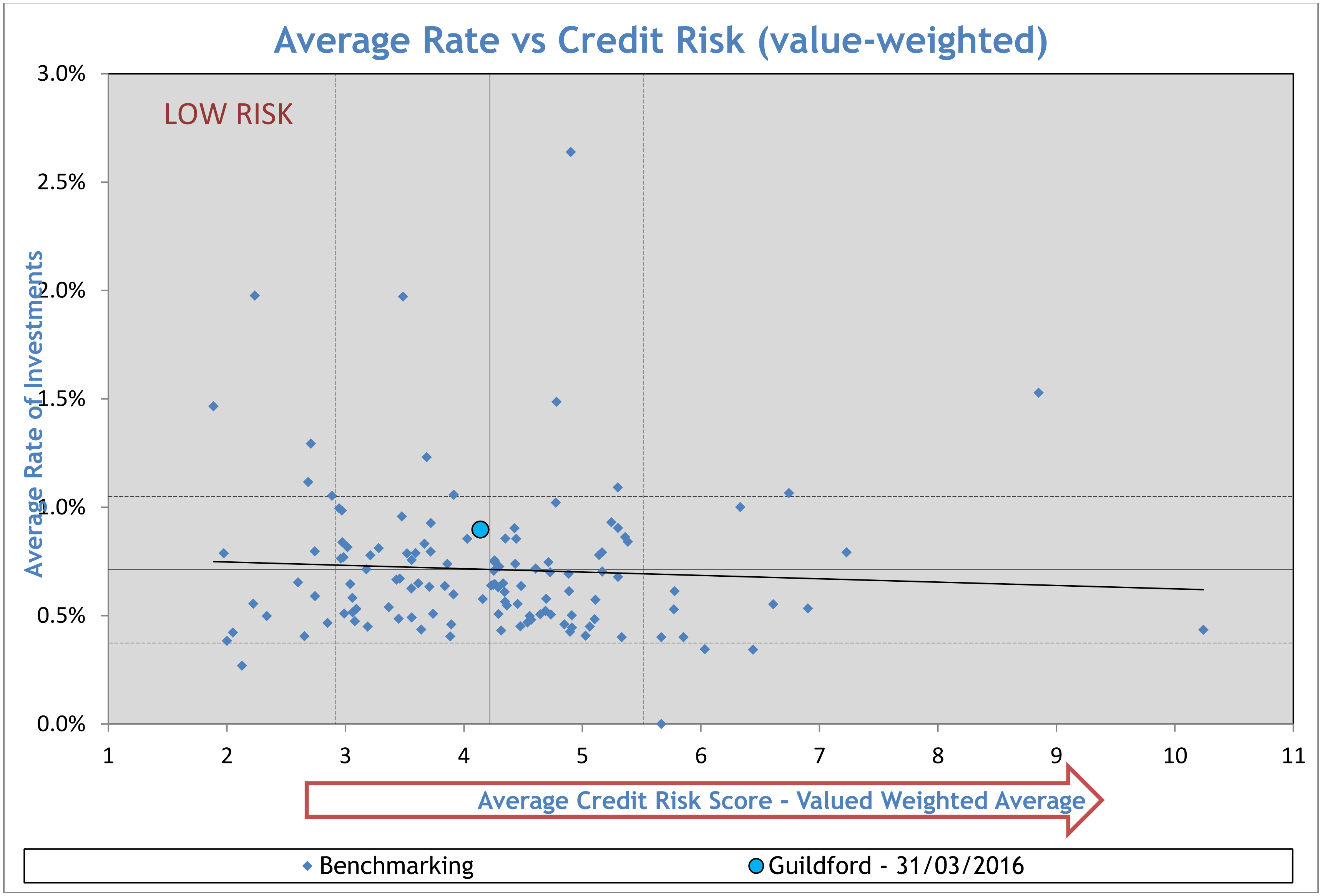
Improvement in household spending, business fixed investment, a strong housing sector and solid employment gains in the US allowed the Federal Reserve to raise rates in December 2015 for the first time in nine years to take the new Federal funds range to 0.25%-0.50%. Despite signalling four further rate hikes in 2016, the Fed chose not to increase rates further in Q1 and markets pared back expectations to no more than two further hikes this year.

However central bankers in the Eurozone, Switzerland, Sweden and Japan were forced to take policy rates into negative territory. The European Central Bank also announced a range of measures to inject sustained economic recovery and boost domestic inflation which included an increase in asset purchases (Quantitative Easing).

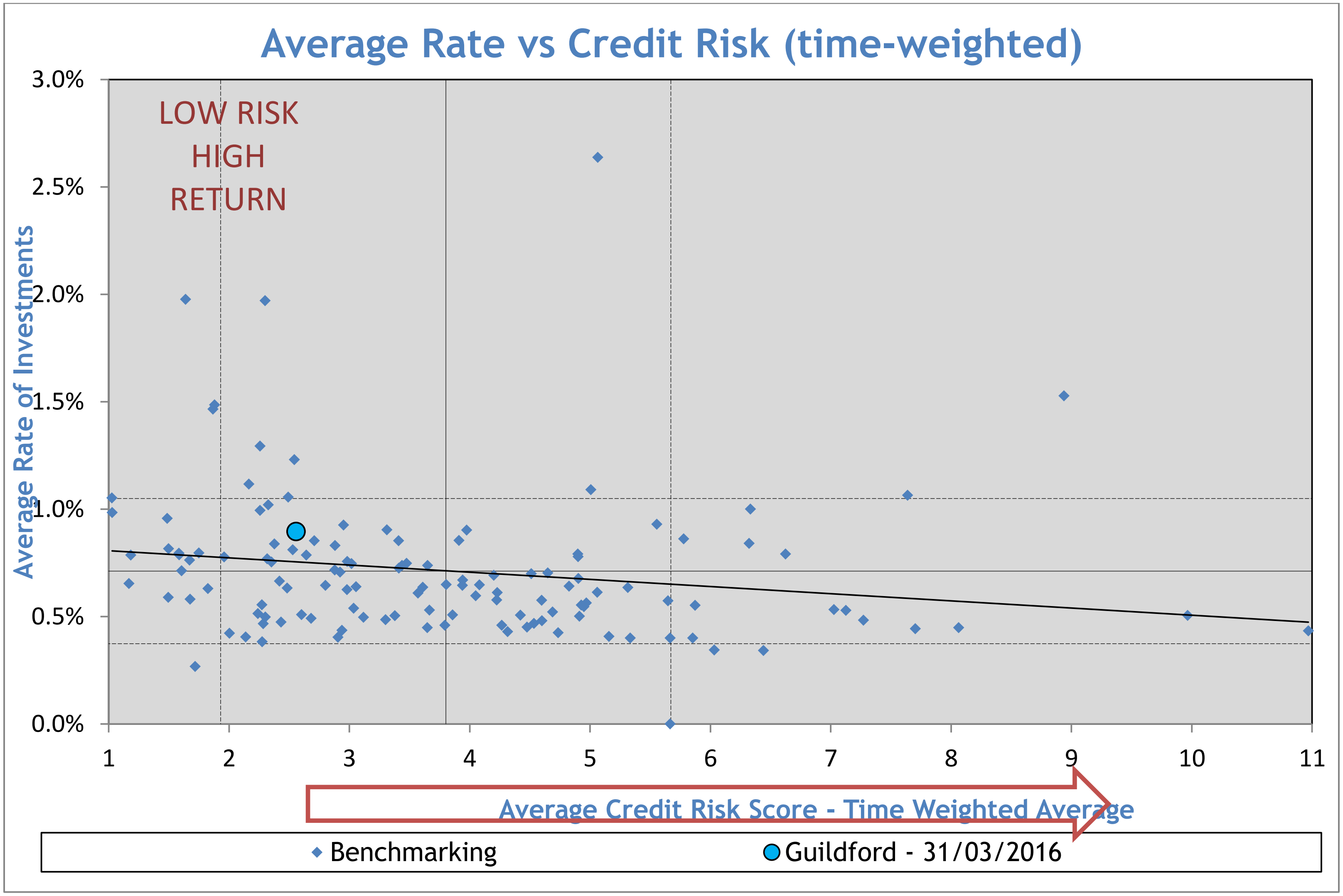
Market reaction: From June 2015 gilt yields were driven lower by the a weakening in Chinese growth, the knock-on effects of the fall in its stock market, the continuing fall in the price of oil and commodities and acceptance of diminishing effectiveness of central bankers' unconventional policy actions. Added to this was the heightened uncertainty surrounding the outcome of the UK referendum on its continued membership of the EU as well as the US presidential elections which culminated in a significant volatility and in equities and corporate bond yields.

10-year gilt yields moved from 1.58% on 31/03/2015 to a high of 2.19% in June before falling back and ending the financial year at 1.42%. The pattern for 20-year gilts was similar, the yield rose from 2.15% in March 2015 to a high of 2.71% in June before falling back to 2.14% in March 2016. The FTSE All Share Index fell 7.3% from 3664 to 3395 and the MSCI World Index fell 5.3% from 1741 to 1648 over the 12 months to 31 March 2016.

Appendix 4


Average Rate vs Credit Risk (value-weighted)
LOW RISK
Average Rate of Investments
3.0%
2.5%
2.0%
1.5%
1.0%
0.5%
0.0%
1
2
3
4
5
6
7
8
9
10
11
Average Credit Risk Score - Valued Weighted Average
Benchmarking
Guildford - 31/03/2016

Appendix 4



Average Rate vs Credit Risk (time-weighted)
LOW RISK
HIGH
RETURN
Average Rate of Investments
3.0%
2.5%
2.0%
1.5%
1.0%
0.5%
0.0%
1
2
3
4
5
6
7
8
9
10
11
Average Credit Risk Score - Time Weighted Average
Benchmarking
Guildford - 31/03/2016

Rates

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
31/10/2015		0.50		0.36	0.41	0.43	0.54	0.77	1.00	0.97	1.16	1.49
30/11/2015		0.50		0.30	0.42	0.43	0.54	0.88	1.00	0.93	1.10	1.39
31/12/2015		0.50		0.43	0.35	0.43	0.54	0.76	1.01	1.09	1.30	1.58
31/01/2016		0.50		0.43	0.42	0.43	0.54	0.71	0.99	0.77	0.89	1.14
29/02/2016		0.50		0.25	0.43	0.43	0.54	0.73	0.99	0.71	0.74	0.85
31/03/2016		0.50		0.30	0.44	0.52	0.62	0.71	0.93	0.79	0.84	1.00
Average		**0.50**		**0.38**	**0.45**	**0.43**	**0.54**	**0.76**	**0.99**	**0.96**	**1.14**	**1.43**
Maximum		**0.50**		**0.48**	**0.58**	**0.57**	**0.66**	**0.92**	**1.02**	**1.17**	**1.44**	**1.81**
Minimum		**0.50**		**0.17**	**0.35**	**0.43**	**0.51**	**0.55**	**0.84**	**0.68**	**0.73**	**0.85**
Spread		**--**		**0.31**	**0.23**	**0.14**	**0.15**	**0.37**	**0.18**	**0.49**	**0.71**	**0.96**

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	127/15	1.33	2.10	2.69	3.24	3.37	3.32	3.31
30/04/2015	166/15	1.41	2.27	2.90	3.44	3.55	3.50	3.48
31/05/2015	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
31/08/2015	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
31/10/2015	423/15	1.44	2.38	2.93	3.56	3.65	3.56	3.53
30/11/2015	465/15	1.42	2.23	2.85	3.48	3.54	3.42	3.39
31/12/2015	505/15	1.41	2.38	3.01	3.61	3.68	3.56	3.53
31/01/2016	040/16	1.24	1.96	2.62	3.28	3.37	3.23	3.20
29/02/2016	082/16	1.27	1.73	2.43	3.23	3.36	3.24	3.19
31/03/2016	124/16	1.33	1.81	2.48	3.21	3.30	3.16	3.12
	Low	1.21	1.67	2.30	3.06	3.17	3.05	3.01
	Average	1.41	2.20	2.85	3.46	3.54	3.45	3.42
	High	1.55	2.55	3.26	3.79	3.87	3.80	3.78

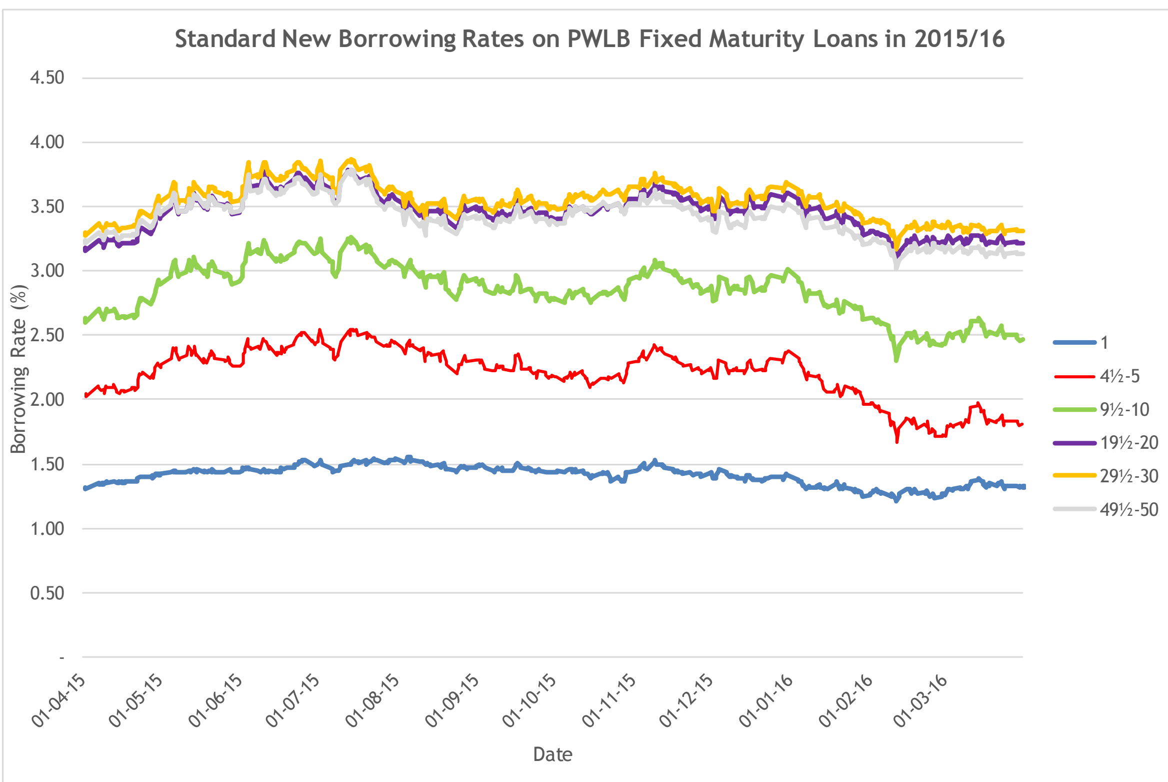


Table 3: PWLB Borrowing Rates – Fixed Rate, Equal Instalment of Principal (EIP) Loans

Change Date	Notice No	4½-5 yrs	9½-10 yrs	19½-20 yrs	29½-30 yrs	39½-40 yrs	49½-50 yrs
01/04/2015	127/15	1.66	2.14	2.71	3.03	3.24	3.35
30/04/2015	166/15	1.79	2.31	2.92	3.24	3.45	3.54
31/05/2015	204/15	1.78	2.30	2.93	3.26	3.45	3.53
30/06/2015	248/15	1.90	2.49	3.15	3.47	3.65	3.72
31/07/2015	294/15	1.96	2.50	3.09	3.39	3.57	3.63
31/08/2015	334/15	1.83	2.34	2.94	3.27	3.48	3.55
30/09/2015	379/15	1.76	2.23	2.82	3.19	3.43	3.51
31/10/2015	423/15	1.81	2.32	2.96	3.33	3.57	3.66
30/11/2015	465/15	1.79	2.27	2.87	3.25	3.49	3.56
31/12/2015	505/15	1.89	2.42	3.03	3.39	3.62	3.70
31/01/2016	040/15	1.54	2.00	2.65	3.04	3.29	3.38
29/02/2016	082/16	1.42	1.77	2.46	2.95	3.24	3.36
31/03/2016	124/16	1.50	1.85	2.51	2.96	3.22	3.31
	Low	1.36	1.70	2.33	2.78	3.07	3.18
	Average	1.76	2.25	2.88	3.24	3.47	3.55
	High	1.99	2.60	3.28	3.61	3.79	3.87

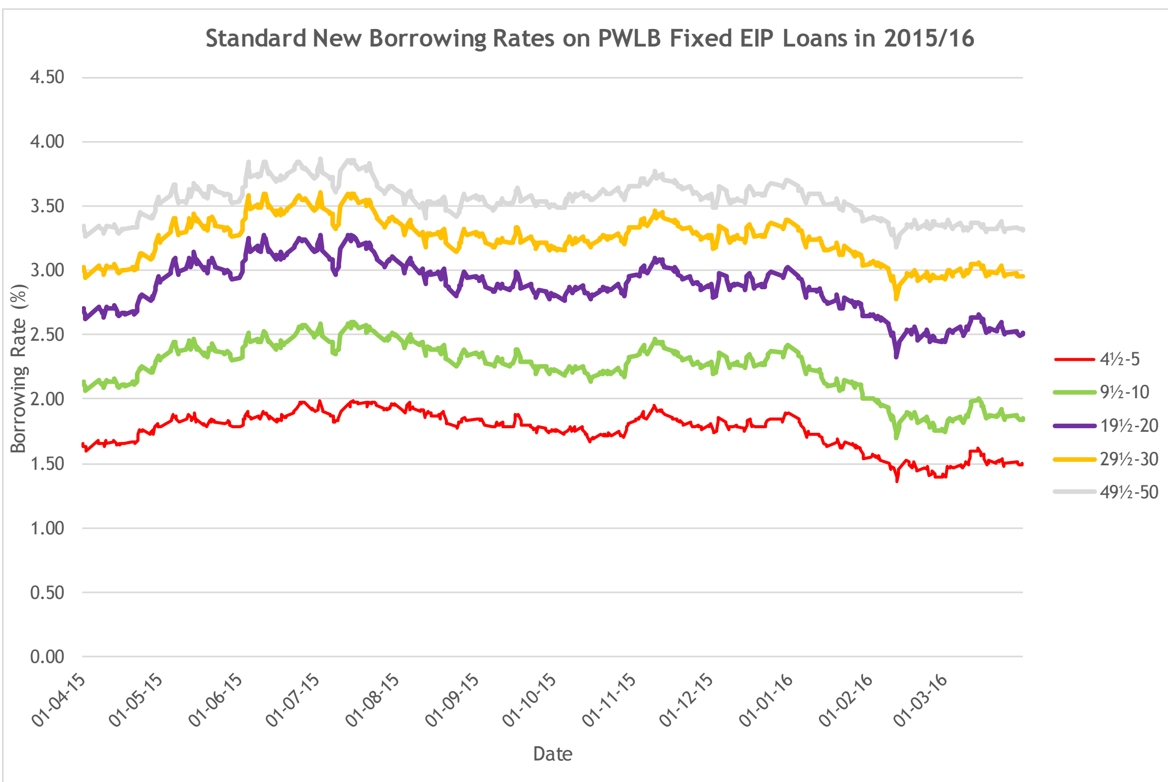


Table 4: PWLB Variable Rates

	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
31/05/2015	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
31/08/2015	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
31/10/2015	0.66	0.67	0.76	1.46	1.56	1.57
30/11/2015	0.64	0.67	0.72	1.54	1.57	1.62
31/12/2015	0.63	0.65	0.72	1.53	1.55	1.62
31/01/2016	0.64	0.66	0.69	1.54	1.56	1.59
29/02/2016	0.63	0.65	0.68	1.53	1.55	1.58
31/03/2016	0.61	0.65	0.67	1.51	1.55	1.57
Low	0.61	0.61	0.66	1.51	1.51	1.56
Average	0.63	0.66	0.71	1.53	1.56	1.61
High	0.67	0.69	0.78	1.57	1.59	1.68

Credit score analysis

Scoring:

Long-Term Credit Rating	Score
AAA	1
AA+	2
AA	3
AA-	4
A+	5
A	6
A-	7
BBB+	8
BBB	9
BBB-	10

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

The Authority aimed to achieve a score of 7 or lower, to reflect the Authority's overriding priority of security of monies invested and the minimum credit rating of threshold of A- for investment counterparties.

Credit Rating Equivalents and Definitions

	Fitch	Moody's	Standard & Poor's
Long Term Investment Grade	AAA	Aaa	AAA
	AA+ AA AA-	Aa1 Aa2 Aa3	AA+ AA AA-
	A+ A A-	A1 A2 A3	A+ A A-
	BBB+ BBB BBB-	Baa1 Baa2 Baa3	BBB+ BBB BBB-
Sub Investment Grade	BB+ BB BB-	Ba1 Ba2 Ba3	BB+ BB BB-
	B+ B B-	B1 B2 B3	B+ B B-
	CCC+ CCC CCC-	Caa1 Caa2 Caa3	CCC+ CCC CCC-
	CC+ CC CC-	Ca1 Ca2 Ca3	CC+ CC CC-
	C+ C C-	C1 C2 C3	C+ C C-
	D		D or SD

Fitch	Moody's	Standard & Poor's
AAA Highest credit quality. 'AAA' ratings denote the lowest expectation of credit risk. They are assigned only in the case of exceptionally strong capacity for payment of financial commitments. This capacity is highly unlikely to be adversely affected by foreseeable events.	**Aaa** Obligations rated Aaa are judged to be of the highest quality, with minimal credit risk.	**AAA** An obligator rated 'AAA' has extremely strong capacity to meet its financial commitments. 'AAA' is the highest issuer credit rating assigned by Standard & Poors.
AA Very high credit quality. 'AA' ratings denote expectations of very low credit risk. They indicate very strong capacity for payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.	**Aa** Obligations rated Aa are judged to be of high quality and are subject to very low credit risk.	**AA** An obligator rated 'AA' has very strong capacity to meets its financial commitments. It differs from the highest rated obligators only to a small degree.
A High credit quality. 'A' ratings denote expectations of low credit risk. The capacity for payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to changes in circumstances or in economic conditions than is the case for higher ratings.	**A** Obligations rated A are considered upper-medium grade and are subject to low credit risk.	**A** An obligator rated 'A' has strong capacity to meet its financial commitments but is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligators in higher rated categories.
BBB Good credit quality. 'BBB' ratings indicate that there are currently expectations of low credit risk. The capacity for payment of financial commitments is considered adequate but adverse changes in circumstances and economic conditions are more likely to impair this capacity. This is the lowest investment grade category.	**Baa** Obligations rated Baa are subject to moderate credit risk. They are considered medium-grade and as such may possess certain speculative characteristics.	**BBB** An obligator rated 'BBB' has adequate capacity to meets its financial commitments. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligator to meet its financial commitments.

Background to externally managed funds

CCLA – The Local Authorities Property Fund

The fund's objective is to generate long-term growth in capital and a high and rising income over time.

The aim is to have high quality, well-diversified commercial and industrial property portfolio, in the UK, focussing on delivering attractive income and is actively managed to add value.

The fund will maintain a suitable spread between different types of property and geographical location. Importance will be attached to location, standard of construction and quality of covenant with lease terms preferably embodying upwards only rent reviews at intervals of not more than five years.

M&G Global Dividend Fund

The fund aims to deliver a dividend yield above the market average, by investing mainly in a range of global equities. It aims to grow distributions over the long-term whilst maximising total return (a combination of income and growth of capital).

Exposure to global equities may be gained by using derivatives. The fund may invest across a wide range of geographies, sectors and market capitalisations. It may also invest in other assets including collective investment schemes, other transferrable securities, cash and near cash, deposits, warrants, money market instruments and derivatives.

The fund employs a bottom-up stockpicking approach, driven by the fundamental analysis of individual companies. The fund seeks to invest in companies that understand capital discipline, have the potential to increase dividends over the long-term and are undervalued by the stock market. Dividend yield is not the primary consideration for stock selection.

The fund manager aims to create a diversified portfolio with exposure to a broad range of countries and sectors designed to perform well in a variety of market conditions. It usually holds around 50 stocks with a long-term investment view and a typical holding period of 3-5 years.

Risk and reward profile

Low risk						High risk
Typically lower reward				Typically higher reward		
1	2	3	4	5	6	7

The fund's risk factor based on historical data and may not be the same moving forward. It is rated a 5 because of the investments the fund makes:

- Value of investments, and income from them, will fluctuate and will cause the fund price to rise or fall
- Currency exchange rate fluctuations will impact the value of the investment
- There is a risk that a counterparty may default on its obligations or become insolvent, which may have a negative impact on the fund
- Investments in Emerging markets tend to have larger price fluctuations than more developed countries.
- There is a risk that one or more countries will exit the Euro and re-establish their own currencies. There is an increased risk of asset prices fluctuating or losing value. It may also be difficult to buy and sell securities and issuers may be unable to repay the debt. In addition, there is a risk that disruption in Eurozone markets could give rise to difficulties in valuing the assets of the fund.

SWIP Absolute Return Bond Fund

The objective of the fund is to achieve capital return, regardless of market conditions, over rolling 12-month periods.

The fund mainly invests in fixed-interest securities (including government and supranational bonds, corporate bonds, non-investment grade bonds and emerging markets debt), index-linked securities, money market transactions, cash, near-cash and deposits.

The fund may use derivatives (financial contracts whose value is linked to an underlying asset) to manage risks and costs.

The fund will be managed with the aim of delivering absolute (more than zero) return in any market conditions. An absolute return is not guaranteed and the fund may experience periods of negative returns.

At any one time a substantial amount of the fund may be held in cash.

Risk and reward profile

Low risk						High risk
Typically lower reward				Typically higher reward		
1	2	3	4	5	6	7

The risk profile represents where the fund ranks in terms of its potential risk and reward.

The fund is rated 4 because:

- The value in the underlying value of the investments are subject to price fluctuations
- Interest rate risk – fluctuations in interest rates are likely to affect the value of the bonds and other fixed-interest securities held by the fund. If long-term interest rates rise, the value of the investment is likely to fall.
- Credit risk – there is a risk that the issuers of bonds may not be able to repay the money they have borrowed nor make any interest payments. The risk is greater than average where the fund invests in a bond with a below investment grade rating.
- Currency risk – the fund may have holdings which are denominated in different currencies and may be affected by movements in exchange rates.
- Derivatives risk – Derivative transactions will or maybe used to a significant extent. At times, through the use of these instruments could lead to considerable short-term fluctuations in price. The impact to the fund is greater where derivatives are used in an extensive or complex way.
- Absolute return risk – due to its investment strategy, the fund may not move in line with market trends or fully benefit from a positive market environment.

Schroder Income Maximiser Fund

The funds objective is to provide income with potential capital growth primarily through investment in equity and equity related securities of UK companies. The fund will also use derivative instruments to generate income.

The manager may selectively sell short dated call options over securities or portfolios of securities held by the fund or indicies, in order to generate additional income by setting target 'strike' prices at which those securities may be sold in the future. The manger may also, for the purpose of efficient management, use derivative instruments which replicate the performance of a basket of short dated call options or a combination of equity securities and short dated call options. Investment will be in directly held transferable securities. The fund may also invest in collective investment schemes, derivatives, cash, deposits, warrants and money market transactions.

The fund aims to deliver a target yield of 7% per year, although this is an estimate and is not guaranteed. There are four quarterly distributions in a year, each calculated by dividing the quarterly distribution amount by the unit price at the start of that quarter.

City Financials Multi Asset Diversified Fund

The investment objective of the fund is to achieve a consistent long-term return from both capital and income by investing across a diversified global portfolio of assets.

The investment manager uses a global asset allocation framework to invest across a diversified range of asset classes, geographies, sectors and investment styles. The portfolio invests in a combination of specialist funds, ETFs, listed investment vehicles, individual securities and cash, and uses derivatives for hedging and investment purposes to both reduce market risk and enhance returns. As a consequence, the portfolio exhibits low correlation to traditional asset classes. Positions are generally held with a three to five year time horizon. However, the management of the portfolio is active and the investment strategy is liquid and dynamic in order to adapt to changing market conditions.

<u>Risk and reward profile</u>

Low risk ↔ High risk

Typically lower reward — Typically higher reward

1	2	3	4	5	6	7

The risk category is based on the rate at which the value of the Fund has moved up or down in the past. Simulated and historical data is used in calculating the risk category and may not be a reliable indication of the future risk profile of the Fund.

The Fund is in risk category 4 as its price has experienced moderate rises and falls historically.

The Fund has little exposure to credit or cash flow risk. There are no borrowings or unlisted securities of a material nature and so there is little exposure to liquidity risk. The main risks it faces from its financial instruments are market price, foreign currency and interest rate risk. The ACD reviews the policies for managing these risks in order to follow and achieve the investment objectives.

UBS Multi-Asset Income Fund

The fund seeks to provide income, through a diversified portfolio of investments. Capital growth will not be a primary consideration, although opportunities for growth may occur if market conditions are favourable.

The fund will invest in a mix of transferrable securities including domestic and international equities and bonds, units in collective investment schemes, warrants, money market instruments, deposits, and cash or near cash, as the Investment Manager deems appropriate. There are no geographical restrictions on the countries of investment.

The Fund may use a range of derivative instruments which include foreign exchange, forward and futures contracts, swaps and options and other derivatives for investment purposes and / or to manage interest rate and currency exposures.

Index futures and other derivatives are used to manage market exposure inherent in an invested portfolio. Increasing or reducing market and currency exposure will entail the use of long or net short positions in some derivative instruments.

Risk profile

The main risks arising from the funds instruments are market price risk and foreign currency risk. Market price risk is the uncertainty about future price movements of the financial instruments the fund is invested in. Foreign currency risk is the risk that the value in the funds investments will fluctuate as a result in foreign exchange rates. Where the fund invests in overseas securities, the balance sheet can be affected by these funds due to movements in foreign exchange rates.

Investments in less developed markets may be more volatile than investments in more established markets. Less developed markets may have additional risks due to less established market practices. Poor liquidity may result in a holding being sold at a less favourable price, or another holding having to be sold instead.

Bonds carry varying levels of underlying risk, including default risk, dependent upon their type. These range from gilts, which carry limited levels, to speculative/non-investment grade corporate bonds, that carry higher levels of risk but with the potential for greater capital growth.

Over 35% of the fund may be invested in securities issued by any one body.

The fund will use derivatives as part of its investment capabilities. This allows it to take ‘short positions’ in some investments and it can sell a holding they do not own, on the anticipation that its value will fall. These instruments carry a material level of risk and the fund could potentially experience higher levels of volatility should the market move against them.

In order to trade in derivative instruments they enter into an agreement with various counterparties. Whilst they assess the credit worthiness of each counterparty, the fund is at risk that it may not fulfil its obligations under the agreement.

In aiming to reduce the volatility of the fund they utilise a risk management process to monitor the level of risk taken in managing the portfolio, however there is no guarantee that this process will work in all instances.

Glossary

Affordable Housing Grants – grants given to Registered Providers to facilitate the provision of affordable housing.

Arlingclose – the Council's treasury management advisors

Asset Quality Review (AQR) – a review conducted by the ECB and national competent authorities examine whether assets were properly valued on a banks' balance sheet at 31 December 2013. It made banks comparable across national borders, by applying common definitions for previously diverging concepts and a uniform methodology when assessing balance sheets. The review provides the ECB with substantial information on the banks that will fall under its direct supervision and will help its efforts in creating a level playing field for supervision in future.

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

Bail in risk – following the financial crisis of 2008 when governments in various jurisdictions injected billions of dollars into banks as part of bail-out packages, it was recognised that bondholders, who largely remained untouched through this period, should share the burden in future by making them forfeit part of their investment to "bail-in" a bank before taxpayers are called upon.

A bail in takes place before a bankruptcy and under current proposals, regulators would have the power to impose losses on bondholders while leaving untouched other creditors of similar stature, such as derivatives counterparties. A corollary to this is that bondholders will require more interest if they are to risk losing money to a bail-in.

Balances and Reserves – accumulated sums that are maintained either earmarked for specific future costs or commitments or generally held to meet unforeseen or emergency expenditure

Bank of England – the central bank for the UK. It has a wide range of responsibilities, including act as the Government's bank and the lender of last resort, it issues currency and, most importantly, oversees monetary policy.

Bank Rate – the Bank of England base rate

Bank Recovery and Resolution Directive (BRRD) – this directive ensures that EU member states have a harmonised toolkit to deal with the failure of banks and investment firms. It will make the EU financial system less vulnerable to shocks and contagion

Banks – Secured – covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the banks assets, which limits the potential losses in the unlikely event of insolvency and means they are exempt from bail in.

Banks – Unsecured – accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. Subject to the risk of credit loss via a bail in should the regular determine that the bank is failing or likely to fail.

Bonds – bonds are debt instruments issued by government, multinational companies, banks and multilateral development banks. Interest is paid by the issuer to the bond holder at regular pre-agreed periods. The repayment date of the principal is also set at the outset.

Capital expenditure – expenditure on the acquisition, creation or enhancement of capital assets

Capital Financing Requirement (CFR) – the Council's underlying need to borrow for a capital purpose, representing the cumulative capital expenditure of the Council that has not been financed

CCLA – the local authority property investment fund

Certainty rate – the government has reduced by 20 basis points (0.20%) the interest rates on loans via the Public Works Loan Board (PWLB) to principal local authorities who provide information as specified on their plans for long-term borrowing and associated capital spending.

Certificates of deposit – Certificates of deposit (CDs) are negotiable time deposits issued by banks and building societies and can pay either fixed or floating rates of interest. They can be traded on the secondary market, enabling the holder to sell the CD to a third party to release cash before the maturity date.

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.

CLG – department of Communities and Local Government

Consumer Price Index (CPI) – measures changes in the price level of a market basket of consumer goods and services purchased by households.

Corporates – loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent.

Corporate bonds – corporate bonds are those issued by companies. Generally, however, the term is used to cover all bonds other than those issued by governments. The key difference between corporate bonds and government bonds is the risk of default.

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

Covered bonds – a bond backed by assets such as mortgage loans (covered mortgage bond). Covered bonds are backed by pools of mortgages that remain on the issuer's balance sheet, as opposed to mortgage-backed securities such as collateralised mortgage obligations (CMOs), where the assets are taken off the balance sheet.

Credit default swaps (CDS) – similar to an insurance policy against a credit default. Both the buyer and seller of a CDS are exposed to credit risk. The buyer effectively pays a premium against the risk of default.

Credit Rating – an assessment of the credit worthiness of an institution

Creditworthiness – a measure of the ability to meet debt obligations

Deposit Guarantee Scheme Directive (DGSD) – directive which requires EU member states to introduce at least one deposit guarantee scheme in their jurisdiction to provide protection for depositors and to reduce the risk of bank runs.

Derivative investments – derivatives are securities whose value is derived from the some other time-varying quantity. Usually that other quantity is the price of some other asset such as bonds, stocks, currencies, or commodities.

Derivatives – financial instruments whose value, and price, are dependent on one or more underlying assets. Derivatives can be used to gain exposure to, or to help protect against, expected changes in the value of the underlying investments. Derivatives may be traded on a regulated exchange or traded 'over the counter'.

Diversification / diversified exposure – the spreading of investments among different types of assets or between markets in order to reduce risk.

DMADF – Debt Management Account Deposit Facility operated by the DMO where users can place cash in secure fixed-term deposits. Deposits are guaranteed by the government and therefore have the equivalent of the sovereign credit rating.

DMO – debt management office. An Executive Agency of Her Majesty's Treasury (HMT) with responsibilities including debt and cash management for the UK Government, lending to local authorities and managing certain public sector funds.

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

European Central Bank (ECB) – the central bank responsible for the monetary system of the European Union (EU) and the euro currency. Their responsibilities include to formulate monetary policy, conduct foreign exchange, hold currency reserves and authorise the issuance of bank notes.

European Investment Bank (EIB) – the European Investment Bank is the European Union's non-profit long-term lending institution established in 1958 under the Treaty of Rome. It is a "policy driven bank" whose shareholders are the member states of the EU. The EIB uses its financing operations to support projects that bring about European integration and social cohesion.

Federal Reserve Bank (Fed) – the central bank of the US and the most powerful institution of the world.

Finance Lease - a finance lease is a lease that is primarily a method of raising finance to pay for assets, rather than a genuine rental. The latter is an operating lease. The key difference between a finance lease and an operating lease is whether the lessor (the legal owner who rents out the assets) or lessee (who uses the asset) takes on the risks of ownership of the leased assets. The classification of a lease (as an operating or finance lease) also affects how it is reported in the accounts.

Floating rate notes – floating rate notes (FRNs) are debt securities with payments that are reset periodically against a benchmark rate, such as the three month London inter-bank offer rate (LIBOR). FRNs can be used to balance risks incurred through other interest rate instruments in an investment portfolio.

FTSE – a company that specialises in index calculation. Co-owners are the London Stock Exchange and the Financial Times. The FTSE 100 is an index of blue chip stocks on the London Stock Exchange.

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

Government – loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail in, and there is an insignificant risk of insolvency.

Gross Domestic Product – the monetary value of all finished goods and services produced within a country's borders in a specific time period, although it is usually calculated on an annual basis.

Housing Grants – see Affordable Housing Grants

Illiquid – cannot be easily converted into cash

Interest rate risk – the risk that unexpected movements in interest rates have an adverse impact on revenue due to higher interest paid or lower interest received.

Liability benchmark – the minimum amount of borrowing required to keep investments at a minimum liquidity level (which may be zero)

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. Fixed every day by the British Bankers Association to five decimal places.

Liquidity risk – the risk stemming from the inability to trade an investment (usually an asset) quickly enough to prevent or minimise a loss.

M&G – M&G Global Dividend fund. The fund invests mainly in global equities.

Market risk – the risk that the value of an investment will decrease due to movements in the market.

Mark to market accounting – values the asset at the price that could be obtained if the assets were sold (market price)

Maturity loans – a repayment method whereby interest is repaid throughout the period of the loan and the principal is repaid at the end of the loan period.

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

Moody's - a credit rating agency. They provide international financial research on bonds issued by commercial and government entities. They rank the creditworthiness of borrowers using a standardised ratings scale which measures expected investor loss in the event of default. They rate debt securities in several markets related to public and commercial securities in the bond market.

Money Market - the market in which institutions borrow and lend

Money market funds – an open-end mutual fund which invests only in money markets. These funds invest in short-term debt obligations such as short-dated government debt, certificates of deposit and commercial paper. The main goal is the preservation of principal, accompanied by modest dividends. The fund's net asset value remains constant (e.g. £1 per unit) but the interest rates does fluctuate. These are liquid investments, and therefore, are often used by financial institutions to store money that is not currently invested. Risk is extremely low due to the high rating of the MMFs; many have achieved AAA credit status from the rating agencies:

- <u>Constant net asset value (CNAV)</u> refers to funds which use amortised cost accounting to value all of their assets. They aim to maintain a net asset value (NAV), or value of a share of the fund, at £1 and calculate their price to two decimal places known as "penny rounding". Most CNAV funds distribute income to investors on a regular basis (distributing share class), though some may choose to accumulate the income, or add it on to the NAV (accumulating share class). The NAV of accumulating CNAV funds will vary by the income received.
- <u>Variable net asset value (VNAV)</u> refers to funds which use mark-to-market accounting to value some of their assets. The NAV of these funds will

vary by a slight amount, due to the changing value of the assets and, in the case of an accumulating fund, by the amount of income received.

This means that a fund with an unchanging NAV is, by definition, CNAV, but a fund with a NAV that varies may be accumulating CNAV or distributing or accumulating VNAV.

Money Market Rates – interest rates on money market investments

Monetary Policy Committee – the regulatory committee of the Central Bank that determine the size and rate of growth of the money supply, which in turn, affects interest rates.

Multilateral Investment banks – International financial institutions that provide financial and technical assistance for economic development

Municipal Bonds Agency – an independent body owned by the local government sector that seeks to raise money on the capital markets at regular interval to on-lend to participating local authorities.

Non Specified Investments - all types of investment not meeting the criteria for specified 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, diversification and professional money management.

Project rate – the government has reduced by 40 basis points (0.40%) the interest rates on loans via the Public Works Loans Board (PWLB) for lending in respect of an infrastructure project nominated by a Local Enterprise Partnership (LEP).

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

Prudential Regulation Authority (PRA) – is responsible for the prudential regulation and supervision of around 1,700 banks, building societies, credit unions, insurers, and major investment firms. It sets standards and supervises financial institutions at the level of the individual firm.

PWLB (Public Works Loans Board) - a central government agency which provides long- and medium-term loans 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.

Quantitative easing (QE) – a type of monetary policy used by central banks to stimulate the economy when standard monetary policy has become ineffective. It is implemented by buying specified amounts of financial assets from commercial banks and other private institutions, raising the prices of those financial assets and lowering their yield, while simultaneously increasing the monetary base.

Registered Providers (RPs) – also referred to as Housing Associations.

Repo - a repo is an agreement to make an investment and purchase a security (usually bonds, gilts, treasuries or other government or tradeable securities) tied to an agreement to sell it back later at a pre-determined date and price. Repos are secured investments and sit outside the bail-in regime.

Reserve Schemes – category of schemes within the General Fund capital programme that are funded from earmarked reserves, for example the Car Parks Maintenance reserve or Spectrum reserves.

SME (Small and Midsize Enterprises) – a business that maintains revenue or a number of employees below a certain standard.

Sovereign – the countries the Council are able to invest in

Specified Investments - Specified investments are defined as:

a. denominated in pound sterling;
b. due to be repaid within 12 months of arrangement;
c. not defined as capital expenditure; and
d. invested with one of:
    i. the UK government;
    ii. a UK local authority, parish council or community council, or
    iii. a body or institution scheme of high credit quality

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

Standard & Poors (S&P) – a credit rating agency who issues credit ratings for the debt of public and private companies, and other public borrowers. They issue both long and short term ratings.

Subsidy Capital Financing Requirement – the housing capital financing requirement set by the Government for Housing Subsidy purposes

SWAP Bid – a benchmark interest rate used by institutions

SWIP – SWIP Absolute Return Bond fund. They invest in fixed income securities, index linked securities, money market transactions, cash, near-cash and deposits.

Temporary borrowing – borrowing to cover peaks and troughs of cash flow, not to fund spending

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 with those risks.

Treasurynet – the Council's cash management system

Treasury Management Practices – schedule of treasury management functions and how those functions will be carried out

Treasury Management Strategy Statement – also referred to as the TMSS.

Voluntary Revenue Provision – a voluntary amount charged to an authority's revenue account and set aside towards repaying borrowing.

Working capital – timing differences between income and expenditure (debtors and creditors)