STROUD DISTRICT COUNCIL
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Council Offices Ebley Mill Ebley Wharf Stroud Gloucestershire GL5 4UB

08 January 2016

AUDIT & STANDARDS COMMITTEE

A meeting of the Audit and Standards Committee will be held on **THURSDAY, 21 JANUARY 2016** in the Council Chamber, Ebley Mill, Ebley Wharf, Stroud at **19:00**.

David Hagg
Chief Executive

Please Note: This meeting will be filmed for live or subsequent broadcast via the Council's internet site (www.stroud.gov.uk). By entering the Council Chamber you are consenting to being filmed. The whole of the meeting will be filmed except where there are confidential or exempt items, which may need to be considered in the absence of the press and public.

A G E N D A

1 **APOLOGIES**
To receive apologies of absence.

2 **DECLARATIONS OF INTEREST**
To receive declarations of interest.

3 **MINUTES**
To approve and sign as a correct record the minutes of the meeting held on 26 November 2015.

4 **PUBLIC QUESTION TIME**
The Chair of the Committee will answer any questions from members of the public, submitted in accordance with the Council's procedures.

DEADLINE FOR RECEIPT OF QUESTIONS
Noon on Monday 18 January 2016.

Questions must be submitted in writing to the Chief Executive, Democratic Services, Ebley Mill, Ebley Wharf, Stroud, and sent by post, by fax (01453 754957), or by Email: democratic.services@stroud.gov.uk.

5 **WORK PROGRAMME**
To consider and update accordingly.

6 **ANNUAL SUMMARY OF CERTIFICATION OF GRANT CLAIMS AND RETURNS 2014/15**
To receive a summary of the above from KPMG, the Council's external auditor (to be sent under separate cover).

7 **3RD QUARTER TREASURY MANAGEMENT ACTIVITY REPORT 2015-16**
To provide an update to Committee on Treasury Management Activity.

8 **TREASURY MANAGEMENT STRATEGY, ANNUAL INVESTMENT STRATEGY AND MINIMUM REVENUE PROVISION POLICY STATEMENT 2016-17**
To consider the Council's prudential indicators for 2016/17 – 2018/19, together with the treasury strategy for this period and make recommendations to Council as set out within the report.

9 **INTERNAL AUDIT PLAN MONITORING REPORT**
To inform Committee of the Audits completed as part of the 2015/16 Internal Audit Plan.

10 **MEMBERS' QUESTIONS**
See Agenda Item 4 for deadline for submission.

Members of Audit & Standards Committee

Councillor Nigel Studdert-Kennedy (Chair)
Councillor Tom Williams (Vice Chair)
Councillor Martin Baxendale
Councillor Karon Cross
Councillor Stephen Davies
Councillor Colin Fryer
Councillor Keith Pearson
Councillor Rhiannon Wigzell
Councillor Penny Wride

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AUDIT AND STANDARDS COMMITTEE

3

26 November 2015

7.00 pm – 8.30 pm

Council Chamber, Ebley Mill, Stroud

Minutes

Membership:

Councillor Nigel Studdert-Kennedy (Chair)	P	Councillor Colin Fryer	A
Councillor Tom Williams (Vice Chair)	P	Councillor Keith Pearson	P
Councillor Martin Baxendale	A	Councillor Rhiannon Wigzell	P
Councillor Karon Cross	A	Councillor Penny Wride	P
Councillor Stephen Davies	A		

A = Absent P = Present

Officers in attendance

Principal Procurement Officer	Internal Audit Manager
Accountancy Manager	Democratic Services Assistant
Principal Accountant	Facilities Management Officer
Head of Asset Management	Senior Facilities Management Officers
Community and Facilities Manager	

Others in attendance
Darren Gilbert – KPMG

AC.026 APOLOGIES

Apologies for absence were received from Councillors Martin Baxendale, Karon Cross and Stephen Davies.

The meeting was chaired by the Vice Chair, Councillor Tom Williams.

AC.027 DECLARATIONS OF INTEREST

There were none.

AC.028 MINUTES

RESOLVED **That the Minutes of the meeting held on 29 September 2015, are approved as a correct record, subject to the following amendment and signed by the Chair.**

Minute AC.020, second paragraph, last but one sentence to read; “Except for some issues that had been identified in respect of the procurement process which had resulted in a qualification to the VFM conclusion”.

AC.029 PUBLIC QUESTION TIME

None received.

AC.030 AUDIT AND STANDARDS WORK PROGRAMME FOR 2015/16

The programme was agreed with the addition of a report in January 2016 concerning procurement. There would also be an internal audit plan monitoring report.

RESOLVED To note the work programme, subject to the inclusion of the above in the 2015/16 work programme.

AC.031 UPDATE ON CAR PARK AUDIT

The Community and Facilities Manager gave a verbal report on the car park audit. He confirmed that he had discussed the action taken on implementing the audit recommendations with the appropriate auditor and had requested Internal Audit to undertake a full review in April 2016. It was confirmed that a ‘park by phone’ option would be introduced in January 2016 along with cash machines. A debit/credit card facility would be introduced at Merrywalks when the new machines are installed in January 2016.

RESOLVED To accept the report.

AC.032 ANNUAL AUDIT LETTER 2014/15

Darren Gilbert, KPMG presented the report which provided a summary of the work undertaken in 2014/15 and summarised the key outcomes. Members asked for details of the cost of £891 for considering a response to an objection raised by an elector. Darren Gilbert informed Members that it was related to the level of precept raised by a parish council and was not really an issue from a district council perspective.

RESOLVED To accept the report.

AC.033 HALF YEAR TREASURY MANAGEMENT ACTIVITY REPORT 2015/16

The report, presented by the Principal Accountant, was a formal requirement under the Treasury Management Code to provide Members with an overview of investment activity. The report contained two separate elements. The first was to seek Committee approval to change the rating for permitted investments in money market funds. The second element provided a summary of the second quarter investments.

The change to the rating would permit the Council to invest in different money market funds which would provide a better return for minimal risk.

The summary of the Council's investments identified that the Council had sold its remaining interest in the Icelandic bank and 98% of the original principal sum invested had been recovered. In respect of current investments the Council had received £114,491 interest on its investments up to 30 September 2015.

Members noted the procedure for borrowing in advance of need which could be used if; capital spend would be likely within 12 months, interest rates were likely to rise in the future or treasury advisers evaluate a net saving after assessing the cost of carry.

The report advised of a planned property fund investment selection process and the requirement to procure a new treasury advice contract from October 2016.

RECOMMENDED TO COUNCIL **To approve the treasury management activity half year report for 2015/2016, including the revisions to the 2015/16 strategy as set out in paragraphs 3.5, 5.2 and 5.3.**

AC.034 INTERNAL AUDIT PLAN MONITORING REPORT

The report by the Internal Audit Manager included details of the number of completed audits against the target. Due to resource issues the target completion figure had not been achieved. However, it was planned to advertise and recruit to the vacant posts early in 2016. In respect of the internal audit work completed, as a result of the issues identified in the Capital Accounting audit, it was suggested that a follow-up audit be added to the audit plan for 2016/17.

RESOLVED **To accept the report and the assurance given on the adequacy of internal controls operating in the systems audited.**

AC.035 REVIEW OF THE PROCUREMENT ACTION PLAN

The Principal Procurement Officer presented the report which summarised the Council's progress of the action plan. Members were informed that a training plan was in place and that every employee would receive awareness training and would form part of the induction process.

RESOLVED **To note the progress made on the Procurement Action Plan.**

AC.036 RISK MANAGEMENT UPDATE

The Accountancy Manager presented the report and appendix. In Appendix A to the report there should be a focus on items with a risk factor of eight and above. In response to members questions it was noted that the 'basket' icon on the management system Excelsis provided a way of grouping items together. It was suggested that the report should list items in risk order.

RESOLVED **That the Risk Register as set out in Appendix A, is representative of the key risks facing the Council.**

AC.037 **MEMBERS' QUESTIONS**

There were none.

The meeting closed at 8.30 pm.

Chair

STROUD DISTRICT COUNCIL

AUDIT & STANDARDS COMMITTEE

21 JANUARY 2016

AGENDA ITEM NO

5

WORK PROGRAMME 2015/16

Date of meeting	Matter to be considered (i.e. insert report / project title)	Lead Member and Officer)
7 July 2015	Audit Fee Letter 2015/16	KPMG
	Interim Audit Letter	KPMG
	Annual Governance Statement 2014/15*	Sandra Cowley
	Treasury Management Outturn 2014/15*	Graham Bailey
	Internal Audit Plan Monitoring 2014/15*	Terry Rodway
	Review of Effectiveness of Internal Audit*	Sandra Cowley
	Internal Audit Annual Report 2014/15*	Terry Rodway
29 Sept 2015	Report to those Charged with Governance*	KPMG
	Statement of Accounts 2014/15*	Graham Bailey
	Treasury Management Activity 15/16*	Graham Bailey
	Internal Audit Plan Monitoring report*	Terry Rodway
	Annual Report on Fraud Activity/Counter Fraud*	Terry Rodway
	Review of Code of Conduct and Standards Panel	
	Review of Homelessness/Notice of Possession Proceedings Reviews	
26 Nov 2015	Annual Audit Letter	KPMG
	Treasury Management Half Year Review*	Graham Bailey
	Internal Audit Plan Monitoring 2015/16*	Terry Rodway
	Review of Procurement Action Plan	Sarah Turner
	Review of Risk Register*	Sandra Cowley
	Update on Car Park Audit	Terry Rodway
21 Jan 2016	Annual Summary of Certification of Grant Claims and Returns 2014/15	KPMG
	Treasury Management Activity Q3 15/16*	Graham Bailey
	Treasury Management, Annual Investment and MRP Strategies 2016/17*	Graham Bailey
	Internal Audit Charter/Partnership update – Briefing Note	Terry Rodway
	Internal Audit Plan Monitoring 2015/16	Terry Rodway
5 April 2016	Financial Statements 2015/16 Audit Plan*	KPMG
	Internal Audit Plan Monitoring 2015/16*	Terry Rodway
	Annual Internal Audit Plan 2016/17*	Terry Rodway
	Review of the Procurement Action Plan	Sarah Turner
	Annual Report Of the Audit & Standards Committee*	Cllr Studdert-Kennedy

	Review of Anti-Fraud Policies*	Terry Rodway

Information sheets sent to committee members

Date sent (and reference number)	Topic	Notes (e.g. responsible officer)
31.3.15	Briefing Note for Audit	Karen Trickey
29.6.15, No. 1	Update on the position with the balance of the Council's deposits in Iceland.	Sandra Cowley
16.11.15	Appointing your external auditor	KPMG

STROUD DISTRICT COUNCIL

AGENDA ITEM NO

AUDIT AND STANDARDS COMMITTEE

21 JANUARY 2016

7

Report Title	**3RD QUARTER TREASURY MANAGEMENT ACTIVITY REPORT 2015/16**
Purpose of Report	To provide an update on treasury management activity as at 31/12/2015.
Decision(s)	**The Audit and Standards Committee APPROVES the treasury management activity third quarter report for 2015/2016.**
Consultation and Feedback	Capita Asset Services Limited
Financial Implications and Risk Assessment	Interest of £205k in the third quarter is on likely to exceed the revised budgeted figure of £260k for 2015/16. Graham Bailey, Principal Accountant Tel: 01453 754133 E-mail: graham.bailey@stroud.gov.uk
Legal Implications	The report is provided for information only. There aren't any direct legal implications. Karen Trickey, Legal Services Manager and Monitoring Officer Email : karen.trickey@stroud.gov.uk Tel: 01453 754369
Report Author	Maxine Bell, Snr Accounting Officer Tel: 01453 754134 E-mail: maxine.bell@stroud.gov.uk
Chair of Committee	Councillor Nigel Studdert-Kennedy Tel: 01453 821491 E-mail: cllr.nigel.studdert-kennedy@stroud.gov.uk
Options	None
Performance Management Follow Up	A full 2015/16 annual report

Background Papers/ Appendices	○ Council Report 26 February 2015, Agenda Item 8a, Treasury Management Strategy, Annual Investment Strategy and Minimum Revenue Provision Policy Statement 2015/16 A – Economic Update B – Prudential Indicators as at 31 December 2015 C – Explanation of prudential indicators

Background

1. Treasury management is defined as: 'The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.'

2. This report is presented to the Audit and Standards Committee to provide an overview of the investment activity and performance for the third quarter of the financial year, and to report on prudential indicators and compliance with treasury limits. A quarterly report is regarded as good practice, but is not essential under the Code of Practice for Treasury Management (the Code).

Discussion

3. The Chartered Institute of Public Finance and Accountancy (CIPFA) issued the revised Code in November 2011, originally adopted by this Council on 21 January 2010. This third quarter report has been prepared in compliance with CIPFA's Code of Practice, and covers the following:

    - An economic update – Appendix A
    - A review of the Treasury Management Strategy Statement (TMSS) and Investment Strategy
    - A review of the Council's investment portfolio for 2015/16
    - A review of the Council's borrowing strategy for 2015/16
    - A review of compliance with Treasury and Prudential Limits for 2015/16.
    - Other Treasury Issues

Treasury Management Strategy Statement and Investment Strategy update

4. The TMSS for 2015/16 was approved by Council on 26 February 2015. The Council's Investment Strategy, which is incorporated in the TMSS, outlines the Council's investment priorities as follows:

    - Security of Capital
    - Liquidity
    - Yield

5. The Council will also aim to achieve the optimum return on investments commensurate with the proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term, less than 1 year, with highly credit rated financial institutions, using Capita's suggested creditworthiness approach, which includes a sovereign credit rating and Credit Default Swap (CDS) overlay. The Council is prepared to invest for up to 366 days with UK Government supported banks.

6. A breakdown of the Council's investment portfolio as at 31 December 2015 is shown in Table 2 of this report. Investments and borrowing during the year have been in line with the Strategy, and there have been no deviations from the strategy.

7. Capita's latest economic analysis is set out in Appendix A. Current advice from Capita is to invest for no more than a year with UK banks, or up to a maximum of five years with government or local government provided they are sufficiently highly rated on Capita's weekly list.

Investment Portfolio 2015/16

8. In accordance with the Code, it is the Council's priority to ensure security and liquidity of investments, and once satisfied with security and liquidity, to obtain a good level of return. The investment portfolio yield for the third quarter is shown in the table below:

<u>TABLE 1: Average Interest Rate Compared With Benchmark Rates</u>

Period	Investment Interest Earned	Average Investment	Average Interest Rate	Benchmark 7 day LIBID	Benchmark 3 month LIBID
01/04/15 - 30/06/15	£53,298	£29.640m	0.72%	0.36%	0.45%
01/07/15 - 30/09/15	£61,193	£34.012m	0.64%	0.36%	0.46%
01/10/15 - 31/12/15	£58,095	£33.436m	0.68%	0.36%	0.46%
Total	£172,586	£32.36m	0.68%	0.36%	0.46%

9. An amount of Icelandic Krona equivalent to £331k was held in an Escrow account during part of 2015/16 due to currency controls in Iceland earning 3.65%. This Interest amount is excluded from the figures shown in the above table. Also the Local Area Mortgage Scheme investment of £1m at 3.8% with Lloyds has been excluded from the above figures. If this interest is included the interest earned is £205k at an average interest rate of 0.7907%.

10. Table 2 below shows the investments and borrowing position at the end of December 2015.

11. The approved limits as set out in the Treasury Management Strategy report to Council 26th February 2015 within the Annual Investment Strategy were not breached during the first 9 months of 2015/16.

12. Funds were available for investment on a temporary basis. The level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the Capital Programme and canal project. The authority holds £6m core cash balances for investment purposes (i.e. funds that potentially could be invested for more than one year).

TABLE 2: Investments & Borrowing

	Sep 2015 £'000		Dec 2015 £'000	
Standard Life	3,199		0	
Federated Prime Rate	3,873		3,538	
Goldman Sachs	2,965		0	
Money Market Funds Total		**10,037**		**3,538**
Bank of Scotland	7,000		7,000	
Lloyds	6,000		5,800	
Lloyds Banking Group Total		**13,000**		**12,800**
NatWest	0		1,141	
Royal Bank of Scotland	2,008		2,008	
RBS Banking Group Total		**2,008**		**3,149**
Credit Suisse	0		0	
Standard Chartered	1,000		1,000	
Santander	2,000		7,982	
Barclays Bank Plc	7,001		7,901	
Svenska Handelsbanken	10		10	
Other Banks Total		**10,011**		**16,893**

-		
Nationwide	0	2000
Building Society Total	**0**	**2000**
-		
TOTAL INVESTMENTS	**£35,056**	**£38,380**
Local Authority	2,000	2,000
PWLB	97,717	97,717
TOTAL BORROWING	**£99,717**	**£99,717**

External Borrowing

13. The Council's revised Capital Financing Requirements (CFR) for 2015/16 is £101.949m. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (External Borrowing) or from internal balances on a temporary basis (Internal Borrowing). The Council has borrowing of £99,717m as at 31 December 2015. During August two 2m PWLB loans were taken at rates of 3.16% and 3.20% for 48 and 50 years respectively. These rates are 0.3% lower than the preferential rates offered by the Government for HRA financing. No further HRA borrowing is planned for this financial year.

Compliance with Treasury and Prudential Limits

14. It is a statutory duty for the Council to determine and keep under review the "Affordable Borrowing Limits". Council's approved Treasury and Prudential Indicators are outlined in the approved TMSS.

15. During the period to 31 December 2015 the Council has operated within the treasury limits and Prudential Indicators set out in the Council's TMSS and in compliance with the Council's Treasury Management Practices. The Prudential and Treasury Indicators are shown in Appendix B.

Economic Background

The UK recovery showed signs of some acceleration, but the imbalances remain. Q3 GDP saw solid domestic demand growth continue but the drag from net trade was the largest on record. In particular, trade with the Eurozone has deteriorated further. Nevertheless, the services PMI strengthened in November although there was weakening in both the manufacturing and construction numbers. This is not the ideal form of recovery, and the services sector looks set to take responsibility for the overall health of the economy for a while yet. The surge in US October non-farm payrolls allayed concerns that the recent slowing could possibly be the start of a downturn. With the unemployment rate slipping to 5% it is now at the lower end of the Fed's range for equilibrium unemployment. Meanwhile, the numbers of involuntary part time workers is also on the decline, and now stands at a seven year low. With full employment getting nearer, there are also signs that wage growth is gathering pace, and the unexpected strength of the latter, along with core inflation, is now looking likely to be a feature of 2016. That combination could see the Fed pushed into "normalising" policy more rapidly than initially expected by the market. In the Eurozone, while early indications seem to confirm that Q3 GDP growth slowed further, it does appear that there has been some improvement in early Q4 data, with the PMIs pointing to some acceleration. Growth, though, will remain modest at best and inflationary pressures are negligible. This all underpins the delivery of economic support that Mario Draghi has indicated will be actioned at the December ECB policy meeting. Asia remains an area of concern with the two main economies, China and Japan, struggling to generate the required levels of growth.

UK

The first update on Q3 GDP confirmed quarterly growth of 0.5% but the breakdownshowed that household spending has continued to provide the main support for growth, while the drag on performance from net trade was the largest that has ever been seen. Business investment posted a solid quarterly pick up to push annual growth to 6.6%, and survey investment intentions indicate that this healthy growth should continue, at least in the near future. The decline in the manufacturing PMI points to the strength seen in the October survey having been a blip, however, the robust services PMI ensured that the composite measure is consistent with growth accelerating a touch in the final quarter. As noted, household spending has proved resilient, rising 0.8% for a third successive quarter, with retail sales volumes gains equally healthy as consumer confidence remains at elevated levels. The high street battle for business has led to heavy discounting, benefiting consumer purchasing power, but depressing nominal retail sales. The BRC shop price index indicates that annual prices fell at an increased rate. Consumer services nominal spending has been more consistent, as has the housing market. Mortgage approvals rose by an annualised 0.9% in October and, with excess demand, prices are likely to be pushed higher. The trade deficit did improve in September but widened significantly over Q3, from £3.5bn to £8.5bn. As a result, net trade wiped 1.5% from quarterly GDP growth, its greatest negative impact, which more than reversed the 1.3% it added in Q2. Q3 export volumes growth of 0.9% was dwarfed by the 5.5% seen in imports. While the November manufacturing PMI offers upbeat export orders' indications, other surveys remain weak. There are significant headwinds facing exporters, with Sterling rising by 2.5% since the start of October, on a tradeweighted basis. Reducing Sterling prices has helped to reduce the impact on sales but margins cannot be squeezed indefinitely, or indeed further. Strong employment gains in Q3 pulled the unemployment rate down to 5.3%, the lowest for nine years, though it remains above the all-time low of 4.7% seen in 2005. Underlying the headline figure is a less positive picture as part time work drove the job figure rise and self-employment is picking up once more. Furthermore, the timelier claimant count unemployment measure pushed higher in October. Also less positive was the slowing of annual average earnings growth from 3.2% to 2.0% in September, and output per worker has eased in Q3. However, hourly productivity rose by 0.6% q/q, to back up the near 1% gain in Q2. CPI of -0.1% m/m in October was the joint lowest since the 1960's, but this is likely to be the last month of deflation, as inflation should pick up as the sharp decline in petrol prices, a year ago, drop out of the calculations. More stable oil prices should limit further falls in petrol prices in coming months. Food prices should also add to the pot as the influence of previous falls in agricultural commodity prices and Sterling gains in the supply chain starts to wane. Overall, analysts do not foresee inflation breaching BoE target levels in 2016. Monetary indicators point to the pace of recovery being maintained with annual money growth (M4) rising at 4.5% in October, which would equate to annual real GDP growth of 2%. Lending has also picked up, driven by households, but corporate lending remained weak, with growth having only just sneaked into positive territory. Small and Medium-sized Enterprises' (SME) lending has been stronger than that for larger firms and it has been smaller firms where subdued lending has been problematic, as large firms have the benefit of being able to raise funds through bond issuance. Interest rate expectations have been pushed back further with markets looking as far ahead as the start of Q2 2017 for the first Bank Rate rise.

US

There was a further drift lower in industrial production in October but this is largely down to a weather related decline in utilities. Mining output also fell further, continuing a year long decline, as the number of active drilling rigs fell again, but there is limited scope for further sharp declines in activity. Domestic oil production is, though, starting to reflect the earlier falls in drilling activity. Manufacturing output did bounce but the wider picture of activity in the sector is of a lateral movement, with annualised growth now sub-2%. The ISM manufacturing index is only marginally above the 50 level, which indicates that the bounce may be temporary. While the sector struggles with the strength of the US$, survey evidence from the broader economy is much more upbeat. Retail sales grew a modest 0.1% m/m as motor sales falls added to a modest dip in gasoline sales. Core sales were 0.2% higher m/m and the previous two months figures were revised higher, indicating that underlying sales remain solid. However, annual real consumption growth is set to ease to 3% in Q4. Real incomes have been on an upwards trajectory, helped by the lower price of gasoline. Fuel prices have stabilised recently but strong employment growth allied to improved wage growth will support those gains in real incomes. With that in place, consumer confidence is consistent with healthy real consumption growth. Prospects for business investment do not look strong, with a renewed decline in drilling activity pointing to another large contraction in mining investment in Q4. Survey evidence on planned expenditure has improved but external funding costs have picked up through 2015, though they remain at historically low levels still. Capital expenditure is in line with domestic internal funds but the latter could be pressured as the proportion of income that is absorbed by labour costs picks up. Construction spending increased at a healthy rate, despite a slowdown in nonresidential spending growth. The trade deficit narrowed markedly in September, to more than reverse the August increase. Over Q3, net trade had a near neutral impact on GDP as export gains only marginally exceeded those in imports. Exports have been dented by the strong $ this year, whilst imports have generally trended higher. Non-farm payrolls grew strongly in October, to end speculation that the slowing seen in August/September was anything more serious than just a blip. The unemployment rate hit a seven year low of 5% and there has been a decline in the numbers of involuntary part time workers, suggesting that slack in the market is limited. Wage growth has been improving, pushing annualised average weekly earnings gains to a six year high of 2.5%, though other measures of wage growth have been less robust. Nevertheless, “voluntary quits” are consistent with wage growth picking up to 3% in 2016. Firms are also reporting jobs harder to fill, which also points to a possible greater acceleration in wages.

Consumer prices edged 0.2% higher m/m in October, dragging the annual rate from zero to 0.2%. In addition, though energy prices have fallen recently, headline inflation may rise quite sharply in the coming months as the larger gasoline price slumps, from November 2014 through January 2015, fall out of the annual calculation. Core inflation is moving higher and services inflation is firming, but the stronger dollar is dampening imported goods’ prices and offsetting domestic pressures. Headline and core producer price inflation declined further in October, in part because of one off factors, but a strong dollar is exerting downward pressure on core goods inflation by lowering import prices. However, the pace of currency gains will recede in 2016 and reduce deflationary pressures. Annualised unit labour costs are trending higher, a reflection of tightening labour conditions, which in turn will push core inflation higher, above 2% next year. The market’s inflation expectations fell on the earlier collapse in energy prices but that sentiment has faded, though longer term expectations remains subdued, which is a concern. Household longer term expectations have altered little, but those for twelve months hence have eased. Market interest rate expectations have picked up as a December rate rise becomes ever more likely, but thereafter they suggest a slow path of tightening. However, with accelerating wage growth and core inflation there is a risk that rate hikes could occur more rapidly than anticipated. US dollar strength is a function of the relative prospects for monetary policy elsewhere, with the UK position looking more towards a later hike, while in Europe and Japan the likelihood of tightening remain as distant as ever. Despite these developments US equities have recovered the losses posted in late summer. The rhetoric from key Fed members has been very much along the lines that the economy is in position to accept the first interest rate rise in a decade. It seems inconceivable that they would not deem the 16th December meeting as appropriate timing for the move after all that has been said, and the expectation that they have built into the markets.

EZ

The pace of recovery slowed for a second quarter in Q3, but early indications suggest that Q4 has started well and may see some acceleration in GDP growth. The November composite PMI edged higher to its highest level since May 2011, and is indicative of growth picking back up to 0.4-0.5% q/q. Elsewhere, while the Economic Sentiment Indicator was unchanged from October, that is still consistent with annual growth improving to 2%. There are signs that Italy is finally experiencing an improved pace of recovery, but overall gains across the currency block have been held back by a slowing in Spain. Low inflation is continuing to benefit consumer spending with Q3 growth relatively strong, despite a soft month in September. A weighted average of retail and car spending points to total spending growth improving in Q3. There is a more complex picture developing in Q4, with a disconnect between the EC measure of retailer confidence, reflective of stellar annual sales growth of over 3%, and national information for October which has been weak, particularly in Germany and France. Industry data has been weak, but business surveys are optimistic of potential small gains in industrial growth. September saw a contraction in industrial production, but forward looking manufacturing PMIs are upbeat and point to annualised industrial growth of 2% for the rest of 2015. The service sector is in a healthy position and should underpin performance in the bloc, with services' firms confidence consistent with annual growth of over 2%, and the sector PMI pointing to quarterly output growth of 0.5%. Exports have disappointed given that the €uro has weakened quite markedly and that impact will start to dissipate shortly. The trade surplus did widen in September as exports grew faster than imports. However, there has been a slowing in the former in subsequent months and the three month average annualEZ export growth has eased to 4.5%, with the leading economies also experiencing export slowing, including internal trade between members. This may be the start of the waning of the effect of late last year's big depreciation, which will continue if there is no further decline in value. The latest EC survey indicates that export growth will remain in the 5-10% range, and that German export performance will deteriorate, but this has not always proved a reliable proxy for future activity. The labour market recovery has remained steady with unemployment declining for thirteen straight months, leaving the jobless rate at 10.7% but there is a wide variance in fortunes between member states. Despite the composite PMI employment index hitting a four and a half year high, the survey evidence does not see job gains gathering great pace, with annual employment growth of less than 1%. This would be insufficient to generate meaningful wage growth across the region, as strong growth in Germany offsets ongoing weakness elsewhere due to levels of slack in the weaker economies. Inflation remains subdued, with the headline rate at just 0.1%, and indicators show that weak price pressures will remain. Energy prices have picked up as last year's big decline in oil prices pass out of the annual figure, but this impact has been offset by weaker core inflation. The negative effect of energy prices will fade as oil price inflation picks up, but goods inflation will dip as the upside influence of the weaker €uro on import prices declines, and previous falls in producer prices feed through. Weak wage growth will contain services inflation but while deflation does not look too great a risk, inflation will remain below the ECB's 2% target for some considerable time. October monetary data supports further ECB policy action with only modest growth in money measures and the broadest measure has been flat on the year. This would suggest that core inflation will remain below target levels. Annual private sector lending may have picked up but it remains low in historic terms, while lending to firms was notably weak and still falling in some states, with Italian and Greek contractions getting worse. Quantitative Easing (QE) has done little to boost credit to date but it has had a small macroeconomic benefit. The evidence suggests that the ECB both needs to do more and has the scope to do so, and Mario Draghi has suggested that this will be delivered in December. Market expectations of ECB support has firmed with short term overnight interest rate swaps trading at sub-ECB deposit rate levels, indicating that they expected at least a 10bp cut in rates. Bond yields have turned lower with two year German bunds trading at -0.4% and the 10 year at just 0.5%. Peripheral government bond rates have declined further, narrowing their spread over the bund, which in part reflects improved sentiment levels. Equities bounced further in November and outperformed bourses in both the US and UK, on the hopes for increased QE. At the end of November then, the stage is set for the central bank to step up support, and itwould be a major surprise, and indeed disappointment, if it did not transpire. The ECB cannot afford to let everyone down as the consequences would be far reaching.

Asia

The Chinese economy continues to underperform and threatens to miss the authorities' growth target for the year. Debate about the economy is now focussing on whether it can be turned around in 2016. Some argue that the slowdown is due to the slump in investment, responding to increased overcapacity and debt levels, which would suggest that the troubles in the economy may prove more long term. Others say that this was inevitable and has been occurring over the last five years and that the sharp growth decline earlier in the year was more cyclical, and thus reversible. Fiscal tightening in late 2014 and early 2015 is suggested as the principal cause, and that impact is now being reversed and thus a cyclical rebound will ensue. Time will tell which view is correct, but in the meantime the data remains on the soft side, which is a concern to hopes of improved global demand. Japan is in the throes of returning to technical recession. With GDP growth having turned negative in Q2, the initial Q3 estimate showed a further contraction which is another blow to the Abe government's ambitions, which are already under threat, leaving markets looking for further supportive action to bolster the ailing economy.

Summary and interest rate view

It seems certain that both the ECB and Fed will be making policy adjustments in December, with Mario Draghi and Janet Yellen, the respective heads of the central banks, all but saying as much. However, the similarities end there, with the Europeans easing monetary policy to generate life in the ailing economy and the Americans tightening policy to rein in pressures in their healthily growing economy. Sitting in the middle of this is the Bank of England, which is offering no great clues on its policy, other than that the majority accept that a rise is the next move, which is something that markets are comfortable with. What would be useful is to have some indication as to what the potential timescale is that we could be looking at? The market is pushing a sterling rate rise further out but there are clear risks that could bring about a swift foreshortening of that view. Capita still feels that these risks, particularly escalating inflation, could push the Bank to react rather earlier.

	Open	Close	High	Low
FTSE	6,361	6,356	6,459	6,080
£/$	$1.545	$1.505	$1.550	$1.499
€/£	£0.713	£0.702	£0.720	£0.698
5y Gilt	1.284%	1.215%	1.434%	1.189%
10y Gilt	1.927%	1.826%	2.089%	1.801%
25y Gilt	2.594%	2.513%	2.743%	2.482%
50y Gilt	2.517%	2.396%	2.656%	2.369%

The uncertainty over when UK interest rates will be raised has weighed on the market, generating some volatility over the past month. However, the increasing view is that it will happen later rather than sooner, possibly as late as April 2017. This was reflected by the decline in the £/US$ exchange rate and gilt yields falling from mid-month to month-end. The decline in gilt yields has seen the spread of US Treasury yields over gilts widen with the US Federal Reserve seemingly all but assured to tighten policy in December, if the rhetoric from Janet Yellen and her colleagues is anything to go by. With the ECB set to offer further support to the Eurozone economy in December, Sterling strengthened against the €uro on the divergence in policy. However, the weaker interest rate expectations in the UK, compared to the US, saw £/$ slip below the $1.50 level for the first time since late April. UK equities on the FTSE 100 have, once more, underperformed those on other frontline bourses during the month. However, the more UK centric FTSE 250, which better reflects the perceived fortunes of the domestic economy, has performed rather better.

Prudential Indicators as at December 2015

Prudential Indicator	2015/16 Indicator £'000	Actual as at 31 Dec 2015 £'000
Capital Financing Requirement (CFR)	107,611	104,597
Gross Borrowing	106,779	99,717
Authorised Limit for external debt	118,000	99,717
Operational Boundary for external debt	112,000	99,717
Limit of fixed interest rates based on net debt	100%	100%
Limit of variable interest rates based on net debt	100%	0%
Principal sums invested > 364 days	6,000	0
Maturity structure of borrowing limits		
Under 12 months	100%	0%
12 months to 2 years	100%	0%
2 years to 5 years	100%	3%
5 years to 10 years	100%	0%
10 years and above	100%	97%

Explanation of prudential indicators

Central Government control of borrowing was ended and replaced with Prudential borrowing by the Local Government Act 2003. Prudential borrowing permitted local government organisations to borrow to fund capital spending plans provided they could demonstrate their affordability. Prudential indicators are the means to demonstrate affordability.

Gross borrowing – compares estimated gross borrowing in February 2015 strategy with actual gross borrowing as at 31 December 2015.

Capital financing requirement (CFR) – the capital financing requirement shows the underlying need of the Council to borrow for capital purposes as determined from the balance sheet. The overall positive CFR of £107.611m provides the Council with the opportunity to borrow if appropriate. No further borrowing is planned for 2015/16.

Authorised limit for external debt - this is the maximum limit for gross external indebtedness. This is the statutory limit determined under section 3(1) of the Local Government Act 2003. This limit is set to allow sufficient headroom for day to day operational management of cashflows. This limit has not been breached in the period 1 April 2015 to 31 December 2015.

Operational boundary for external debt – this is set as the more likely amount that may be required for day to day cashflow. This limit has not been breached in the period 1 April 2015 to 31 December 2015.

Upper limit for fixed and variable interest rate exposure – these limits allow the Council flexibility in its investment and borrowing options. Current investments are either fixed rate term investments or on call. Borrowing is at a fixed rate.

Upper limit for total principal sums invested for over 364 days – the amount it is considered can prudently be invested for a period in excess of a year. Current policy only permits lending beyond 1 year with other Local Authorities up to a maximum of 3 years, apart from the £1m invested for 5 years as part of the Local Area Mortgage Scheme.

STROUD DISTRICT COUNCIL

AUDIT AND STANDARDS COMMITTEE

21 JANUARY 2016

AGENDA ITEM NO

8

Report Title	TREASURY MANAGEMENT STRATEGY, ANNUAL INVESTMENT STRATEGY AND MINIMUM REVENUE PROVISION POLICY STATEMENT 2016/17
Purpose of Report	This report outlines the Council's prudential indicators for 2016/17 – 2018/19 and sets out the treasury strategy for this period. It fulfils three key reports required by the Local Government Act 2003: • reporting prudential indicators required by the CIPFA Prudential Code for Capital Finance in Local Authorities; • a treasury management strategy in accordance with the CIPFA Code of Practice on Treasury Management; • an investment strategy in accordance with the DCLG investment guidance. It also fulfils the statutory duty to approve a minimum revenue policy statement for 2016/17.
Decision(s)	**The Audit and Standards Committee RECOMMEND that Council:** **1. adopt the prudential indicators and limits for 2016/17 to 2018/19;** **2. approve the treasury management strategy 2016/17, and the treasury prudential indicators;** **3. approve the investment strategy 2016/17, and the detailed criteria for specified and non-specified investments; and** **approve the Minimum Revenue Policy Statement 2016/17.**
Consultation and Feedback	Capita Asset Services (CAS)

Financial Implications and Risk Assessment	This report sets out the expected activities of the Council's Treasury function for 2016/17 and recommends the investment instruments that are available to the council and the limits on these investments. The report also sets out the Council's borrowing strategy, limits and associated policies. The Council has £99.717m of borrowing and the Council's capital spending plans increase the borrowing to £114.141m by 31 March 2019. It will be important to consider carefully, in conjunction with our Treasury Management advisers, the optimum timing and nature of any new borrowing to minimise the cost to the Council. The Council makes investments during the year as part of its management of treasury balances. The investment strategy sets out the Council's investment priorities and the criteria used to make those investments to ensure security of capital, liquidity and a return on investment. The Treasury Management Strategy is designed to protect the Council's finances through limiting exposure to risk. David Stanley, Accountancy Manager Tel: 01453 754100 Email: david.stanley@stroud.gov.uk
Legal Implications	No direct legal implications to report. Karen Trickey, Legal Services Manager Tel: 01453 754369 Email: karen.trickey@stroud.gov.uk
Report Author	Graham Bailey, Principal Accountant Tel: 01453 754133 E-mail: graham.bailey@stroud.gov.uk
Chair of Committee	 Councillor Nigel Studdert-Kennedy Tel: 01453 821491 E-mail: cllr.nigel.studdert-kennedy@stroud.gov.uk
Options	Full Council is required to adopt the prudential indicators and approve the annual treasury management strategy. These are largely determined by the Council's revenue and capital budget decisions when setting the 2016/17 Council Tax and Housing rent levels.

Performance Management Follow Up	Quarterly, half-yearly and annual Treasury Management reports of actual compared with estimated prudential indicators for 2016/17. Any breaches of the Prudential Code will be reported to the Audit and Standards Committee. A breach of the Authorised Borrowing Limit would require immediate investigation and reporting to Council.
Background Papers/ Appendices	Treasury Management Policy Statement Treasury Management Practices - Main Principles Treasury Management Practices – Schedules The Prudential Code (2011) Treasury Management in the Public Services Guidance Notes for Local Authorities (2011) Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes (2011). Reports: o Capital Programme and Proposed Schemes, 7 January 2016 o General Fund Revenue Estimates – Revised 2015/16 and Original 2016/17, 7 January 2016 o The General Fund Revenue Budget 2016/17 and Medium Term Financial Plan 2015/16 – 2019/20, 7 January 2016 o Housing Revenue Account Revised Estimates 2015/16 and Original Estimates 2016/17, 7 January 2016 A. Investments at 22 December 2015 B. Explanation of Prudential Indicators C. Economic Background D. Treasury Management Scheme of Delegation

Discussion

1. Under the Local Government Act 2003 (the Act) and supporting regulations the Council is required to "have regard to" the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

2. Council is required to approve an Annual Treasury Management Strategy Statement for borrowing, and an Investment Strategy which sets out the Council's policies for managing its investments and for giving priority to security and liquidity of investments.

3. Also, there is a statutory duty to approve a Minimum Revenue Provision (MRP) Policy Statement for the year and this is set out in paragraphs 2.6 – 2.9 of this report.

4. CIPFA Code of Practice on Treasury Management (revised November 2011) as adopted by this Council on 21 January 2010 requires the Council to maintain a Treasury Management Manual, which is reviewed annually. This manual is a record of internal procedures and operational guidance, as such it does not need to be approved by Members. The manual incorporates the following documentation relating to Treasury management:

   - <u>Treasury Management Policy Statement</u>. This was approved by Members in 2002 and is reviewed annually.
   - <u>Treasury Management Practices (TMP) – Main Principles</u>. There are 12 practices which set out the manner in which this Council will seek to achieve its treasury management policies and objectives and how it will manage and control those activities. These were adopted in 2002. They are reviewed annually.
   - <u>Treasury Management Practices – Schedules</u>. These schedules set out the details of how the TMPs are put into effect by this Council. This document is revised annually to include the latest detailed procedural documents.
   - <u>Counterparty Lending List and lending criteria</u>. The list used by the Council is provided by Capita Asset Services (CAS), the Council's treasury advisors. A new list is provided weekly, and there are daily updates by email of any changes to ratings.

5. Other CIPFA requirements are:

   - a Mid-year Review Report and an Annual Report covering activities during the previous year;
   - delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions. At this Council, delegation is to the Strategic Head (Finance & Business Services), the Council's Section 151 officer;
   - delegation by the Council of the role of scrutiny of treasury management reports and strategy to a specific named body. For this Council the delegated body is the Audit and Standards Committee.

Treasury Management Strategy Statement, Annual Investment Strategy and Minimum Revenue Provision Statement 2016/17

1. INTRODUCTION

1.1 The Act and supporting regulations require the Council to 'have regard to' the CIPFA Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

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

1.3 The 2016/17 strategy for the following aspects of the treasury management function is based upon the treasury officers' views on interest rates, supplemented with market forecasts provided by the Council's treasury advisor, CAS. The strategy covers:

- limits in force to mitigate the Council's treasury risk;
- Prudential Indicators;
- current treasury position;
- borrowing requirement;
- prospects for interest rates;
- borrowing strategy;
- policy on borrowing in advance of need;
- investment strategy;
- creditworthiness policy;
- policy on use of external service providers;
- Minimum Revenue Provision (MRP) statement;
- treasury management scheme of delegation and section 151 role;
- miscellaneous treasury issues.

1.4 It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from:

- increases in interest charges caused by increased borrowing to finance additional capital expenditure, and
- any increases in running costs from new capital projects are limited to a level which is affordable for the foreseeable future.

2. CAPITAL PRUDENTIAL INDICATORS FOR 2016/17 TO 2018/19

2.1 Capital expenditure plans are a key driver of treasury management activity. There are prudential indicators that focus on the Council's capital spending plans.

2.2 The first prudential indicator is a summary of the Council's capital expenditure plans, shown in Table 1.

Table 1: Capital Expenditure

Capital Expenditure	2014/15 £000 Actual	2015/16 £000 Estimate	2016/17 £000 Estimate	2017/18 £000 Estimate	2018/19 £000 Estimate
Community Services	839	2,218	703	350	350
Environment	1,217	1,598	1,300	11	-
Strategy & Resources	225	2,303	10,620	1,500	-
General Fund	**2,281**	**6,119**	**12,623**	**1,861**	**350**
HRA	**12,818**	**17,767**	**17,136**	**9,540**	**7,290**
Total	**15,099**	**23,886**	**29,759**	**11,401**	**7,640**

2.3 Any shortfall of resources to finance the capital programme results in a borrowing need as set out in Table 2 below.

Table 2: Capital Financing

Capital Expenditure	2014/15 £000 Actual	2015/16 £000 Estimate	2016/17 £000 Estimate	2017/18 £000 Estimate	2018/19 £000 Estimate
General Fund	2,281	6,119	12,623	1,861	350
HRA	12,818	17,767	17,136	9,540	7,290
Total	**15,099**	**23,886**	**29,759**	**11,401**	**7,640**
Financed by:					
Capital receipts	812	1,812	2,127	211	-
Capital grants	8,478	1,143	1,563	817	175
Capital reserves	350	1,975	1,270	600	175
Revenue	5,459	12,557	12,366	8,773	7,290
Net Financing Need for the year	**-**	**6,400**	**12,432**	**1,000**	**-**

2.4 The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic capital expenditure which has not yet been financed from either revenue or capital resources. It is the measure of the Council's underlying borrowing need. Any newly planned unfinanced capital expenditure will increase the CFR.

2.5 The Council is asked to approve the CFR projections below:

Table 3: The Council's borrowing need (Capital Financing Requirement)

Capital Financing Requirement	2014/15 £000 Actual	2015/16 £000 Estimate	2016/17 £000 Estimate	2017/18 £000 Estimate	2018/19 £000 Estimate
CFR - General Fund	7,569	9,969	18,639	18,935	18,231
CFR - HRA	87,980	91,980	95,742	95,742	95,742
Total CFR	95,549	101,949	114,381	114,677	113,973
Movement in CFR	-	6,400	12,432	296	-704

Movement in CFR represented by					
Net financing need for the year	-	6,400	12,432	1,000	-
Less MRP / VRP and other financing movements	-	-	-	-704	-704
Movement in CFR	-	6,400	12,432	296	-704

Minimum revenue provision (MRP) policy statement 2016/17

2.6 The Council's MRP policy statement for 2016/17 is in accordance with the main recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003. MRP is only chargeable on General Fund outstanding capital liabilities.

2.7 An MRP charge is not currently required for the HRA. Following the introduction of HRA self-financing it is currently proposed that the HRA will be required to charge depreciation on its assets. This will have a revenue effect. In order to address any possible adverse impact, regulations allow the Major Repairs Allowance as a proxy for depreciation until 31 March 2017. The Council awaits confirmation of the accounting requirements from accounting year 2017/18.

2.8 The government has protected the General Fund from any adverse MRP liability arising from HRA self-financing borrowing. Consequently, as there was no General Fund MRP liability for the General Fund prior to HRA Self-Financing, there is no General Fund MRP liability for 2016/17. The Council's MRP liability for 2016/17 is therefore NIL.

2.9 When the Council's General Fund CFR (for MRP purposes) becomes positive, MRP will be charged under Option 3 of the DCLG guidance. Option 3 is an MRP charge over a time period reasonably commensurate with the estimated useful life of a new asset. The Council is funding £1m of expenditure on Dursley Pool fitness extension by borrowing, there is £8.4m of borrowing planned in respect of the Multi-

Service Contract commencing in July 2016, and also £2m of borrowing in relation to Brimscombe Port redevelopment. Under Option 3, MRP will be chargeable in the year following the completion of the asset. So MRP will commence in 2017/18 and its duration will be linked to the asset funded and so will last from 5 to 25 years.

2.10 The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year-end balances for each resource and anticipated day-to-day cash flow balances.

Table 4: Core Funds and Expected Investments

Year end resources	2014/15 £m Actual	2015/16 £m Estimate	2016/17 £m Estimate	2017/18 £m Estimate	2018/19 £m Estimate
Fund balances / reserves	22.268	17.657	15.006	12.641	9.925
Capital receipts	1.507	1.283	-0.265	0.104	0.684
Provisions	0.859	0.859	0.859	0.859	0.859
Other	0.477	0.500	0.500	0.500	0.500
Total Core funds	**25.111**	**20.299**	**16.100**	**14.104**	**11.968**
Working capital	-0.467	0.500	0.500	0.500	0.500
Under / over borrowing	0.168	0.168	0.168	0.168	0.168
Expected investments	**24.812**	**20.967**	**16.768**	**14.772**	**12.636**

Affordability of capital plans prudential indicators

2.11 Prudential indicators are required to assess the affordability of capital expenditure plans. These provide an estimate of the impact of capital investment plans on the Council's overall finances. The Council is asked to approve the indicators shown in tables 5, 6 and 7.

2.12 The indicator shown in table 5 shows the cost of capital expenditure plans against the net revenue stream.

Table 5: Ratio of financing costs to net revenue stream

	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Non-HRA	-2.86%	-1.31%	6.38%	7.21%	7.10%
HRA	15.09%	15.47%	16.05%	15.91%	16.08%

2.13 The indicator shown in Table 6 shows estimates of the revenue costs arising from proposed changes to the 2015-16 to 2018-19 capital programme recommended in this year's 'Capital Programme and Proposed Schemes' report compared to the Council's existing approved commitments and current plans.

Table 6: Incremental impact of capital investment decisions on council tax

	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Council Tax - Band D	£0.16	-£1.94	£2.84	£0.50	-£0.02

2.14 Similar to the council tax calculation, Table 7 indicator identifies the cost of proposed changes in the housing capital programme recommended in this budget report compared to the Council's existing commitments and current plans, expressed as a discrete impact on weekly rent levels.

Table 7: Estimates of the incremental impact of capital investment decisions on housing rent levels

	2014/15 Actual	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Weekly Housing Rents	-£0.03	£0.19	£0.57	£0.00	-£0.30

3. BORROWING

3.1 Amongst the objectives of the treasury management function are to ensure that the Council's cash is managed in accordance with relevant professional codes and that sufficient cash is available at the right times to facilitate revenue and capital spending plans. Capital expenditure plans as set out in section 2 indicate if borrowing is required.

3.2 Table 8 shows the actual external debt (the treasury management operations), compared against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

Table 8: Gross Debt compared with Capital Financing Requirement (CFR)

	2014/15 £m Actual	2015/16 £m Estimate	2016/17 £m Estimate	2017/18 £m Estimate	2018/19 £m Estimate
External Debt					
Debt at 1 April	95.717	95.717	102.117	114.549	114.845
Expected change in debt	-	6.400	12.432	0.296	-0.704
Other long term liabilities at 1 Apr	-	-	-	-	-
Actual Gross Debt at 31 March	95.717	102.117	114.549	114.845	114.141
Capital Financing Requirement	95.549	101.949	114.381	114.677	113.973
Under / (over) borrowing	-0.168	-0.168	-0.168	-0.168	-0.168

3.3 Within the prudential indicators, there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2016/17 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not for revenue purposes.

3.4 The Strategic Head (Finance & Business Services) reports that the Council complied with this prudential indicator in the current year and does not expect any breaches up to and including financial year 2018-19. This view takes into account current commitments, existing plans, and the proposals in this budget report.

3.5 There are two Treasury indicators set which limit external debt. The operational boundary is the limit that external debt should not normally exceed. If external debt were to exceed this figure then it should prompt an internal investigation to establish the reasons why the breach had occurred.

Table 9: Operational Boundary

Operational Boundary	2015/16 £m Estimate	2016/17 £m Estimate	2017/18 £m Estimate	2018/19 £m Estimate
Debt	112	125	125	125
Other Long Term Liabilities	-	-	-	-
Total	112	125	125	125

3.6 The Authorised Limit is set or revised by full Council, and must not be exceeded. It represents the level of debt that is unsustainable in the longer term. It is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control local government borrowing in total or for specific councils. This power has not been used to date.

3.7 The Council is asked to approve the following Authorised Limit:

Table 10: Authorised Limit for External Debt

Authorised Limit	2015/16 £m Estimate	2016/17 £m Estimate	2017/18 £m Estimate	2018/19 £m Estimate
Debt	118	130	130	130
Other Long Term Liabilities	-	-	-	-
Total	118	130	130	130

3.8 A separate control on the Council's borrowing is a limit on the maximum HRA CFR introduced as part of HRA self-financing. This Council has some headroom to borrow over and above the self-financing settlement amount. This is set out in the next table:

Table 11: HRA Debt Limit

HRA Debt Limit	2014/15 £m Actual	2015/16 £m Estimate	2016/17 £m Estimate	2017/18 £m Estimate	2018/19 £m Estimate
Actual HRA CFR	87.980	91.980	95.742	95.742	95.742
Limit	95.742	95.742	95.742	95.742	95.742
Headroom	7.762	3.762	-	-	-

3.9 CAS are treasury advisers to the Council and part of their service is to assist the Council to formulate a view on interest rates. The following table gives the CAS forecast as at November 2015.

Table 12: Interest Rate Forecast

Month	Bank Rate	PWLB Borrowing Rates		
		5 year	25 year	50 year
Mar-16	0.5	2.5	3.8	3.8
Jun-16	0.75	2.6	3.9	3.9
Sep-16	0.75	2.8	4	4
Dec-16	1	2.9	4.1	4.1
Mar-17	1	3	4.2	4.2
Jun-17	1.25	3.1	4.3	4.3
Sep-17	1.5	3.2	4.4	4.4
Dec-17	1.5	3.3	4.5	4.5
Mar-18	1.75	3.4	4.6	4.6
Jun-18	2	3.5	4.6	4.6

Borrowing Strategy

3.10 Currently the Council has £99.7m of borrowing, compared with a Capital Financing Requirement (CFR) of £101.949m. This means that the capital borrowing need (the CFR), is greater than loan debt by £2.249m. The Council borrowed £2m of PWLB at a fixed rate of 3.20% on 18 August 2015 and £2m on 20 August 2015 at a fixed rate of 3.16% to take advantage of particularly low rates to fund part of the borrowing requirement.

3.11 There is a limit on HRA borrowing set by the Government in the Localism Act 2011 known as the HRA debt cap. The Council's HRA debt cap is £95.742m. This cap is the absolute limit for HRA borrowing under the Prudential Code, even if the Council considers further borrowing is affordable by the HRA. The current HRA CFR is £91.980m, which means a borrowing 'headroom' of £3.762m measured against the cap, as shown by table 11.

3.12 Current HRA capital plans are borrowings of £3.762m during 2016/17 and General Fund plans include borrowing of £8.672m. The Strategic Head (Finance & Business Services) will decide on the length and type of borrowing, as well as the optimum time to borrow in consultation with CAS, and take into account the latest projections for interest rates and other relevant factors including any benefits arising from internal borrowing.

Treasury management limits on activity

3.13 The purpose of treasury management limits are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs or improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments;
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits

3.14 The Council is asked to approve the following treasury indicators and limits:

Table 13: Limits on interest rate exposure

Interest Rate Exposures	2015/16 Upper	2016/17 Upper	2017/18 Upper
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates on net debt	100%	100%	100%

Table 14: Maturity structure of borrowing

Maturity structure of new fixed and variable rate borrowing during 2016/17	Upper Limit	Lower Limit
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

Table 15: Non-specified investment limit

Upper Limit for total principal sums invested for over 364 days	2014/15	2015/16	2016/17	2017/18	2018/19
Investments	£8m	£8m	£8m	£8m	£8m

Policy on borrowing in advance of need

3.15 The Council will not borrow more than, or in advance of, need purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within approved Capital Financing Requirement estimates as required by the Prudential Code (see paragraph 3.3). Decisions to borrow will seek to ensure value for money and security of funds.

3.16 The Council will consider borrowing up to 12 months ahead of capital spend:

- If such capital spend is considered very likely to occur within 12 months;
- treasury advisers demonstrate that rates are particularly low and likely to move higher within 12 months;
- treasury advisers evaluate a net saving after assessing cost of carry;
- a trigger rate(s) will be set by s151 officer in consultation with treasury advisers and treasury officers;

- borrowing will be conducted in parcels – eg £4m could be split into 4 x £1m or 2 x £2m;
- ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been fully considered;
- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow;
- consider the merits and demerits of alternative forms of funding;
- consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use;

3.17 The foregoing usual procedure will not prevent the S151 officer from forward borrowing to the fullest extent permitted by the Prudential Code, CFR for the current year plus the following two years, if extraordinary conditions arise in the short term to make such action in the interests of the authority.

Debt rescheduling

3.18 Now that the Council has £99.7m of long-term debt, the Strategic Head (Finance & Business Services) will keep under review opportunities for debt rescheduling. Debt rescheduling is reported to Council at the next meeting after it occurs.

4. ANNUAL INVESTMENT STRATEGY

Investment Policy

4.1 The Council will have regard to the DCLG's Guidance on Local Government Investments ("the Guidance") issued in March 2004, any revisions to that guidance such as the March 2010 revision, and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA Treasury Management Code"). The Council's investment priorities in order are:

1) security of capital
2) liquidity of investments
3) rate of return

4.2 In accordance with the above, and in order to minimise the risk to investments, the Council has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies with a full understanding of what the ratings mean for each agency. CAS's bank ratings service enables real-time monitoring of a bank's rating. Daily emails are sent to the Council to notify of any significant change to a bank rating.

4.3 Further, the Council’s officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector. Assessment will also take account of information reflecting the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as “credit default swaps” (CDS). Other information sources used will include the financial press, share price and other such information about the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

4.4 The intention of the strategy is to provide security of investment and minimisation of risk.

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

4.6 Borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

4.7 ‘Specified’ and ‘Non-Specified’ Investments categories identify investment instruments for use during the financial year.

Specified Investments

4.8 All specified investments will be sterling denominated, with maturities up to 1 year (including any forward deal time), subject to CAS’s colour coding rating system as set out in creditworthiness policy paragraphs 4.16 – 4.22.

Table 16: Specified Investments

Type of Investment	Minimum 'High' Credit Criteria	Max Sum per institution / group
Debt Management Agency Deposit Facility	*	£40m
Term deposits – local authorities	*	£8m
Term deposits – banks and building societies	Colour coded as per Sector Weekly counterparty listing (AAA countries & UK only)	£8m
UK Government Gilts	*	£12m
Bonds issued by multilateral development banks	*	£8m
Bonds issued by a financial institution which is guaranteed by the UK government	*	£8m
Treasury Bills	*	£12m
Certificates of deposits issued by banks and building societies	Colour coded as per Sector Weekly counterparty listing (AAA countries & UK only)	£8m
Certificates of deposits issued by banks and building societies	Colour coded as per Sector Weekly counterparty listing (AAA countries & UK only)	£8m
Money Market Funds	AAA	£4m per MMF & £12m total in MMFs
Enhanced Money Market Funds	AAA	£4m per MMF & £12m total in MMFs

Non-Specified Investments

4.9 All investments will be sterling denominated.

Table 17: Non-specified Investments - Maturities in excess of 1 year

Financial instrument / institution	Minimum Credit Criteria	Max. maturity period	Max. Sum**
Term deposits – banks and building societies	Colour coded as per Sector Weekly counterparty listing (AAA countries & UK only)	3 years	£8m
Certificates of deposits issued by banks and building societies	Colour coded as per Sector Weekly counterparty listing (AAA countries & UK only)	3 years	£8m
Property Funds	***	25 years	£3m
Corporate Bonds	AA-	3 years	£3m
UK Local Authorities	*	3 years	£8m
UK Government Gilts	*	3 years	£8m
Bonds issued by multilateral development banks	*	3 years	£8m
Bonds issued by a financial institution which is guaranteed by the UK government	*	3 years	£8m

* Government institutions have the highest security, although they are not formally rated.

** A maximum sum refers to the combined total of specified and non-specified investments with a particular bank.

*** Any investment would be subject to an evaluation process and a report to Strategy and Resources Committee.

4.10 Under the Local Authority Mortgage Scheme (LAMS) as per Cabinet report 15 December 2011 the Council has a 5-year deposit of £1m with Lloyds bank. This £1m LAMS investment is a service investment, rather than a treasury management investment, and is therefore outside of the Specified and Non-Specified investment categories where there is a 3-year limit for banks.

Investment Strategy

4.11 Cash flow forecast requirements and the outlook for short-term interest rates are important factors considered when making investments. During 2015 interest rates have continued to fall, whilst the number of available counter-parties has increased.

4.12 In 2016-17 the Council will continue to invest for the longest permitted duration with quality counterparties to maximise return without compromising security. In particular instances the Strategic Head (Finance & Business Services) will authorise UK investments in excess of a year for example to take advantage of enhanced interest rates on Lloyds 366-day notice deposit. Otherwise, the length of investments permitted will vary if necessary in line CAS advice subject to the Council's 3-year upper limit.

Table 18: Investments maturing after the end of the current financial year.

Financial Institution	Amount £	Maturity	Rate
Nationwide	2,000,000	01/06/2016	0.68%
Santander	1,400,000	10/05/2016	1.15%
Bank of Scotland	2,000,000	08/04/2016	1.00%

4.13 Bank Rate has been unchanged at 0.5% since March 2009. Bank Rate is forecast to commence rising in quarter 2 of 2016.

4.14 The Council will primarily make short-dated deposits of up to a year with appropriately rated banks or UK local authorities rather than utilising call accounts or money market funds in order to maximise interest. Transaction costs will be taken into account in any investment decision for smaller sums, which means balances of up to £1m may be retained in lower interest rate, but transaction cost free, accounts for short periods when this is cost-efficient.

4.15 At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

Creditworthiness policy

4.16 This Council applies the creditworthiness service provided by Capita Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

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

4.17 This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end-product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:

- **Yellow** 3 years
- **Dark pink** 3 years
- **Light pink** 3 years
- **Purple** 2 years
- **Blue** 1 year (only applies to nationalised or semi nationalised UK Banks)
- **Orange** 1 year
- **Red** 6 months
- **Green** 100 days
- **No colour** not to be used

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

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

4.20 All credit ratings will be monitored prior to making an investment decision. The Council is alerted to changes to ratings of all three agencies through its use of the CAS creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a daily basis via CAS's Passport website. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

4.21 The Council will not place sole reliance on the use of this external service. In addition this Council will use market data and information on government support for banks and the credit ratings of particular countries.

Country limits

4.22 The following countries have sovereign ratings of AA- or higher, and also have banks operating in sterling markets which have credit ratings of green or above in CAS credit worthiness service.

AAA	**AA+**	**AA**	**AA-**
Australia	Finland	Abu Dhabi (UAE)	Belgium
Canada	Netherlands	France	
Denmark	UK	Qatar	
Germany	USA		
Singapore			
Sweden			
Switzerland			

5. MISCELLANEOUS TREASURY ISSUES

Use of external service providers

5.1 Capita Asset Services (CAS) are the Council's treasury management advisers. As responsibility for treasury management decisions remains with the Council at all times, undue reliance will not be placed upon our external treasury management advisers.

5.2 The contract with CAS expires on 30 September 2016, and so treasury advice services for October 2016 onwards need to be procured during 2016.

Member Training

5.3 The CIPFA Code requires the provision of adequate training for members by the Section 151 officer. Member training is planned for 13 January 2016. Training is necessary to enable Audit and Standards Committee members to fulfil their role more effectively.

INVESTMENTS AS AT 22 DECEMBER 2015

Counterparty	£	%	S / NS	Type	Issue	Maturity
NatWest Treasury Reserve	355,824	0.25%	S	Call		
RBS CD	2,000,000	0.96%	S	Fixed	17/07/2015	15/07/2016
RBS Deposit Account	7,476	0.25%	S	Call		
NatWest/RBS GroupTotal	**2,363,300**					
Goldman	2,862	0.44%	S	Call		
Federated Prime Rate	3,861,255	0.49%	S	Call		
Ignis	895	0.45%	S	Call		
Money Market Fund Total	**3,865,012**					
Nationwide	**2,000,000**	0.68%	S	CD	01/12/2015	01/06/2016
Standard Chartered	**1,000,000**	0.78%	S	CD	10/06/2015	10/03/2016
Santander	2,000,000	0.69%	S	Fixed	07/07/2015	06/01/2016
Santander - 95 day Notice	1,000,000	0.90%	S	Notice	08/10/2015	19/01/2016
Santander - 95 day Notice	1,000,000	0.90%	S	Notice	09/10/2015	19/01/2016
Santander - 95 day Notice	845,000	0.90%	S	Notice	13/10/2015	05/02/2016
Santander - 95 day Notice	1,737,000	0.90%	S	Notice	16/10/2015	05/02/2016
Santander - 180 day Notice	1,400,000	1.15%	S	Notice	12/11/2015	10/05/2016
Santander	**7,982,000**					
Svenska	**10,380**	0.35%	S	Call		
Bank of Scotland	1,000,000	0.57%	S	Fixed	15/12/2015	21/03/2016
Bank of Scotland	2,000,000	0.70%	S	Fixed	16/07/2015	15/01/2016
Bank of Scotland	2,000,000	0.57%	S	Fixed	13/11/2015	15/02/2016
Bank of Scotland	2,000,000	1.00%	S	Fixed	10/04/2015	08/04/2016
Bank of Scotland	**7,000,000**					
Lloyds	1,000,000	0.57%	S	Fixed	15/12/2015	21/03/2016
Lloyds	1,800,000	0.57%	S	Fixed	22/10/2015	22/01/2016
Lloyds	2,000,000	0.70%	S	Fixed	07/07/2015	06/01/2016
Lloyds	1,000,000	0.57%	S	Fixed	04/12/2015	11/03/2016
Lloyds	**5,800,000**					
Barclays FIBCA	1,433	0.10%	S	Call		
Barclays	1,900,000	0.56%	S	Fixed	17/11/2015	11/03/2016
Barclays	1,000,000	0.58%	S	Fixed	17/11/2015	21/03/2016
Barclays	2,000,000	0.64%	S	Fixed	23/09/2015	22/02/2016
Barclays	2,000,000	0.70%	S	Fixed	05/08/2015	05/02/2016
Barclays	1,000,000	0.57%	S	Fixed	15/12/2015	21/03/2016
Barclays	**7,901,433**					
TOTAL INVESTMENTS	**37,922,125**					

S = Specified Investment - less than 1 year
NS = Non-specified investment - 1 year and over

EXPLANATION OF PRUDENTIAL INDICATORS

Central government control of borrowing was ended and replaced with Prudential borrowing by the Local Government Act 2003. Prudential borrowing permits local government organisations to borrow to fund capital spending plans provided they can demonstrate their affordability. Prudential indicators are the means to demonstate affordability.

Capital expenditure – table 1 shows last year's capital expenditure, this year's projected capital expenditure and the approved programme until 2018/19.

Ratio of financing costs to net revenue stream – table 5 shows that the General Fund currently receives an income from the investment of balances which turns into a net expenditure in 2016/17 with General Fund borrowing. The HRA borrowing means that interest on net borrowing now accounts for between 15.09% and 16.08% of net revenue.

Net borrowing need – table 2 shows borrowing planned to fund the capital programme.

Capital financing requirment (CFR) as at 31 March – table 3 shows the CFR which is the council's underlying need to borrow for capital purposes as determined from the balance sheet. Table 8 shows the overall CFR is £101.949m. As the Council has borrowing of £99.717m the balance sheet shows there is under borrowing of £2.232m.

HRA debt limit – table 11 shows the absolute limit for HRA indebtedness which is measured against the HRA CFR. This shows that the HRA has borrowing 'headroom' of £95.742m - £91.980m = £3.762m.

Incremental impact of capital investment decisions – increase in Council Tax (band D) per annum – table 6 shows the effect of the latest capital programme report on annual council tax. This indicator is based on the estimated decrease or increase in interest payable to or by the General Fund each year due to the changed funding of the capital programme in the latest capital report to January 2016 Strategy and Resources as compared with the previous capital report in June 2015.

Incremental impact of capital investment decisions – increase in average housing rent per week – table 7 shows the effect of the latest capital programme report on weekly housing rent. This indicator is based on the estimated decrease or increase in interest payable to or by the HRA each year due to the changed funding of the capital programme in the latest capital report to January 2016 Strategy and Resources as compared with the previous capital report in June 2015.

Authorised limit for external debt - table 10 shows the maximum limit for external borrowing. This is the statutory limit determined under section 3(1) of the Local Government Act 2003. This limit is set to allow sufficient headroom for day to day operational management of cashflows.

Operational boundary for external debt – table 9 shows the more likely limit to the level of external debt that may be required for day to day cashflow.
Upper limit for fixed and variable interest rate exposure – table 13 shows these limits that allow the Council flexibility in its investment and borrowing options.

Upper limit for total principal sums invested for over 364 days – table 15 shows the amount it is considered can be prudently invested for period in excess of a year.

Economic Background

UK. UK GDP growth rates of 2.2% in 2013 and 2.9% in 2014 were the strongest growth rates of any G7 country; the 2014 growth rate was also the strongest UK rate since 2006 and the 2015 growth rate is likely to be a leading rate in the G7 again. However, quarter 1 of 2015 was weak at +0.4%, although there was a short lived rebound in quarter 2 to +0.7% before it subsided again to +0.5% (+2.3% y/y) in quarter 3. The Bank of England's November Inflation Report included a forecast for growth to remain around 2.5% – 2.7% over the next three years. For this recovery, however, to become more balanced and sustainable in the longer term, it still needs to move away from dependence on consumer expenditure and the housing market to manufacturing and investment expenditure. The strong growth since 2012 has resulted in unemployment falling quickly to a current level of 5.3%.

The MPC has been particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of CPI inflation in order to underpin a sustainable recovery. It has, therefore, been encouraging in 2015 to see wage inflation rising significantly above CPI inflation which has been around zero since February. The Inflation Report was notably subdued in respect of the forecasts for CPI inflation; this was expected to barely get back up to the 2% target within the 2-3 year time horizon. However, once the falls in oil, gas and food prices over recent months fall out of the 12 month calculation of CPI, there will be a sharp tick up from the current zero rate to around 1% in the second half of 2016. Indeed, the increase in the forecast for inflation at the three year horizon was the biggest in a decade and at the two year horizon it was the biggest since February 2013. Nevertheless, despite average weekly earnings ticking up to 3.0% y/y in the three months ending in September, this is unlikely to provide ammunition for the MPC to take action to raise Bank Rate in the near future as labour productivity growth has meant that net labour unit costs appear to be rising by about only 1% y/y. Having said that, at the start of October, data came out that indicated annual labour cost growth had jumped sharply in quarter 2 from +0.3% to +2.2%: time will tell if this is just a blip or the start of a trend.

There is, therefore, considerable uncertainty around how quickly inflation will rise in the next few years and this makes it difficult to forecast when the MPC will decide to make a start on increasing Bank Rate. There are also concerns around the fact that the central banks of the UK and US currently have few monetary policy options left to them given that central rates are near to zero and huge QE is already in place. There are, therefore, arguments that they need to raise rates sooner, rather than later, so as to have some options available for use if there was another major financial crisis in the near future. But it is unlikely that either would raise rates until they are sure that growth was securely embedded and 'noflation' was not a significant threat.

The forecast for the first increase in Bank Rate has, therefore, been pushed back progressively during 2015 from Q4 2015 to Q2 2016 and increases after that will be at a much slower pace, and to much lower levels than prevailed before 2008, as increases in Bank Rate will have a much bigger effect on heavily indebted consumers than they did before 2008.

The Government's revised Budget in July eased the pace of cut backs from achieving a budget surplus in 2018/19 to achieving that in 2019/20.

USA. GDP growth in 2014 of 2.4% was followed by Q1 2015 growth, which was depressed by exceptionally bad winter weather, at only +0.6% (annualised). However, growth rebounded very strongly in Q2 to 3.9% (annualised) before dipping again in Q3 to 1.5%.

Until the turmoil in financial markets in August, caused by fears about the slowdown in Chinese growth, it had been strongly expected that the Fed. may start to increase rates in September. However, the Fed pulled back from that first increase due to global risks which might depress US growth and put downward pressure on inflation, as well as a 20% appreciation of the dollar which has caused the Fed. to lower its growth forecasts. Although the non-farm payrolls figures for growth in employment in August and September were disappointingly weak, the October figure was stunningly strong and, together with a likely perception by the Fed. that concerns on the international scene have subsided since August, has now firmly opened up the possibility of a first rate rise in December.

Eurozone. The ECB fired its big bazooka in January 2015 in unleashing a massive €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it is intended to run initially to September 2016. This appears to have had a positive effect in helping a recovery in consumer and business confidence and a start to a significant improvement in economic growth. GDP growth rose to 0.5% in Q1 2015 (1.0% y/y) but came in at +0.4% (+1.5% y/y) in Q2 and looks as if it may maintain this pace in Q3. However, the recent downbeat Chinese and Japanese news has raised questions as to whether the ECB will need to boost its QE programme if it is to succeed in significantly improving growth in the EZ and getting inflation up from the current level of around zero to its target of 2%.

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

China and Japan. Japan is causing considerable concern as the increase in sales tax in April 2014 suppressed consumer expenditure and growth. In Q2 2015 quarterly growth shrank by -0.3% after a short burst of strong growth of 1.0% during Q1. Japan has been hit hard by the downturn in China during 2015. This does not bode well for Japan as the Abe government has already fired its first two arrows to try to stimulate recovery and a rise in inflation from near zero, but has dithered about firing the third, deregulation of protected and inefficient areas of the economy.

As for China, the Government has been very active during 2015 in implementing several stimulus measures to try to ensure the economy hits the growth target of 7% for the current year and to bring some stability after the major fall in the onshore Chinese stock market during the summer. Many commentators are concerned that recent growth figures could have been massaged to hide a downturn to a lower growth figure. There are also major concerns as to the creditworthiness of much of the bank lending to corporates and local government during the post 2008 credit expansion period. Overall, China is still expected to achieve a growth figure that the EU would be envious of. Nevertheless, concerns about whether the Chinese economy could be heading for a hard landing, and the volatility of the Chinese stock market, which was the precursor to falls in world financial markets in August and September, remain a concern.

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

This change in investors' strategy, and the massive reverse cash flow, has depressed emerging country currencies and, together with a rise in expectations of a start to central interest rate increases in the US, has helped to cause the dollar to appreciate significantly. In turn, this has made it much more costly for emerging countries to service their dollar denominated debt at a time when their earnings from commodities are depressed. There are also likely to be major issues when previously borrowed debt comes to maturity and requires refinancing at much more expensive rates.

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

CAPITA ASSET SERVICES FORWARD VIEW

Economic forecasting remains difficult with so many external influences weighing on the UK. Our Bank Rate forecasts, (and also MPC decisions), will be liable to further amendment depending on how economic data evolves over time. Capita Asset Services undertook its last review of interest rate forecasts on 9 November 2015 shortly after the publication of the quarterly Bank of England Inflation Report. There is much volatility in rates and bond yields as news ebbs and flows in negative or positive ways. This latest forecast includes a first increase in Bank Rate in quarter 2 of 2016.

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

The overall balance of risks to economic recovery in the UK is currently evenly balanced. Only time will tell just how long this current period of strong economic growth will last; it also remains exposed to vulnerabilities in a number of key areas.

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

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

- Geopolitical risks in Eastern Europe, the Middle East and Asia, increasing safe haven flows.
- UK economic growth turns significantly weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU, US and China.
- A resurgence of the Eurozone sovereign debt crisis.
- Recapitalisation of European banks requiring more government financial support.
- Emerging country economies, currencies and corporates destabilised by falling commodity prices and / or the start of Fed. rate increases, causing a flight to safe havens

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

- Uncertainty around the risk of a UK exit from the EU.
- The commencement by the US Federal Reserve of increases in the Fed. funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
- UK inflation returning to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

TREASURY MANAGEMENT SCHEME OF DELEGATION AND ROLE OF THE SECTION 151 OFFICER

1. Council

- Approval of annual strategy, mid-year report and outturn report

2. Audit and Standards Committee

- Receipt, review and recommendation to Council of quarterly monitoring reports
- Receipt, review and recommendation to Council of reports on treasury strategy, policy and activity

3. Section 151 Officer / Strategic Head (Finance & Business Services)

- Reviewing the treasury management policy, procedures, strategy and making recommendations to the Audit and Standards Committee;
- Approving the selection of external service providers and agreeing terms of appointment;
- Submitting regular treasury management strategy reports;
- Receiving and reviewing management information reports;
- Reviewing the performance of the treasury management function;
- Ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- Ensuring the adequacy on internal audit and liaising with external audit.

STROUD DISTRICT COUNCIL | **AGENDA ITEM NO**

AUDIT & STANDARDS COMMITTEE

21 JANUARY 2016 | **9**

Report Title	**INTERNAL AUDIT PLAN MONITORING REPORT**
Purpose of Report	To inform Members of the audits completed as part of the 2015/16 Internal Audit Plan.
Decision(s)	**The Committee RESOLVES to accept the report and the assurance given on the adequacy of internal controls operating in the systems audited.**
Consultation and Feedback	Internal Audit findings are discussed with service managers. Management responses to audit recommendations are included in each assignment report.
Financial Implications and Risk Assessment	There are no financial implications arising directly from the report. However, there are clearly ongoing issues around letting and managing contracts which need to be addressed. By doing so, contract management costs may be reduced, additional costs will be avoided and the risk of challenges to procurement processes will be limited. A review of the Council's approach to procurement was undertaken early in 2015 and an action plan for improvement put in place. Based on the outcome of more recent audits of procurement activity, it is clear that more needs to be done to improve the Council's performance in this area. A review will be undertaken before the next meeting of this Committee. A comprehensive training programme will also be delivered in the first quarter of 2016 to staff at all levels whom have responsibility for procuring and managing contracts. An update on the progress with this will be given at the next Audit & Standards Committee meeting in April. Sandra Cowley Strategic Head (Finance & Business Services) Tel: 01453 754136 Email: Sandra.cowley@stroud.gov.uk

	Risk Assessment It is important that planned audits are carried out so that assurance can be given about the adequacy of the Council's control environment. If too few audits are undertaken, this limits the extent of assurance that can be given.
Legal Implications	There aren't any direct legal implications arising from this committee report which records the auditor's findings. Nevertheless, the plan outlined in the Financial Implications to put in place an on-going comprehensive programme of corporate training will help ensure that any legitimate or reasonable concerns regarding procurement and / or contract management do not reoccur in the future. The detailed training should focus on those responsible for decisions to procure contracts and for effective contract management and complement the delivery of the on-going procurement action plan commenced in early 2015. Practical issues to date regarding the contract procedure rules updated in July 2015, indicate further amendments would be sensible to ensure the changes are consistent with the delivery of best value services as well as competition law / procurement regulations. It is anticipated that these will be included in the report to the April committee meeting. Karen Trickey, Legal Services Manager Tel: 01453 754369 Email: karen.trickey@stroud.gov.uk
Report Author	Terry Rodway, Internal Audit Manager Tel: 01453 754111 Email: terry.rodway@stroud.gov.uk
Options	The Public Sector Internal Audit Standards (PSIAS) require the Internal Audit Manager to report on internal activity to the Audit & Standards Committee. The lack of reporting would lead to non-compliance with these Standards.
Performance Management Follow Up	This is the third report relating to the 2015/16 Plan. The Committee will continue to receive regular monitoring reports on achievement against the 2015/16 Internal Audit Plan.
Background Papers/ Appendices	Internal Audit Plan 2015/16. Public Sector Internal Audit Standards. **Appendix A** – List of audits completed as part of the Internal Audit Plan 2015/16: November 2015 to December 2015.

1.0 Background

1.1 At the Audit and Standards Committee meeting held on 7 April 2015 Members approved the Internal Audit Annual Plan 2015/16. In accordance with the requirements of the Public Sector Internal Audit Standards this report details the outcomes of Internal Audit work.

2.0 Progress

2.1 This is the third report on compliance against the 2015/16 Plan and includes details of the audits completed during the period November to December 2015. The performance information is based on the number of completed audits vs. the number of planned audits (i.e. an output measure). The indicator for the period April 2015 to December 2015 is 70% (16 out of 23 planned audits completed), against a target of 90% (21 out of 23 planned audits completed). However, these figures do not take into account 4 reports that were at draft report stage as at 31st December 2015.

2.2. Details of the audits completed are given in **Appendix A**. The Audit Opinion reached on each audit has been provided, which should provide Members with a view on the adequacy of the controls operating within each area audited.

3.0 Other Audit Work Undertaken

3.1 <u>Contract Audits</u>

3.1.1 The internal audit work on contracts during this financial year has highlighted gaps in the corporate Procurement Guidance in place at the time of the commencement of the procurement process for these contracts. Therefore, to address these issues corporately, they have also been included in a separate report which has been issued to the Principal Procurement Officer with a recommendation to update the corporate Procurement Guidance.

3.2 <u>Audit of the Parliamentary Election Fee Account 2015</u>

3.2.1 An audit review was undertaken on the Stroud UK Parliamentary Election Fee account for 2015. In summary this involved checking the accuracy and validity of supporting information from which data had been entered in the various forms comprised in the overall claim.

3.2.2 Based on the audit work carried out, it was concluded that the Claim had been completed accurately, data was adequately supported by subsidiary records, and the Claim had been authorised properly and despatched before the deadline set

4.0 Conclusions

4.1 The role of Internal Audit is to examine, evaluate, and report on the adequacy of internal controls. The audit work that has been completed has either identified that controls are operating as intended, or, where weaknesses have been identified, made recommendations to improve the level of control.

List of Audits Completed
2015/16 Audit Plan: November 2015 – December 2015

Audit	Comments	Level of Assurance
Housing Rents	<u>Audit Objective</u> The objective of the audit was to identify and assess the adequacy of controls operating in the following areas: • Periodic reconciliation of the Housing Rents system to the Cash Receipting system; • Periodic reconciliation of the Housing Rents system to the General Ledger; <u>Period of Audit</u> The audit covered the seven month period to October 2015. <u>Audit Opinion</u> On the basis of work carried out during this audit review, and the number and classifications of recommendations identified through audit testing, the audit opinion is that there is a **Good** level of assurance on the adequacy and operating effectiveness of controls in place over all areas covered by this audit.	Good
Contract Audit - External Works to Housing Properties	<u>Audit Objective</u> The objective of the audit was to identify and assess the adequacy of controls operating in the following areas: • Procurement approach has been approved and complies with the Council Contract & Procurement Procedure Rules (CPPRs); • The work has been procured in accordance with Council and EU timeframes; • Tenders are received, stored and opened in a secure environment and manner; • Tenders received are correctly assessed and evaluated against and agreed and transparent predetermined criteria; • The contractor awarded the contract has been appropriately approved and subject to financial checks; • There is a formal contract between the Council and contractor that has been signed and sealed by both parties; • The contract award decision and the notification of the contract are updated to the various registers. <u>Period of Audit</u> The scope of the audit covered the period of the	Satisfactory

	procurement to the signing and sealing of the contract (August/September 2014). <u>Audit Opinion</u> On the basis of work carried out during this audit review, and the number and classifications of recommendations identified through audit testing, the audit opinion is that there is a **Satisfactory** level of assurance on the adequacy and operating effectiveness of controls in place over all areas covered by this audit, The main areas of weakness identified for which two Rank 2 'Medium Priority' recommendations have been made, are as follows: • The method used to determine the lowest contractor tender price was based on establishing the contractor's single unit price (labour and materials) for specified work. No account was taken of the different volumes of work likely to be undertaken under the contract; • Two of the sub contractors that were to be used by the main contractor did not provide documentary evidence of the required level of Public Liability insurance. The recommendations made as a result of this audit have been agreed by management, with the latest implementation date being November 2015.	
Contract Audit - Dursley Pool Extension	<u>Audit Objective</u> The objective of the audit was to identify and assess the adequacy of controls operating in the following areas: • Procurement approach has been approved and complies with the Council Contract & Procurement Procedure Rules; • The work has been procured in accordance with Council and EU timeframes; • Tenders are received, stored and opened in a secure environment and manner; • Tenders received are correctly assessed and evaluated against an agreed and transparent predetermined criteria; • The contractor awarded the contract has been appropriately approved and subject to financial checks; • There is a formal contract between the Council and contractor that has been signed and sealed by both parties; • The contract award decision and the notification of the contract are updated to the various registers	Satisfactory/ Limited

	<u>Period of Audit</u> The audit covered the period of the procurement exercise up to September 2015. <u>Audit Opinion</u> On the basis of work carried out during this audit review, and the number and classifications of recommendations identified through audit testing, a **Satisfactory** level of assurance has been determined relating to the procurement process, with the exception of the receipt of tenders and evaluation process of contractor submissions, for which a **Limited** level of assurance has been determined for these areas. The main areas of weakness identified for which two Rank 1 'High Priority' recommendations have been made, are as follows: • Contractors were advised, in the ITT, to submit their tenders through the South West Portal and also, via post to the Council's appointed external consultants. The ITT instructions did not detail how (as per CPPRs) the tenders should be submitted by post in order to maintain the integrity of the process; • The decision by the Strategic Head (Customer Services) to enter into the contract was not recorded in the Decisions Register as per the requirement of the Openness of Local Government Bodies regulations. The recommendations made as a result of this audit have been agreed by management, with the latest implementation date being December 2016.	
Contract Audit - Leonard Stanley New Build	<u>Audit Objective</u> The objective of the audit was to identify and assess the adequacy of controls operating in the following areas: • Procurement approach has been approved and complies with the Council Contract & Procurement Procedure Rules; • The work has been procured in accordance with Council and EU timeframes; • Tenders are received, stored and opened in a secure environment and manner; • Tenders received are correctly assessed and evaluated against an agreed and transparent predetermined criteria; • The contractor awarded the contract has been appropriately approved and subject to financial checks;	Satisfactory/ Limited

	• There is a formal contract between the Council and contractor that has been signed and sealed by both parties; • The contract award decision and the notification of the contract are updated to the various registers. <u>Period of Audit</u> The scope of the audit covered the period of the procurement to the signing and sealing of the contract (October 2014 – April 2015). <u>Audit Opinion</u> On the basis of work carried out during this audit review, and the number and classifications of recommendations identified through audit testing, there is a **Satisfactory** level of assurance with the exception of the contractor assessment/evaluation process. For this specific area of the procurement process a **Limited** level of assurance has been determined. The main areas of weakness identified for which two Rank 1 'High Priority' recommendation and two Rank 2 'Medium Priority' recommendations have been made, are as follows: • Non compliance with the Council's Contract & Procurement Procedure Rules (CPPRs) as the successful contractor was allowed to amend their tender price, after all contractors had submitted their tenders, to include for work specified in the ITT, for which they did not provide a price; • The decision by the Head of Asset Management to enter into the contract was not recorded in the Decisions Register as per the requirements of the Openness of Local Government Bodies regulations. In addition the contract was not recorded in the Stroud District Council Contracts Register; • Lack of documentary evidence to support the rationale for the decision to amend contract requirements; • The Principal Procurement Officer was not consulted on the proposed amendments to contract requirements. The recommendations made as a result of this audit have been agreed by management. The management response states that one recommendation has already been implemented, and the other agreed recommendations will be implemented "For all future tenders from this date". The one recommendation relating to documentary evidence to support the rationale for amending the	

	contract conditions has not been accepted. The Head of Asset Management has stated that the recommendation is not accepted as the corporate risks (especially the risk of challenge) were considered at length and are a matter of email record.	
Contract Audit – Renewable Energy Heating	<u>Audit Objective</u> The objective of this audit was to verify that the following controls were in place and operating effectively: <u>Procurement:</u>- • Procurement approach of the renewable energy work from 1st April 2014 has been approved and complies with the Council Contract & Procurement Procedure Rules; • The procurement process for the storage, management and transportation of renewable energy materials has been correctly performed and complies with Council Contract Procurement & Procedure Rules. <u>Contract Management</u>:- • Stock recording, management and control of renewable energy materials is correctly performed and accounted for; • The management of the work has been effectively administered and controlled in accordance with the contract terms and conditions; • The financial position of the work is correctly calculated and effectively managed; • Appropriate surveys and assessments on properties have been promptly performed, managed and appropriate certificates obtained; • Registration for the feed in tariff (FIT) and renewable energy heat incentive (RHI) have been correctly performed, promptly completed and income fully and correctly accounted for. <u>Period of Audit</u> The audit covered the 14 month period to May 2015. <u>Audit Opinion</u> On the basis of work carried out during this audit review, and the number and classifications of recommendations identified through audit testing, the audit opinion is that there is an **Unsatisfactory** level of assurance on the adequacy and operating effectiveness of controls in place over all areas covered by this audit. The main areas of weakness identified, for which a number of recommendations have been made, are as follows:- • Lack of documentary evidence relating to:- ○ Compliance with Council Contract Procedure	Unsatisfactory

	Rules, o Satisfactory resolution of identified risks, o Use of an appropriate Framework Agreement; • Lack of investigation of stock differences identified at various stock takes; • Non-compliance with contract conditions; • Contract for the storage of materials not signed; • Incomplete records to enable effective monitoring of Renewable Heating Incentive (RHI) and Feed in Tariff (FIT). The majority of the recommendations made as a result of this audit have been accepted by management, with the latest implementation date being December 2015. <u>Additional Comment from the Head of Housing Contracts</u> The Head of Housing Contracts accepts that there have been a number of issues in the delivery of this project and it is a matter of fact that the majority of failures and poor decisions relate to officers who are no longer employed by the Authority. A number of actions have been put in place following the 19 recommendations set out within the report as follows: • Not Accepted = 1 • Recommendations completed = 3 high and 1 medium • Recommendations in place and ongoing = 1 high and 4 medium This leaves 9 recommendations which will be implemented by Tenant Services no later than December 2015.	

The report includes an 'opinion' on the adequacy of controls in the area that has been audited, classified in accordance with the following descriptions:

CONTROL LEVEL	DESCRIPTION
Good	Robust framework of controls – provides substantial assurance. A few minor recommendations (if any) i.e. Rank 3 (Low Priority).
Satisfactory	Sufficient framework of controls – provides satisfactory level of assurance – minimal risk. A few areas identified where changes would be beneficial. Recommendations mainly Rank 3 (Low Priority), but one of two in Rank 2 (Medium Priority).
Limited	Some lapses in framework of controls – provides limited assurance. A number of areas identified for improvement. Mainly Rank 2 (Medium Priority) recommendations, but one or two Rank 1 (High Priority) recommendations.
Unsatisfactory	Significant breakdown in framework of controls – provides unsatisfactory level of assurance. Unacceptable risks identified – fundamental changes required. A number of Rank 1 (High Priority) recommendations.

Internal Audit recommendations are graded as follows:

RANK		DESCRIPTION
1	High Priority	Necessary due to statutory obligation, legal requirement, Council policy or major risk of loss or damage to Council assets, information or reputation, or, compliance with External Audit identified key control.
2	Medium Priority	Could cause limited loss of assets or information or adverse publicity or embarrassment. Necessary for sound internal control and confidence in the system to exist.
3	Low Priority	Current procedure is not best practice and could lead to minor inefficiencies.