D

CPR.52 15/16
Corporate Policy and Resources Committee
11 February 2016

Subject: Budget and Treasury Management Monitoring – Quarter 3 2015/16

Report by:	Financial Services Manager (Deputy S151) Tracey Bircumshaw
Contact Officer:	Tracey Bircumshaw Financial Services Manager (Deputy S151) 01427 676560 tracey.bircumshaw@west-lindsey.gov.uk
Purpose / Summary:	This report sets out the revenue, capital and treasury management activity during the period 3 April to 31 December 2015.

RECOMMENDATION(S):

a) **That Members accept the forecast out-turn position as at 31 December 2015. (1.1)**

b) **Members note the use of Earmarked Reserves approved by the Director of Resources using Delegated Powers. (2.1)**

c) **Members approve the amendments to the Capital and Revenue budget, including creating budgets for projects funded by grants and not included in the original budget.**

d) **That Members approve the Capital budget carry forwards of £1,337k. (5.1)**

e) **That Members accept the Treasury Management Report and Treasury position for the nine months to 31 December 2015.**

IMPLICATIONS

Legal: None arising as a result of this report.

Financial FIN/113/16

The revenue forecast out-turn position for 2015/16 is estimated to be a surplus of £797k at 31 December 2015. Of this balance £121k has been identified as carry forward requests which will be subject to future approval. Work will continue throughout the year to monitor the situation and to identify ongoing impacts on the Medium Term Financial Plan as part of the Budget Process.

The Capital forecast out-turn position for 2015/16 is estimated to be £2,495k and reflects a surplus variance of £2,101k against the revised budget. Of this balance £1,337k has been requested as carry forwards into next year. A review of further carry forwards will be undertaken throughout the year prior to financing the final out-turn position.

The Treasury Management activities during the reporting period are disclosed in the body of this report.

There have been no breaches of Treasury or Prudential Indicators to report and we again out-perform our benchmark in relation to investment yields.

Staffing: None arising as a result of this report.

Equality and Diversity including Human Rights: None arising as a result of this report.

Risk Assessment: This is a monitoring report only.

Climate Related Risks and Opportunities: This is a monitoring report only.

Title and Location of any Background Papers used in the preparation of this report:

Call in and Urgency:

Is the decision one which Rule 14.7 of the Scrutiny Procedure Rules apply?

i.e. is the report exempt from being called in due to urgency (in consultation with C&I chairman)	**Yes**		**No**	x

Key Decision:

A matter which affects two or more wards, or has significant financial implications	**Yes**		**No**	x

Executive Summary

1. Revenue Budget Monitoring – Forecast out turn for 2015/16

1.1 The forecast Revenue Budget out turn for the 2015/16 financial year is a surplus position of £797k, (£438k previous quarter forecast). The significant variances are;

EXPENDITURE	£000	Direction of Travel
BUDGET UNDERSPENDS		
Salary savings.	-£81	↓
Saving on lease for Beaumont Street car park.	-£21	↔
Homelessness- demand led service, predicting an underspend based on current activity.	-£30	↑
Base budget review after actual outturn savings.	-£80	↔
Business case development.	-£67	↔
Corporate Training.	-£50	↑
Members Costs - IT purchases and training.	-£16	↑
PRESSURES		
Pressure due to essential maintenance at the Leisure Centre.	£10	↓
Increase in buildings insured due to purchases.	£12	↔
Pressure for ill health insurance.	£15	↔
Housing Benefits pressure on postage £12k.	£12	↓
	-£296	

INCOME	£000	Direction of Travel
WINDFALL INCOME/NEW GRANTS		
DCLG - New Burdens grant for Land Charges legal claims.	-£90	↑
Legal shared services refund.	-£21	↔
Unexpected dividend received from Heritable.	-£80	↔
Flood grant relating to spend funded from reserves during 14/15.	-£10	↑
BUDGETED INCOME EXCEEDED		
NNDR Retention due to WLDC - November Forecast.	-£29	↔
Development Control - Increased number of major applications.	-£130	↓
Guildhall Rents - additional income arising from new tenants and including NNDR and service charges in contracts.	-£20	↑
Increased income from season tickets in car parks.	-£12	↑
Trinity Arts Centre - increased sales.	-£27	↑
BUDGETED INCOME NOT ACHIEVED		
Building Control - reduced market activity in development sector and increased private sector competition, unachieved	£15	↔
Taxi Licence income - reduction in number of applications partly due to	£15	↔
Trade Waste - reduction in forecast income due to delay in charging schools.	£10	↑
Reduction in market stallage fee income due to cancelled markets and lower stall numbers.	£15	↔
	-£364	

1.2 Included in the balance above is £121k which has been identified as carry forward requests which will be subject to approval in a future report when the final balances are confirmed.

2. Use and Contribution to Reserves

2.1 The Director of Resources has used delegated powers to approve the use of earmarked reserves under £50,000, totalling £60.5k;

- £8.5k - to fund consultancy services in respect of Gainsborough Investment Plan work – from Outcomes & Outputs of Gainsborough Masterplan reserve.
- £11k – to fund Trinity Street improvements (stage 1) – from Outcomes & Outputs of Gainsborough Masterplan reserve.
- £41k – to cover the cost of agency Commercial Accountant from the Property Asset Fund reserve. This funding was approved as part of the Land and Property investment Programme.

3. Grants

As at 1st April 2015 we have an amount of £436k relating to grants received which have yet to be expended. Budget provision will be created throughout the financial year as required to deliver projects in accordance with grant terms.

3.1 Successful Grant Bids

- £10k – Prevent duty funding from the Home Office.

- £61.9k – Universal credit funding from the DWP to continue the universal credit scheme after a successful pilot period.

- £165k – from Housing Zone and Homes and Community agency to be spent £55k pa over 3 years from 2016/17 – contributing towards the cost of the Spatial Planning Team.

4. Exceptional Items

A planning appeal against the Council in relation to Saxilby has resulted in costs of £75k during 2015/16. A pending appeal for Bardney is anticipated to have a similar outcome.

5. Capital Budget Monitoring - Forecast out turn for 2015/16

5.1 The capital programme forecast spend for the year is £2,495k, which is a variance against revised budget of £2,101k.

Of this £1,337k is requested to be carried forward and represents slippage on the following schemes. Further narrative is included in the Capital Monitoring table at 11.

£200k	- Capital Enhancements to Council Owned Assets
£955.9k	- Land and Property Investment
£51k	- Civic Enhancements
£130.1k	- Strategic Housing-Empty Homes

6. Treasury Management Update – Forecast Out Turn for 2015/16

There have been no breaches of Prudential Indicators.

Interest received has been in excess of the 7 day libid benchmark (0.36%) with an average yield of 1.14%

7. INTRODUCTION

7.1 This is the third in a series of reports for the financial year 2015/16 that gives Members information on differences between the approved budgets and forecast outturn income and expenditure for the year ended 31 March 2016. The financial information has been presented in an income and expenditure layout.

7.2 The capital programme is presented within the body of the report.

7.3 Compared to the approved budget for 2015/16 the Council's forecast outturn revenue position as at 31st December 2015 is a surplus of £797k.

8. REVENUE OUT-TURN (April 2015 to December 2015)

8.1 The forecast revenue out-turn as at 31 December 2015 income and expenditure variances are shown in the table below.

Revenue Budget Monitoring December 2015	2015/16 Original Budget £	2015/16 Revised Budget £	2015/16 Budget Profile to 31 December £	2015/16 Actual to 31 December £	2015/16 Variance to Budget £	2015/16 Forecast Outturn £	2015/16 Outturn Variance £
Income							
Government Grants	(23,090,600)	0	0	0	0	0	0
Service Specific Government Grants	(644,400)	(23,866,800)	(17,273,897)	(18,202,186)	(928,289)	(23,953,040)	(86,240)
Other Grants and Contributions	(7,000)	(7,000)	(5,251)	(30,150)	(24,899)	(7,900)	(900)
Customer and Client Receipts	(2,483,600)	(2,967,370)	(2,273,655)	(2,708,396)	(434,741)	(3,325,832)	(358,462)
Total Income	**(26,225,600)**	**(26,841,170)**	**(19,552,803)**	**(20,940,732)**	**(1,387,929)**	**(27,286,772)**	**(445,602)**
Expenditure							
Employees	9,202,400	9,504,570	7,007,002	7,141,235	134,233	9,372,076	(132,494)
Premises	803,000	831,900	622,698	641,167	18,469	838,600	6,700
Transport	917,100	901,000	642,472	616,821	(25,651)	876,500	(24,500)
Supplies and Services	1,812,900	2,296,800	1,634,142	1,878,684	244,542	2,396,832	100,032
Third Party Payments	1,810,200	2,285,100	1,415,103	1,501,757	86,654	2,148,238	(136,862)
Transfer Payments	22,843,100	23,126,000	17,162,926	17,175,707	12,781	23,127,720	1,720
Total Expenditure	**37,388,700**	**38,945,370**	**28,484,343**	**28,955,371**	**471,028**	**38,759,966**	**(185,404)**
Business Units Controllable Total	11,163,100	12,104,200	8,931,540	8,014,638	(916,902)	11,473,194	(631,006)
Corporate Accounting							
Interest and Investment Income	(210,600)	(210,600)	(225,374)	(225,374)	0	(290,600)	(80,000)
Interest Payable	37,400	41,100	0	46,641	46,641	41,100	0
Parish Council Tax Requirement	1,551,200	1,551,200	1,551,200	1,551,438	238	1,551,400	200
Drainage Board Precept	331,700	331,700	331,700	334,736	3,036	334,740	3,040
Statutory Accounting							
Capital Expenditure Charged to General Fund	2,947,300	4,876,600	0	0	0	4,876,600	0
Support Services	5,292,600	5,423,700	0	66,213	66,213	5,423,700	0
Recharges	(5,292,600)	(5,423,300)	0	(70,442)	(70,442)	(5,423,300)	0
Movement in Reserves							
Transfer To / From General Fund	712,900	509,500	(2,175,290)	316,168	2,491,458	509,500	0
Transfer To / From Specific Reserves	(1,518,800)	(4,059,900)	1,489,698	0	(1,489,698)	(4,134,400)	(74,500)
Net Revenue Expenditure	15,014,200	15,144,200	9,903,474	10,034,018	130,544	14,361,934	(782,266)
Funded By							
Revenue Support Grant	(2,198,100)	(2,198,100)	(1,665,158)	(1,665,158)	0	(2,198,100)	0
Capital Grants and Contributions	(62,000)	(72,000)	(46,505)	72,717	119,222	(72,000)	0
Other Government Grants	(178,600)	(298,600)	(253,966)	(245,733)	8,233	(298,600)	0
Retained NNDR	(3,460,600)	(3,460,600)	1,922,618	1,922,618	0	(3,475,500)	(14,900)
New Homes Bonus	(1,986,000)	(1,986,000)	(1,498,692)	(1,498,692)	0	(1,986,000)	0
Council Tax	(5,400,400)	(5,400,400)	0	(102,128)	(102,128)	(5,400,400)	0
Parish Council Tax requirement	(1,551,200)	(1,551,200)	0	0	0	(1,551,200)	0
Council Tax Freeze Grant	(61,600)	(61,600)	(48,700)	(48,700)	0	(61,600)	0
Share of Council Tax Surplus	(115,700)	(115,700)	0	0	0	(115,700)	0
Total Funded By	(15,014,200)	(15,144,200)	(1,590,403)	(1,565,076)	25,327	(15,159,100)	(14,900)
(Surplus) / Deficit for the Year	0	0	8,313,071	8,468,942	155,871	(797,166)	(797,166)

8.2 The major variances of note are detailed below.

INCOME

Service Specific Government Grants - £90k surplus

DCLG New Burdens grant for Land Charges legal claim of (£90k). There is no current need to increase provision therefore windfall income at this stage.

Customer and Client Receipts - £165k surplus

We have received a legal shared service refund of (£21k), which was a higher amount than anticipated.

Increased sales at the Trinity Arts Centre have resulted in additional income of (£27k).

Development Control forecast income has increased by (£130k) due to a rise in the number of major applications.

Increased income from season tickets in car parks is forecast to be (£12k) above revised budget. This is due to a number of factors, take up by our partners staff upon occupancy at the Guildhall and the impact of the closure of Beaumont Street Car Park.

Guildhall rent – additional income of (£20k) arising from new tenants and including NNDR and service charges in contracts.

Flood grant of (£10k) has been received relating to spend funded from reserves during 2014/15.

Building Control – reduced market activity in development sector and increased private sector competition has resulted in a forecast reduction in income of £15k against revised budget.

Taxi Licence Income – a reduction in the number of applications, partly due to recent policy changes, and the impact of a change in Government policy to issue licences for 3 years rather than annually has resulted in a forecast reduction in income of £15k.

Market Stallage Fees – cancelled markets and lower stall numbers has resulted in a forecast reduction in income of £15k.

Trade waste – a reduction in forecast income of £10k due to delay in charging schools.

EXPENDITURE

Employees - £131k surplus

Salary costs are forecast to be (£81k) less than revised budget. This variance is due a reduction in costs arising from vacancies and maternity leave net of costs of interims. (£19k) of this balance will be subject to a carry forward request.

Corporate training is forecast to be (£50k) below budget.

Premises - £11k surplus

The negotiations with Co-op have been concluded and the lease of Beaumont Street car park was terminated on 14th July 2015. The termination of the lease has resulted in a reduction in costs against budget of (£21k). We have also received a one-off payment of £80.7k which has been treated as a capital receipt.

Essential maintenance at the leisure centre has resulted in spend above budget of £10k.

Supplies and Services - £4k surplus

Housing benefits have incurred additional costs for utilising a virtual mail room for postage (£12k) against the savings of mailroom staffing.

Members costs of IT purchases and training is forecast to be (£16k) below budget. This surplus will be subject to a carry forward request.

Third Party Payments - £150k surplus

There has been an increase in buildings insurance of £12k due to additional property purchases and the insurable valuation.

Ill Health Insurance has increased by £15k against budget due to changes to the LGPS and the rise in state pension age which has increased the cost of ill health early retirements.

Spend on the homelessness service is forecast to be (£30k) less than budgeted. This is a demand led service and the forecast surplus is based on activity to date.

The budget for business case development to support Business Improvement and Transformation and Invest to Earn projects is expected to underspend by (£67k). A review of original proposals will be carried out and considered as part of the 2016/17 Business Planning process. Any savings will require approval to be carried forward for future business case development.

A review of 2014/15 outturn surplus against the 2015/16 base budget to identify ongoing savings, in total this exercise identified (£80k) of savings against 2015/16 budgets.

9. Aged Debt Summary

Aged Debt Summary Quarter 3 Monitoring Report

At the end of December 2015 there was a total of £270k outstanding debt over 90 days. The majority of this debt was over 150 days old and mainly comprised of £12k for Trade Waste, £35k due to Public Protection, £42k for Housing Benefit Overpayments, £64k for Housing, £59k for Property and Assets.

An exercise of review of outstanding aged debt is currently being undertaken by Financial Services in co-operation with service managers.

Month	90 – 119 days	120 – 149 days	150+ days	Total
April	1,382.35	4,896.68	168,868.58	175,147.61
May	6,724.54	1,318.43	169,553.39	177,596.36
June	66,242.51	5,971.53	167,523.18	239,737.22
July	82,585.18	29,359.38	184,589.04	296,533.60
August	13,904.07	75,538.58	197,214.99	286,657.64
September	64,730.71	14,077.00	200,876.47	279,684.18
October	55,603.00	53,426.89	205,963.20	314,993.09
November	21,581.76	49,580.40	211,837.82	282,999.98
December	12,845.33	11,587.19	245,259.16	269,691.68

10. CHANGES TO THE ORGANISATION STRUCTURE

Changes to the establishment are made under Corporate Delegation by the Chief Executive and S151 Officer.

Spatial Planning Team – A restructure within the Growth Team to bring together the key technical skills to deliver on some of WLDC's key strategic objectives around Housing Zones, Local Development Orders (LDO's) and Town Planning. The team is for a fixed period of up to 3 years with £165k external funding being secured from the Housing Communities Agency as a contribution to staffing costs, In addition to £150k to support staffing and other costs associated with the delivery of the LDO's.

11. Capital Programme Forecast Out turn

11.1 The Capital Programme 2015/16 was approved at Council on 2nd March 2015 and totalled £11,353k.

11.2 The capital programme forecast spend for the year is £2,450k, which is a variance against revised budget of £2,146k.

11.3 Of this £1,337k is requested to be carried forward and represents slippage on the following schemes.

£200k - Capital Enhancements to Council Owned Assets
£955.9k - Land and Property Investment

£51k - Civic Enhancements
£130.1k - Strategic Housing-Empty Homes

The remainder being schemes which are no longer required.

11.4 Amendment to the Capital Programme

A new capital investment of £16.5k is required for the Committee Admin System. This has been approved by Entrepreneurial Board members and is funded from revenue budget Business Improvement and transformation.

11.5. Property Acquisitions to Quarter 3

There have been no property acquisitions during quarter 3.

11.6 Capital Receipts to Quarter 3 - £1.069m

We have received a one-off payment of £81k in relation to a lease settlement agreement

£678k has been received from CAN for balances on the Community Asset Fund held at the end of our contract.

£56k has been received in repayments of Disabled Facilities Grants

£254k has been received from ACIS in accordance with our stock transfer agreement.

The forecast capital out-turn as at 31 December 2015 and capital programme variances are shown in the table below.

CAPITAL INVESTMENT PROGRAMME 2015/16 (PAGE 1 OF 2)

SCHEME	Original Budget 2015/16 £	Revised Budget 2015/16 £	Actual to 30 Dec 15 2015/16 £	Commit-ments to 30 Dec 15 2015/16 £	Budget to Period 2015/16 £	Variance To Period 2015/16 £	Forecast Outturn 2015/16 £	Outturn Variance 2015/16 £	Reason
CURRENT PROGRAMME									
Capital Enhancements to Council Owned Assets incl Energy Efficiency Measures	632,850	450,750	85,677	62,248	338,108	(190,183)	250,750	(200,000)	Delay's in acquiring condition surveys and accessing data has resulted in slip on repairs and energy efficiency works. TAC works to be performed in May/June 2016, Car Park ticket machines are currently being tendered, Heapham Road Recycling monies are being offered to incentivise rental of land (infrastructure works) £200k to be carried forward due to slippage
Civic Enhancements	106,000	121,000	0	0	106,000	(106,000)	70,000	(51,000)	Conference system scheduled to be installed and operational by end of March 2016. Work commencing on delivery and configuration of Committee Admin System. Civic transport report to be prepared for March P&R Committee, c/fwd of budget requested.
Land and Property Investment	1,555,920	955,920	0	0	717,036	(717,036)	0	(955,920)	Negotiations for key capital projects remain ongoing however will not be concluded in this financial year. The budget is identified for potential acquisitions and capital works and therefore a carry forwards is requested.
Gainsborough Growth Fund	347,940	368,840	50,985	0	237,676	(186,691)	368,840	0	Since the Scheme started in Nov 2014 the total grants awarded totalled up £311k of which £76k has been released and claimed back by the applicants (£25k in 2014/15). The next Panel is scheduled for the 18th Jan and currently there are two applications lined up for discussion (requested amount £25k each)
Private Sector Renewal - DFG's	410,500	361,870	208,986	0	307,915	(98,929)	361,870	0	All allocated capital will be spent in year in line with the requirements for DFGs. The pipeline of allocated cases covers the amount of grant yet to be spent.
Strategic Housing - Empty Homes	420,130	482,130	202,178	30,891	361,644	(128,575)	352,070	(130,060)	£50k to be carried forward for young person accommodation final payment. Remaining property works to be completed in year and any carry forward to be reallocated to private sector renewal project for 16/17.
Independent Living	62,000	53,220	36,869	0	46,505	(9,636)	53,220	0	All allocated capital will be spent in year in line with the requirements for independent living.
Housing and Infrastructure Investment	4,900,000	0	0	0	0	0		0	
Commercial Loan	0	350,000	0	0	0	0	0	(350,000)	This is no longer required
Rural Broadband (BDUK)	555,000	555,000	0	0	416,304	(416,304)	555,000	0	Delivery of the scheme is almost finalised and discussions are ongoing in relation to the contribution level.
Rural Broadband (Quickline)	105,000	105,000	35,000	0	35,000	0	35,000	(70,000)	3rd of the 5 Tranche 3 payments, for £35k, has been made this year. This leaves the final 2 remaining. Quickline have now confirmed in writing they do not require the final two £35k tranches. Therefore there will be a budget underspend

CAPITAL INVESTMENT PROGRAMME 2015/16 (PAGE 2 OF 2)

SCHEME	Original Budget 2015/16	Revised Budget 2015/16	Actual to 30 Dec 15 2015/16	Commit-ments to 30 Dec 15 2015/16	Budget to Period 2015/16	Variance To Period 2015/16	Forecast Outturn 2015/16	Outturn Variance 2015/16	Reason
	£	£	£	£	£	£	£	£	
CURRENT PROGRAMME									
Website replacement (CMS)	75,000	75,000	0	0	75,000	(75,000)	75,000	0	There have been delays during the procurement & evaluation process and the contracts as at 2/10/15 have not been signed. Whilst we know the project and software costs are £16620, there will be more development costs required for integrations with 3rd party suppliers. Hosting has been costed at £6960 pa, but it is the intention to agree that the maintenance starts on 1 April each year, therefore the first hosting costs is likely to be approximately 15 months worth (est. £8700), met from the project costs as the existing revenue costs have been used to pay the current year's maintenance to the existing supplier. Therefore I have left the out-turn at £75000, but this will be reduced once the project progresses. By the next quarter report, the figures should all be confirmed.
Replacement Refuse Freighters	129,000	108,800	54,650	670	81,611	(26,291)	108,000	(800)	£55k spent on TLY replacement (£8k less than forecast), £35k to replace KWZ and £18k to replace bulky waste vehicle
Caistor Townscape Heritage Scheme	25,000	25,000	0	0	25,000	(25,000)	0	(25,000)	This is no longer required
Scotter - River Eau Flood Alleviation Scheme	30,000	30,000	0	0	30,000	(30,000)	30,000	0	Awaiting invoice from EA
Parish Council Loan - Big Society	300,000	300,000	0	0	225,030	(225,030)	0	(300,000)	Loan offer not accepted - Budget no longer required
Desktop Refresh/SAN and SQL replacement	18,000	18,000	(15)	0	13,503	(13,518)	0	(18,000)	One of the projects was delivered in a different way which resulted in a £8k saving, £10k no longer required
Financial Ledger Suite	0	40,600	30,593	10,007	38,700	1,900	40,600	0	Testing of the intelligent scanning is underway and go live scheduled for February 2016. The Bank Reconciliation module is underdevelopment and is scheduled to go live February 2016
CCTV System Upgrade	0	180,000	0	0	180,000	(180,000)	180,000	0	Procurement of new CCTV system has completed evaluation process and preparing to award the contract. Delivery timescales are still on track with a completion date by the end of March 2016. As the contract is awarded and upgrade works begin we will continue to explore opportunities to reduce the costs of upgrade works whilst maintaining required quality and system specification.
Customer Self Service Pod	0	15,000	15,000	0	15,000	0	15,000	0	Project completed
Total Investment	**9,672,340**	**4,596,130**	**719,923**	**103,816**	**3,250,032**	**(2,426,293)**	**2,495,350**	**(2,100,780)**	

The forecast underspend on the Capital Programme of £2,101K includes £1,337k of proposed carry forwards into 2016/17 (see 5.1).The details of which are included in the narrative for each scheme in the table above. Remaining forecast underspend on the Capital Programme for 2015/16 is £764k.

12. Treasury Management Quarter 3 April – 31 December 2015

The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that members be updated on treasury management activities regularly (TMSS, annual and midyear reports). This report, therefore, ensures this Council is implementing best practice in accordance with the Code.

12.1 Economic Background

UK GDP growth rates in 2013 of 2.2% and 2.9% in 2014 were the strongest growth rates of any G7 country; the 2014 growth rate was also the strongest UK rate since 2006 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% (+2.9% y/y) though there was a slight increase in quarter 2 to +0.5% (+2.3% y/y) before falling back to +0.4% (+2.1% y/y) in quarter 3. Growth is expected to improve to about +0.6% in quarter 4 but the economy faces headwinds for exporters from the appreciation of Sterling against the Euro and weak growth in the EU, China and emerging markets, plus the dampening effect of the Government's continuing austerity programme, although the pace of reductions was eased in the November autumn statement.

Despite these headwinds, the Bank of England November Inflation Report included a forecast for growth over the three years of 2015, 2016 and 2017 to be around 2.7%, 2.5% and 2.6% respectively, although statistics since then would indicate that an actual outturn for 2015 is more likely to be around 2.2%. Nevertheless, this is still moderately strong growth which is being driven mainly by strong consumer demand as the squeeze on the disposable incomes of consumers has been reversed by a recovery in wage inflation at the same time that CPI inflation has fallen to, or near to, zero over the last quarter. Investment expenditure is also expected to support growth.

The November Bank of England Inflation Report forecast was notably subdued with inflation barely getting back up to the 2% target within the 2-3 year time horizon. However, with the price of oil taking a fresh downward direction and Iran expected to soon re-join the world oil market after the impending lifting of sanctions, there could be several more months of low inflation still to come, especially as world commodity prices have generally been depressed by the Chinese economic downturn.

There are, therefore, considerable risks around whether inflation will rise in the near future as strongly as previously expected; this will make it more difficult for the Bank of England to make a start on raising Bank Rate as soon as had been expected in early 2015, especially given the subsequent major concerns around the slowdown in Chinese growth, the knock on impact on the earnings of emerging countries from falling oil and commodity prices, and the volatility we have seen in equity and bond markets during 2015, which could potentially spill over to impact the real economies rather than just financial markets.

The American economy made a strong comeback after a weak first quarter's growth at +0.6% (annualised), to grow by no less than 3.9% in quarter 2 of 2015 before easing back to +2.0% in quarter 3. While there had been confident expectations during the summer that the Fed. could start increasing rates at its meeting on 17 September, downbeat news during the summer about Chinese and Japanese growth and the knock on impact on emerging countries that are major suppliers of commodities, was cited as the main reason for the Fed's decision to pull back from making that start. The nonfarm payrolls figures for September and revised August, issued on 2 October, were also disappointingly weak. However, since then concerns on both the domestic and international scene have abated and so the Fed made its long anticipated start in raising rates at its December meeting.

In the 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 was intended to run initially to September 2016. At the ECB's December meeting, this programme was extended to March 2017 but was not increased in terms of the amount of monthly purchases. The ECB also cut its deposit facility rate by 10bps from -0.2% to -0.3%. This programme of monetary easing has had a limited positive effect in helping a recovery in consumer and business confidence and a start to some improvement in economic growth. GDP growth rose to 0.5% in quarter 1 2015 (1.3% y/y) but has then eased back to +0.4% (+1.6% y/y) in quarter 2 and to +0.3% (+1.6%) in quarter 3. Financial markets were disappointed by the ECB's lack of more decisive action in December and it is likely that it will need to boost its QE programme if it is to succeed in significantly improving growth in the EZ and getting inflation up from the current level of around zero to its target of 2%.

12.2 Interest Rate Forecast

The Council's treasury advisor, Capita Asset Services, has provided the following forecast:

	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
Bank rate	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.50%	1.50%	1.75%	1.75%	2.00%	2.00%	2.00%
5yr PWLB rate	2.40%	2.60%	2.70%	2.80%	2.80%	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%
10yr PWLB rate	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%
25yr PWLB rate	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%	4.20%	4.30%	4.30%	4.40%	4.40%	4.40%	4.50%
50yr PWLB rate	3.60%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.20%	4.20%	4.30%	4.30%	4.30%	4.40%

Capita Asset Services undertook a review of its interest rate forecasts on 9 November after the August Bank of England Inflation Report. This latest forecast includes no change in the timing of the first increase in Bank Rate as being quarter 2 of 2016. With CPI inflation now likely to be at or near zero for most of 2015 and into early 2016, it is currently very difficult for the MPC to make a start on increasing Bank Rate. In addition, the Inflation Report forecast was also notably subdued with inflation barely getting back up to the 2% target within the 2-3 year time horizon. Despite average weekly earnings excluding bonuses hitting 2.5% in quarter 3, this has subsided to 1.9% and is unlikely to provide ammunition for the MPC to take action to raise Bank Rate soon as labour productivity growth would mean that net labour unit costs are still only rising by less than 1% y/y. The significant appreciation of Sterling against the Euro in 2015 has also acted to dampen UK growth while volatility in financial markets since the Inflation Report has resulted in volatility in equity and bond prices and bond yields (and therefore PWLB rates). But CPI inflation will start sharply increasing around mid-year 2016, once initial falls in fuel and commodity prices fall out of the 12 month calculation of inflation; this will cause the MPC to take a much keener interest in the forecasts for inflation over their 2-3 year time horizon from about mid-year.
The Governor of the Bank of England, Mark Carney, has repeatedly stated that increases in Bank Rate will be slow and gradual after they do start. The MPC is concerned about the impact of increases on many heavily indebted consumers, especially when average disposable income is only just starting a significant recovery as a result of recent increases in the rate of wage inflation, though some consumers will not have seen that benefit come through for them.

12.3 Annual Investment Strategy

The Treasury Management Strategy Statement (TMSS) for 2015/16, which includes the Annual Investment Strategy, was approved by the Council on 2 March 2015. It sets out the Council's investment priorities as being:

- Security of capital;
- Liquidity; and
- Yield

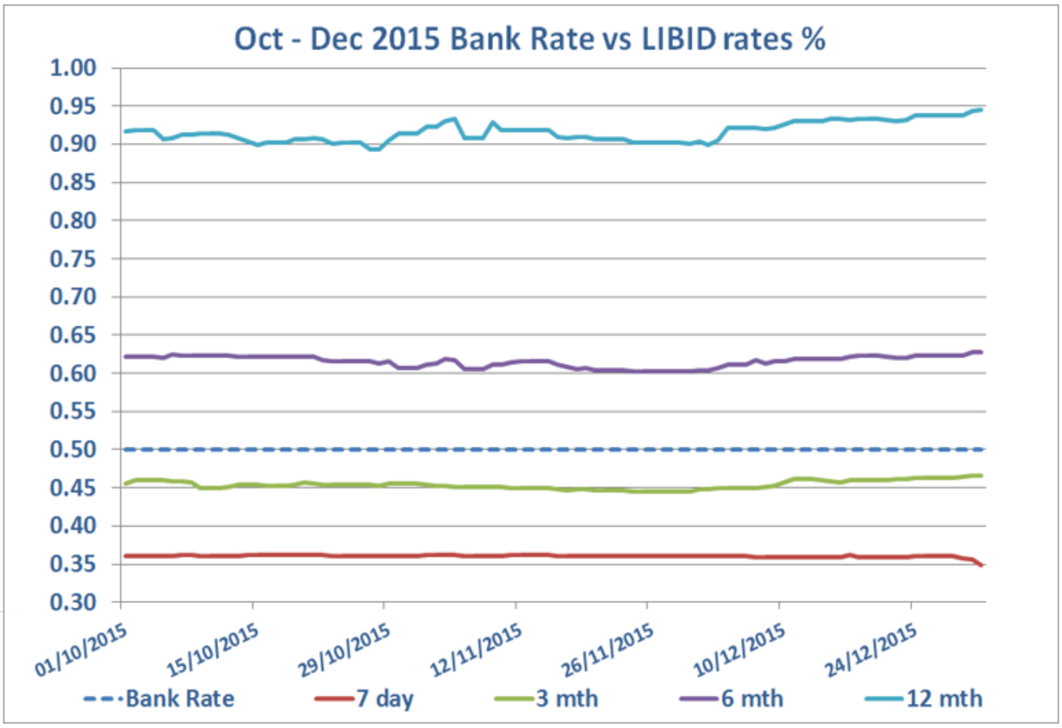
The Council will also aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in periods up to 12 months with highly credit rated financial institutions, using our suggested creditworthiness approach, including a minimum sovereign credit rating, and Credit Default Swap (CDS) overlay information.

Officers can confirm that the approved limits within the Annual Investment Strategy were not breached during the quarter ended 31st December 2015.

Investment rates available in the market have been broadly stable during the quarter and have continued at historically low levels as a result of the ultra-low Bank. The average level of funds available for investment purposes during the quarter was £27.2m. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the Capital Programme. The Council holds £17m core cash balances for investment purposes (i.e. funds available for more than one year).

Investment performance for period ended 31st December 2015

Benchmark	Benchmark Q1	Actual P1	Interest Earned P1 £	Benchmark Q2	Actual Q2	Interest Earned Q2 £	Benchmark Q3	Actual Q3	Interest Earned Q3 £
Overnight	0.35%	0.42%	9,272	0.35%	0.43%	14,853	0.36%	0.44%	11,605
7 day	0.36%	0.94%	3,960	0.35%	0.94%	5,121	0.36%	1.31%	11,854
1 month	0.36%	-	-	0.37%	-	-	0.38%	-	-
3 month	0.40%	0.55%	1,266	0.42%	-	-	0.45%	0.60%	-
6 month	0.51%	0.73%	1,559	0.55%	0.78%	3,362	0.61%	0.71%	17,218
12 month	0.82%	1.00%	22,032	0.88%	1.01%	17,745	0.92%	0.99%	10,452
Other	-	5.47%	27,262	-	6.06%	30,551	-	5.28%	26,617
Total			**65,350**			**71,633**			**77,746**



As illustrated, the Council continues to outperform the benchmark. The Council's budgeted investment return for 2015/16 is £0.200m, and performance for the year to date is above budget.

The Council held £24.8m of investments as at 31st December 2015 (£24.6m Qtr. 2 and £23.7m Qtr. 1) and the investment portfolio yield for the period is 1.14% (1.15% Qtr. 2 and 1.17% Qtr. 1), the improvement reflects the investment in the Local Authority Property Fund.

The annualised weighted average rate of interest for Q3 is 1.14% has been achieved and compares to the benchmark 7 day libid of 0.36%.

Investment in Local Authority Property Fund

The Council now has £2m invested in the CCLA Property Fund. Interest is receivable on a quarterly basis. Interest received can be seen in the table above in the section marked 'other'.

Investment Counterparty criteria

The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

The Chief Financial Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the first two months of 2015/16.

Treasury Officers continue to mitigate investment risk in accordance with Treasury Management Practices.

Changes in credit rating methodology

The main rating agencies (Fitch, Moody's and Standard & Poor's) have, through much of the financial crisis, provided some institutions with a ratings "uplift" due to implied levels of sovereign support. Commencing in 2015, in response to the evolving regulatory regime, all three agencies have begun removing these "uplifts" with the timing of the process determined by regulatory progress at the national level. The process has been part of a wider reassessment of methodologies by each of the rating agencies. In addition to the removal of implied support, new methodologies are now taking into account additional factors, such as regulatory capital levels. In some cases, these factors have "netted" each other off, to leave underlying ratings either unchanged or little changed. A consequence of these new methodologies is that they have also lowered the importance of the (Fitch) Support and Viability ratings and have seen the (Moody's) Financial Strength rating withdrawn by the agency.
In keeping with the agencies' new methodologies, the credit element of our own credit assessment process now focuses solely on the Short and Long Term ratings of an institution. While this is the same process that has always been used by Standard & Poor's, this has been a change to the use of Fitch and Moody's ratings. It is important to stress

that the other key elements to our process, namely the assessment of Rating Watch and Outlook information as well as the Credit Default Swap (CDS) overlay have not been changed.

The evolving regulatory environment, in tandem with the rating agencies' new methodologies also means that sovereign ratings are now of lesser importance in the assessment process. Where through the crisis, clients typically assigned the highest sovereign rating to their criteria the new regulatory environment is attempting to break the link between sovereign support and domestic financial institutions. While this authority understands the changes that have taken place, it will continue to specify a minimum sovereign rating of ….. This is in relation to the fact that the underlying domestic and where appropriate, international, economic and wider political and social background will still have an influence on the ratings of a financial institution.

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

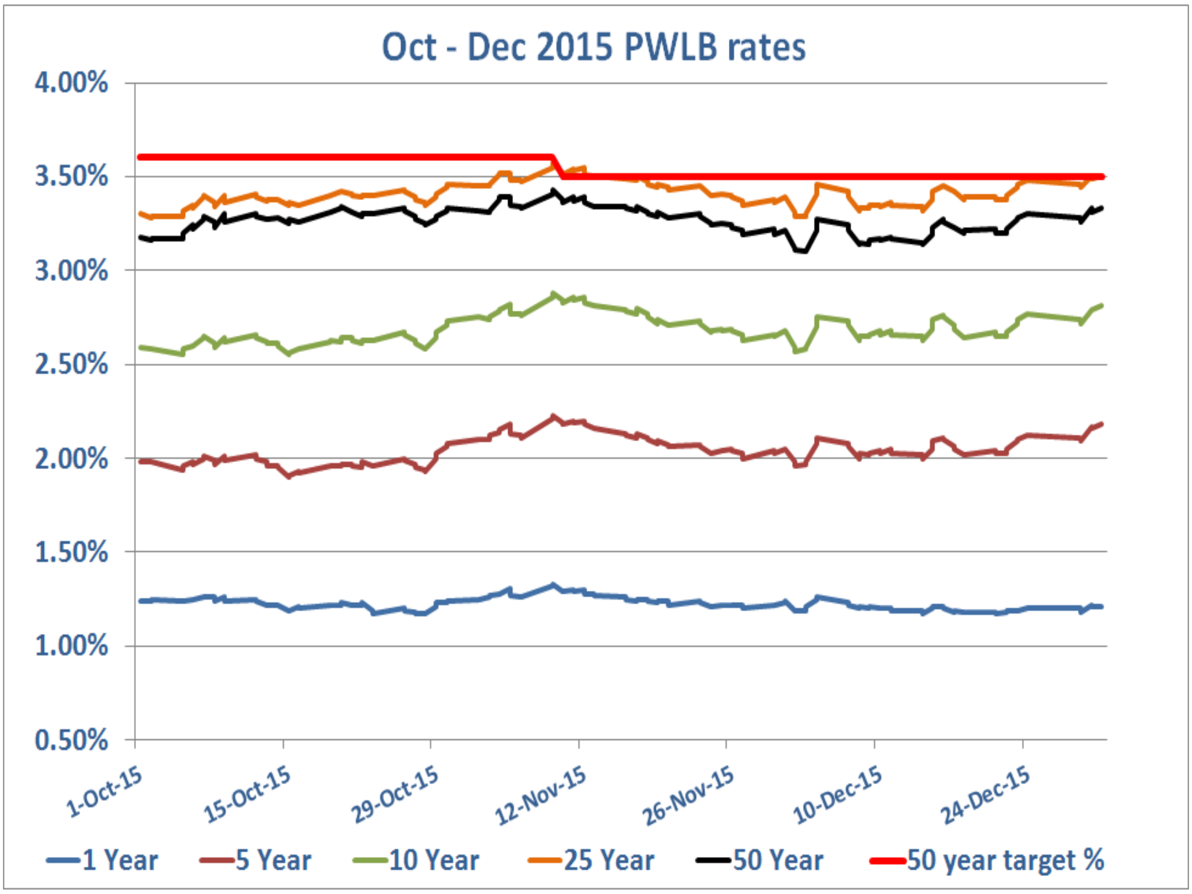
12.4 Borrowing

As outlined below, the general trend in PWLB rates has been an increase in interest rates during the first quarter followed by a fall during the second quarter: in the third quarter rates have been volatile with no overall direction. The 50 year PWLB target (certainty) rate for new long term borrowing, for the quarter ending 31st December, fell slightly during the quarter from 3.60% to 3.50% after the November Bank of England Inflation report.

During the nine months to 31 December, no borrowing – either long or short term was undertaken. However, credit arrangements such as finance leases are classified as borrowing under the capital control arrangements for local authorities. The Council procures replacement vehicles and certain other assets (telephone system, fuel tanks) through finance lease arrangements which count as credit other long term liabilities in the Council's accounts. The operational limit that has been approved for 2015/16 is £0.680m (relates to finance lease principal).

PWLB certainty rates quarter ended 31st December 2015

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.17%	1.90%	2.55%	3.28%	3.10%
Date	23/10/2015	15/10/2015	05/10/2015	02/10/2015	03/12/2015
High	1.33%	2.23%	2.88%	3.57%	3.43%
Date	09/11/2015	09/11/2015	09/11/2015	09/11/2015	09/11/2015
Average	1.23%	2.05%	2.69%	3.41%	3.27%



The Council has not borrowed in advance of need during the quarter ending 31 December 2015 and has not borrowed in advance in all of 2015/16.

12.5 Compliance with Treasury and Prudential Limits

It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. The Council's approved Treasury and Prudential Indicators are included in the approved TMSS.

During the financial year to date the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices. The prudential and treasury Indicators are shown in Appendix 1.

The Council's Capital Position (Prudential Indicators)
This part of the report is structured to update:

- The Council's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

Prudential Indicator for Capital Expenditure
This table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget and draws together the main strategy elements of the capital expenditure plans (above), highlighting the original capital programme, and the expected financing arrangements of this capital expenditure. Any borrowing need increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR).

Capital Expenditure	**2015/16 Original Estimate £'000**	**2015/16 Revised Estimate Q3 £'000**
Total Unsupported spend	9,689	2,450
Financed by:		
Capital receipts	1,249	0.875
Capital grants	743	0.680
Revenue	2,797	0.791
S106	0	0.104
Leases	0	0
Total financing	4,789	2,450
Borrowing need	4,900	0

There have been no changes to the Treasury or Prudential Indicators.

The Director of Resources reports that no difficulties are envisaged for the current or future years in complying with prudential indicators.

	Original £'000	P1 £'000	Q2 £'000	Q3 £'000
Treasury Indicators				
Authorised limit for external debt	12,500	12,500	12,500	12,500
Operational boundary for external debt	608	608	608	608
External Debt	9,900	0	0	0
Long term Leases	608	608	364	342
Investments	16,887	20,600	24,600	24,800
Net Borrowing	**6,379**	**19,992**	**24,236**	**24,458**
Prudential Indicators				
Capital Expenditure	9,689	3,364	4,144	2,450
Capital Financing Requirement (CFR)*	6,260	6,260	1,429	1,407
Annual change in CFR*	4,693	4,693	-202	-228
In year borrowing requirement	4,900	4,900	0	0
Under/(over)borrowing	-3,935	-3,935	1,065	1,065
Ratio of financing costs to net revenue stream*	1.63%	1.63%	1.43%	1.23%
Incremental impact of capital investment decisions:				
Increase in Council Tax (band change per annum)	£0.98	£0.98	£0.47	£0.24

CAPITA
Treasury solutions

Asset Services

West Lindsey District Council

Monthly Investment Analysis Review

December 2015

West Lindsey District Council

Monthly Economic Summary

General Economy

December was dominated by anticipation regarding the outcome of the Federal Reserve meeting. In a watershed moment for the global economy, the first hike in nearly a decade was reported, pushing several months of uncertainty to one side.

The UK services PMI grew for a second month running, reaching 55.9 last month, the fastest pace of expansion since July. This rise from October's 54.9 is set to point towards stronger economic growth in the upcoming months.

For the first time since July, UK CPI returned to positive territory, rising 0.1% annually in November. The ONS numbers reflected rises in transport costs and alcohol and tobacco prices which exerted upside price pressures; however this was slightly offset by a dip in clothing prices, leaving the month-on-month CPI figure standing at 0% for November. With the Brent Crude oil benchmark hovering around $37 a barrel, analysts warn that this positive inflation figure is unlikely to be permanent.

Unemployment within the UK fell to its lowest since the three months to January 2006, with the unemployment rate dwindling to 5.2% in October, confounding forecasts of 5.3%. Nonetheless, in the month alone, regular wages rose by 1.7%, the slowest increase since January. Despite this, with inflation hovering around the zero-mark, rising earnings are expected to translate into notable increases in living standards.

Across "The Pond", US non-farm payrolls increased solidly in November, by 211,000, with the unemployment rate remaining at 5%, the lowest figure for seven-and-a-half years. Data from September and October was revised to show an additional 35,000 more jobs created than previously reported.

Following the robust non-farm data, markets stood prepared and priced in their outlook of a December rate hike, resulting in stocks rising sharply prior to the Fed meeting. The outcome of the much-anticipated meeting was in line with expectations, with the target Federal Funds rates finally increased, by a unanimous vote in favour, for the first time since 2006, by 25bps to 0.25%-0.50%. The subsequent statement revealed the opinion that the economy had expanded "at a moderate pace", alongside considerable improvements in the US labour market this year. Immediately following the announcement of the hike, the US Dollar appreciated further against Sterling, with the rate falling back below the $1.50 level. Many of the European stock markets welcomed the rate rise, including the FTSE 100 index, which rose by 1.1% following the news.

The third and final estimate of UK GDP for Q3 revealed that economic growth was slower than previously thought, mainly weighed down by a worse-than-expected performance in the dominant services sector, which accounts for well over 70% of UK economic activity. The ONS revised the Q3 GDP figure from 0.5% to 0.4%, alongside a slowdown of the annual growth, from the previous estimate of 2.3% to 2.1%, the weakest it has been since Q3 2013. Despite the UK being the fastest growing economy in the G7 last year, it is evident that risks to the economy still remain.

UK retail sales outperformed forecasts in November, mainly driven by the sales on Black Friday. Alongside a 1.7% m/m increase from October, sales grew 5% compared with the same time last year, offering evidence that strong consumer confidence, alongside higher employment and rising real wage growth, has contributed to robust retail sales figures. Despite this, data from GfK has disclosed that although confidence amongst consumers in the UK has edged up from a 6-month low, households are more concerned about the economy than they were in December 2014.

The disappointing figures for November's public finances lead analysts to believe that George Osborne will find difficulty in meeting the OBR's public borrowing forecast for the fiscal year. With public sector net borrowing (excluding public sector banks) reaching a total of £14.2bn, expectations of £11.9bn were greatly exceeded, as was last year's November total of £12.9bn, it seems almost impossible now for the Chancellor to meet the forecasts set.

Currency

Sterling opened the month at $1.506 against the US dollar and closed at $1.483. Against the Euro, Sterling opened at €1.424 and closed at €1.359.

Forecast

Capita Asset Services did not alter its forecast this month. Capita Asset Services expects the first rate hike to come in the second quarter of 2016. Capital Economics left their forecast unchanged in December. They expect the first Bank Rate increase to come in Q2 2016.

Bank Rate	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
Capita Asset Services	0.50%	0.75%	0.75%	1.00%	1.00%
Capital Economics	0.50%	0.75%	0.75%	1.00%	1.00%

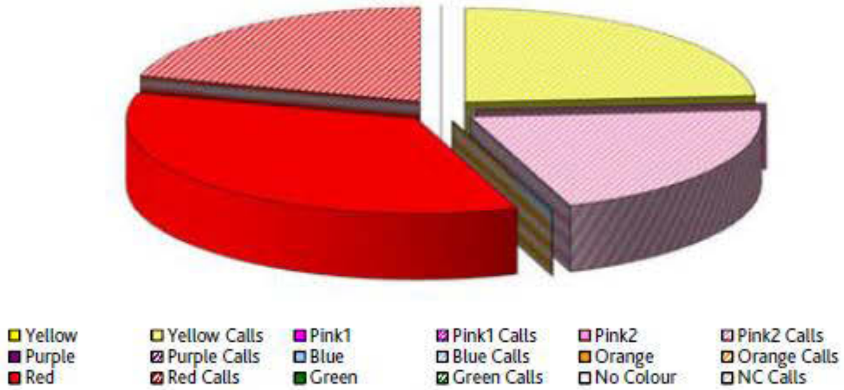
West Lindsey District Council

Current Investment List

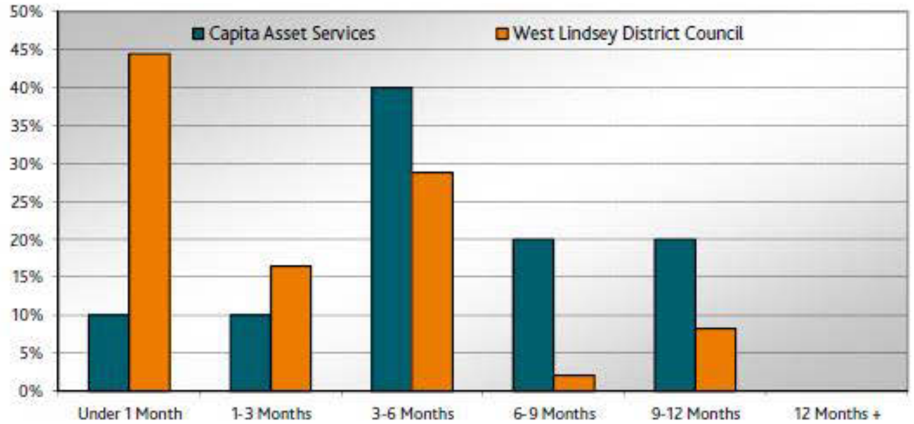
Borrower	Principal (£)	Interest Rate	Start Date	Maturity Date	Lowest Long Term Rating	Historic Risk of Default
MMF Insight	3,800,000	0.46%		MMF	AAA	0.000%
EMMF Insight Liquidity Plus	5,000,000	1.31%		EMMF	AAA	0.000%
MMF CCLA	2,000,000	0.45%		MMF	AAA	0.000%
Lloyds Bank Plc	1,000,000	1.10%	14/04/2015	10/02/2016	A	0.007%
Standard Chartered Bank	2,000,000	0.73%	21/08/2015	19/02/2016	A+	0.008%
Lloyds Bank Plc	1,000,000	0.90%	19/08/2015	19/02/2016	A	0.008%
Goldman Sachs International Bank	2,000,000	0.73%	16/10/2015	15/04/2016	A	0.018%
Santander UK Plc	2,000,000	1.05%		Call120	A	0.020%
Lloyds Bank Plc	1,000,000	0.75%	02/11/2015	03/05/2016	A	0.021%
Nationwide Building Society	1,000,000	0.66%	02/11/2015	03/05/2016	A	0.021%
Santander UK Plc	1,000,000	1.15%		Call180	A	0.031%
Lloyds Bank Plc	500,000	1.00%	10/09/2015	12/09/2016	A	0.043%
Santander UK Plc	2,000,000	1.30%		Call365	A	0.062%
Borrower - Funds	**Principal (£)**	**Interest Rate**	**Start Date**	**Maturity Date**		
CCLA	2,000,000					
Total Investments	**£26,300,000**	**0.83%**				

West Lindsey District Council

Portfolio Composition by Capita Asset Services' Suggested Lending Criteria



Y	Pi1	Pi2	P	B	O	R	G	N/C
1	1.25	1.5	2	3	4	5	6	7
Up to 5yrs	Up to 5yrs	Up to 5yrs	Up to 2yrs	Up to 1yr	Up to 1yr	Up to 6mths	Up to 100days	No Colour



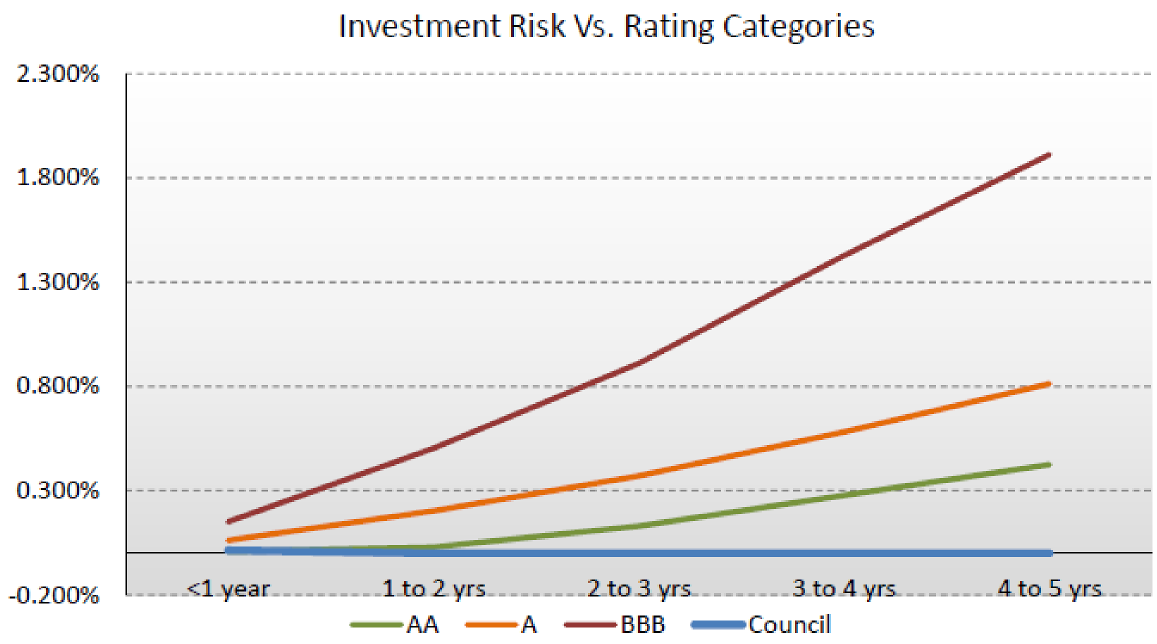
Portfolios weighted average risk number = 3.33

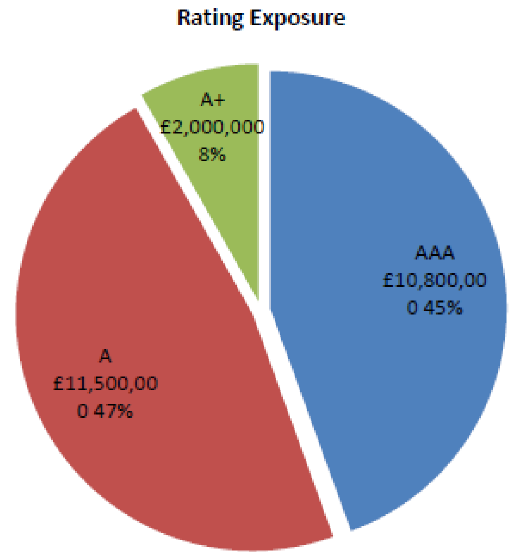
WARoR = Weighted Average Rate of Return
WAM = Weighted Average Time to Maturity

	% of Portfolio	Amount	% of Colour in Calls	Amount of Colour in Calls	% of Call in Portfolio	WARoR	WAM	WAM at Execution	Excluding Calls/MMFs/EMMFs WAM	Excluding Calls/MMFs/EMMFs WAM at Execution
Yellow	23.87%	£5,800,000	100.00%	£5,800,000	23.87%	0.46%	0	0	0	0
Pink1	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
Pink2	20.58%	£5,000,000	100.00%	£5,000,000	20.58%	1.31%	0	0	0	0
Purple	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
Blue	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
Orange	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
Red	55.56%	£13,500,000	37.04%	£5,000,000	20.58%	0.94%	143	216	92	208
Green	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
No Colour	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
	100.00%	**£24,300,000**	**65.02%**	**£15,800,000**	**65.02%**	**0.90%**	**79**	**120**	**92**	**208**

West Lindsey District Council

Investment Risk and Rating Exposure





Historic Risk of Default

Rating/Years	<1 year	1 to 2 yrs	2 to 3 yrs	3 to 4 yrs	4 to 5 yrs
AA	0.007%	0.029%	0.130%	0.278%	0.425%
A	0.062%	0.202%	0.370%	0.581%	0.813%
BBB	0.150%	0.502%	0.910%	1.428%	1.912%
Council	0.014%	0.000%	0.000%	0.000%	0.000%

Historic Risk of Default

This is a proxy for the average % risk for each investment based on over 30 years of data provided by Fitch, Moody's and S&P. It simply provides a calculation of the possibility of average default against the historical default rates, adjusted for the time period within each year according to the maturity of the investment.

Chart Relative Risk

This is the authority's risk weightings compared to the average % risk of default for "AA", "A" and "BBB" rated investments.

Rating Exposures

This pie chart provides a clear view of your investment exposures to particular ratings.

West Lindsey District Council

Monthly Credit Rating Changes

FITCH

Date	Update Number	Institution	Country	Rating Action
09/12/2015	1404	UBS Ltd, UBS AG	UK, Switzerland	The Outlook on both bank Long Term rating was changed from 'Stable' to 'Positive'.
09/12/2015	1405	Deutsche Bank AG	Germany	The Long Term Rating on Deutsche Bank was downgraded from 'A' to 'A-'. The Viability Rating was downgraded from 'a' to 'a-'. The Short Term Rating was affirmed at 'F1'. The Outlook on its Long Term rating was changed from 'Negative' to 'Stable'.

West Lindsey District Council

Monthly Credit Rating Changes
MOODY'S

Date	Update Number	Institution	Country	Rating Action
15/12/2015	1407	The Royal Bank of Scotland plc, National Westminister Bank Plc, The Royal Bank of Scotland Plc	UK	Outlook on the banks' long term rating was changed from 'Stable' to 'Positive'.

Monthly Credit Rating Changes

S&P

Date	Update Number	Institution	Country	Rating Action
03/12/2015	1402	Skandinaviska Enskilda Banken AB, Swedbank AB	Sweden	Swedbank AB: Long term and short term ratings raised to 'AA-/A-1+' from 'A+/A-1'. Skandinaviska Enskilda Banken AB: Long term and short term ratings have been affirmed at 'A+/A-1'
03/12/2015	1403	BNP Paribas Fortis, BNP Paribas, Credit Agricole Corporate and Investment Bank, Credit Agricole SA, Societe Generale, ABN AMRO Bank N.V., Rabobank, UBS AG, UBS Ltd	Belgium, France, Netherlands, Switzerland	Multiple outlook changes but no colour changes
11/12/2015	1406	Bank of Montreal, Bank of Nova Scotia, Canadian Imperial Bank of Commerce, Royal Bank of Canada, Toronto Dominion Bank, National Bank of Canada	Canada	Outlooks revised on Canadian banks that is viewed as having either 'high' or 'moderate' systematic importance to stable from negative. The credit ratings on the banks remain unchanged.

Detailed economic commentary on developments during quarter ended 31st December 2015

Capita Asset Services note: this section has been provided for clients who prefer a more detailed economic commentary than that provided in the main body of this template in section 1. This section has been provided by Capital Economics and therefore includes their views and opinions of future trends and events.

- During the quarter ended 31st December 2015:
    - The economic recovery regain some momentum during Q4 2015 after a disappointing Q3 2015;
    - Household spending growth strengthened;
    - Wage growth slowed despite further falls in unemployment;
    - The UK came out of its brief dip into deflation;
    - The prospect of a rate hike before mid-2016 remained unlikely;
    - The Fed made a start in raising interest rates, and the ECB loosened policy;
    - The Chancellor smoothed out his fiscal austerity plans over the term of this Parliament.

- The economic recovery was shown to have slowed by more than previously thought in Q3 2015 (quarter ended 30.9.15), with real GDP growth decelerating from a downwardly-revised 0.5% in Q2 (from 0.7%) to 0.4% (from 0.5%). The annual growth rate in Q3 was also revised down from 2.3% to 2.1%. The revisions were driven largely by weaker contributions from investment expenditure.
- The latest survey evidence and official monthly data suggest that the recovery picked up pace again during the final quarter of 2015. In addition to the CBI's Composite Growth Indicator pointing to greater economic expansion in Q4 2015, the Markit/CIPS composite PMI is consistent with quarterly GDP growth strengthening to about 0.6%, which would imply 2.2% GDP growth in 2015 as a whole. Q3's unusually weak contribution of construction output to overall GDP is also likely to have been reversed in Q4.
- Consumer spending will probably have provided a significant boost, given that retail sales experienced what was almost certainly their strongest quarter this year in Q4. (In fact, it would take over a 2% monthly plunge in sales volumes in December for Q4's quarterly growth rate to not be the strongest.) Spending off the high street looks to have fared well too, in part owing to consumer confidence remaining high. Survey measures such as the CBI's consumer services business volumes balance indicate that annual growth in real household spending on consumer services could have risen in Q4 from 1.6% to as much as 3%.

- The jobs recovery pressed on in Q3, as employment rose by 176,000, and by a further 91,000 in October, pushing the employment rate up to a record-high. Consequently, the ILO unemployment rate was driven down for four successive months between July and October, from 5.6% to 5.2% – a level not far above some estimates of its natural rate. However, by taking a wider perspective on labour market slack, we do not believe the labour market is as tight as these data alone suggest. First, impressive jobs growth reflected large increases in self-employment, as well as significant numbers of new part-time jobs, rather than conventional full-time placements. Moreover, the percentage of those in part-time work wanting to work extra hours in a full-time role saw the largest upturn for 2½ years in October, and the proportion of temporary workers wanting permanent positions has been on the rise throughout the second half of the year. Meanwhile, employer surveys have shown that recruitment difficulties have either held steady or eased recently. It is, therefore, not too surprising that pay growth has weakened so much of late. Annual growth in regular pay (ex. bonuses) softened to just 1.9% at the beginning of Q4, in contrast to 2.5% in the last quarter.
- These labour market figures will have reassured MPC doves that inflationary pressures remain muted, thereby reinforcing expectations that a rate rise is still some way off. Only recently the newest MPC member, Gertjan Vlieghe, stressed that he needs to see a decisive acceleration of wage growth before considering voting for a rate hike. And weak inflationary pressures from the labour market have been compounded by renewed falls in the energy prices in reinforcing the case to keep rates on hold for a while yet. The sterling price of Brent Crude fell below £24 per barrel in December, and wholesale gas and electricity prices fell further too. While it looks like the UK's brief flirtation with deflation in 2015 came to an end in November – CPI inflation nudged back into positive territory at 0.1% – inflation will remain below target for a long while yet. Despite these disinflationary pressures, inflation will pick up in coming months as the previous, (sharper), falls in oil prices will drop out of the calculation of the annual figure.
- Given this, as well as the monetary policy actions of the Fed and the ECB at the end of the fourth quarter, the Bank of England is now playing 'piggy in the middle' between tightening in the US and further loosening in the euro-zone. The US FOMC commenced its rate "lift off" in December in response to a "considerable improvement" in labour market conditions. In contrast, the ECB Governing Council cut its deposit facility rate by 10bps to -0.3%, and extended (not expanded) its QE programme to March 2017 from September 2016. However, the Council failed to live up to its own hype by failing to follow through on its own dovish signals with a more extensive policy loosening. But as the temporary boosts from the

substantial falls in the oil price and the strength of the euro fade in 2016, we expect the ECB will have to expand its QE programme by Q2 2016.

- Turning to the public finances, the Chancellor delivered his Spending Review and Autumn Statement in November. Due to the OBR "finding" another £27bn of savings over the forecast period, from changing various forecasts and modelling assumptions, Mr Osborne was allowed to reverse his tax credits cuts, and to pursue a more balanced path of consolidation over the parliament. But while the profile and pace of cuts have eased a little, the intensity of the consolidation package as a whole is not that different to the one presented in July's Budget, and remains far more austere than those faced in other advanced economies. The OBR forecasts that Mr Osborne will achieve a £10bn budget surplus in 2019-20 and that net debt as a percentage of GDP will fall in every year of the Parliament.

- However, November's public finance figures now indicate that an overshoot of the borrowing target for this fiscal year is likely. On the other hand, since we think the OBR is too cautious about the scope for productivity and GDP growth to bounce back, it is quite possible that the Chancellor actually ends up reaching his £10bn budget surplus earlier than the current OBR forecast. The big picture is still that austerity will be renewed in 2016, although we think that the economic recovery should be able to weather this relatively well.

- Finally, the FTSE 100 rose by 3% between end-Q3 and end-Q4. However, UK equity prices were still down by 5% over the year as a whole. By comparison, global equities rose over 4% in Q4, and fell by 4.5% over 2015 as a whole. Meanwhile, on a trade-weighted basis, sterling weakened by around 0.4% over Q4. This left it around 3% higher than the start of the year.

Detailed commentary on interest rate forecasts

Capita Asset Services note: this section has been provided for clients who prefer a more detailed commentary on the background to interest rate forecasts than that provided in the main body of this template in section 2.

Our treasury management advisers, Capita Asset Services have provided us with the following update to their interest rate forecasts.

Bank of England Inflation Report November 2015

- *There has been little change in our forecasts since our previous forecasts in May and August. We have left unchanged the start of the increases in Bank Rate at quarter 2 of 2016 despite all the media interpretation that the Bank of England Inflation Report means that Bank Rate is not now expected to go up for eighteen months until quarter 2 2017. We have, however, reduced our forecasts for average investment earnings beyond 2018/19 to reflect a slower expected rate of rise in Bank Rate over a longer timeframe.*

- *The so called 'super Thursday' in the first week of November dumbfounded forecasters' expectations with what was seen to be a very dovish view of inflation risks. This effectively meant that the MPC could go on holiday for all of 2016 as there would be no decision making to do to change Bank Rate! This was met with disbelief by most forecasters, the majority of whom have left their forecasts for quarter 2 2016 unchanged as the first increase in Bank Rate. This begs the question as to whether the Inflation Report has been correctly interpreted.*

- *In his press conference, Mark Carney focused on the need to balance two fundamental forces – domestic UK strength and foreign weakness. In terms of domestic strength, shaving one hair's breadth of 0.1% off growth rate forecasts for 2015, 2016 and 2017 to 2.7%, 2.5% and 2.6% respectively would struggle to provide any justification for a huge shift in Bank Rate forecasts. Rather, these forecasts indicate a continuation of a trend of almost equally strong growth from that in 2013-2015 which has been dependent on strong domestic demand in the face of weak exporting. It should be borne in mind that despite the austerity programme over the last Parliament, a deficit reduction of 5% of GDP was achieved at the same time as strong growth over the last three years. A further reduction of the deficit of 5% of GDP is also planned for the next five years.*

- *So this leaves the Bank's warning over its concerns for emerging market countries as the main change since the previous Inflation Report; this may in part reflect the concerns of the Bank's chief economist, Andy Haldane, who recently warned that China's sharp stock market falls could prove the start of a third act of the global financial crisis which* *started in 2008. Although such concerns did cause the Fed to pull back from making a start on raising rates at its September meeting, by the date of its December meeting, concerns had subsided and so the Fed made that first start on increasing rates.*

- *However, the key to MPC decision making will always be inflation. The latest Inflation Report indicated that inflation was currently expected to struggle to get barely over 2% at the end of the 2 to 3 year time horizon assuming that Bank Rate did not go up until Q2 2017. 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. In addition, increases at the three year horizon were the biggest in a decade and at the two year horizon were the biggest since February 2013. However, forecasting inflation two to three years out requires many subsidiary assumptions, particularly on what will happen to pay inflation as the unemployment rate continues to fall? But that then needs to be offset by the net effect on gross pay inflation of increases in productivity. Then you need to forecast which way already very low unemployment figures and already high vacancy numbers will go and the overall impact on the amount of 'spare capacity'. Add to the mix further austerity measures kicking in during the term of this Parliament and determining which way consumer confidence will go, and you will end up with a 'range of views among MPC members about the balance of risks to inflation', as stated in the Inflation Report. Accordingly there is huge room for MPC perceptions of where inflation will be 2-3 years out to vary over the next year.*

- *The overall view of the Interest Rate Strategy Group is that given the current trend of economic statistics, there is little justification for changing to the prevalent market view that there will not be an increase in Bank Rate for eighteen months until Q2 2017. Such a view would only be warranted by a major downturn in world or UK growth and / or if there is a significant decline in inflationary pressures e.g. from such factors as a sharp increase in the pace of replacement of workers by computers and robots automating work. At the current time, these would be major assumptions. Accordingly, we have opted to leave our central forecast for a first increase in Bank Rate unchanged at Q2 2016 but there are downside risks to our current forecast for the timing of the first increase.*

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 transpires over the next year. Forecasts for average earnings beyond the three year time horizon will be heavily dependent on economic and political developments. Major volatility in bond yields is likely to endure as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities, or the safe haven of bonds.

The overall longer run trend is for gilt yields and PWLB rates to rise, due to the high volume of gilt issuance in the UK, and of bond issuance in other major western countries. 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.

We have pointed out consistently that the Fed. rate is likely to go up both sooner and at a sharper rate than Bank Rate in the UK. These increases will have corresponding effects in pushing up US Treasury and UK gilt yields. While there is normally a high degree of correlation between the two yields, we would expect to see a decoupling of yields between the two i.e. we would expect US yields to go up faster than UK yields. We will monitor this area and the resulting effect on PWLB rates.

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.

We would, however, remind clients of the view that we have expressed in our previous interest rate revision newsflashes of just how unpredictable PWLB rates and bond yields are at present. We are experiencing exceptional levels of volatility which are highly correlated to geo-political and sovereign debt crisis developments. Our revised forecasts are based on the Certainty Rate (minus 20 bps) which has been accessible to most authorities since 1st November 2012.

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 is 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.
- Monetary policy action failing to stimulate sustainable growth and to combat the threat of deflation in western economies, especially the Eurozone and Japan.

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 in the near future, 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.

Approved countries for investments

Clients may wish to inform members of changes to their approved list of countries for investments. Changes during quarter 3 are shown below.

Based on lowest available rating

AAA

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Netherlands (upgraded from AA+)
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Finland
- Hong Kong
- U.K.
- U.S.A.

AA

- Abu Dhabi (UAE)
- Qatar
- France

AA-

- Belgium

REMOVED

- Saudi Arabia was downgraded from AA- to A+ and so removed from this list