



## Report – Finance Committee

### City Fund: 2015/2016 Budget and Medium Term Financial Strategy

*To be presented on Thursday, 5<sup>th</sup> March 2015*

*To the Right Honourable The Lord Mayor, Aldermen and Commons  
of the City of London in Common Council assembled.*

#### **SUMMARY**

1. This report presents the overall financial position of the City Fund (i.e. the Corporation's finances relating to Local Government, Police and Port Health services) and recommends that the Business Rates Premium and Council Tax for 2015/16 remain unchanged from 2014/15. There is a further report to the Court on the financial position of all the City of London Corporation's Funds.
2. The overall strategy is unchanged for City Fund: to have a four year plan with sufficient cashable savings to present a balanced budget.
  - City Fund (non-Police): there are significant cuts to government funding and we are forecasting that the Revenue Support Grant element of our funding will drop to zero by 2020. Following the service based review and inclusion of these savings in budgets, the fund remains in balance or close to breakeven across the period.
  - Police: deficits are forecast across the period with draw down of reserves. The strategy of draw down on reserves is as planned, however the extent of draw down is more than expected. The strategy was to retain £4m in reserves, but we are forecast to breach this level from 2016/17 onwards with reserves forecast to be fully utilised early in 2017/18. This position is to be addressed by the Commissioner in consultation with the Chamberlain and a financial strategy to maintain a minimum general reserve balance of £4m over the period to 2017/18 will be presented to the Police Committee before the summer recess.

#### **RECOMMENDATIONS**

3. We recommend that the Court of Common Council:-
  - Approve the overall financial framework and the revised Medium Term Financial Strategy for the City Fund (paragraph 6)
  - Approve the City Fund Net Budget Requirement of £101.8m (paragraph 10)

- Note the following changes in assumptions from the previous forecast (paragraph 5 ):
  - an inflation assumption is factored in at 2% in 2015/16 and then reducing year on year until 2018/19 - when a freeze is assumed, reflecting public sector finance constraints; and
  - anticipated earnings from cash balances have been reduced to 0.5% for 2015/16 and 2016/17 after which we anticipate a marginal increase and have assumed obtaining a rate of 0.75%.
- Note that no provision in the revenue estimates is made for growth or reductions in the City's baseline funding level as part of the Rates Retention Scheme. Any changes will therefore be an addition or reduction to balances.
- Approve the annual uprating of applicable amounts, premiums, disregarded income, or capital in relation to the Local Council Tax Reduction Scheme 2015-2016 as set out at paragraph 28.

### **Key decisions**

The key decisions to make are in setting the levels of Non Domestic Rates and Council Tax. The recommendations provide for the continuation of the City's business rate premium at 0.4p in the pound and for the City's Council Tax (excluding the Greater London Authority precept) to remain unchanged.

#### **Business Rates**

- Retain the City Business Rate Premium at 0.4p in the pound in 2015/16, but advise ratepayers of a possible increase in 2016/17 to support initiatives to reduce cyber-crime and promote better security of the City e.g. through the ring of steel (paragraph 9)
- Set, inclusive of this premium, a Non-Domestic Rate multiplier of 49.7p for 2015/16 together with a Small Business Non-Domestic Rate multiplier of 48.4p (paragraph 15)
- Note that the Greater London Authority is, in addition, levying a Business Rate Supplement in 2015/16 of 2p in the £ on properties with a rateable value greater than £55,000 (paragraph 20)

Delegate to the Chamberlain the award of the following discretionary rate reliefs awarded under Section 47 of the Local Government Finance Act 1988: relief of up to £1,500 to retail premises; 50% relief from non-domestic rates for up to 18 months between 1<sup>st</sup> April 2014 and 31<sup>st</sup> March 2016 on retail premises that become occupied, having been empty for at least one year; exemption from empty rate for new rating assessments that completed between 1<sup>st</sup> October 2013 and 30<sup>th</sup> September 2016 for up to 18 months; and relief of the value that would have applied under the transitional relief scheme for two years from 1<sup>st</sup> April 2015 to 31<sup>st</sup> March 2017 to properties with a rateable value of less than £25,500 that would otherwise face bill increases above 15% and to properties with a rateable value of £50,000 or less that would otherwise face bill increases above 25% (see paragraphs 18 and 19).

#### **Council Tax**

- Based on a zero increase from 2014/15, determine the provisional amounts of Council Tax for the three areas of the City to which are added the precept of the Greater London Authority (appendix B).

- Determine that the relevant (net of local precepts and levies) basic amount of Council Tax for 2015/16 will not be excessive in relation to the requirements for referendum (paragraph 8).
- Approve that the cost of highways, transportation planning, waste disposal, drains and sewers, open spaces and street lighting functions for 2015/16 be treated as special expenses to be borne by the City's residents outside the Temples (appendix B).
- Remove, from 2015/16, the discount applying to vacant properties that have been empty for more than 6 months.

### **Other recommendations**

All other recommendations are largely of a technical and statutory nature; the only one to highlight for particular attention is that it is proposed that the City of London Corporation remains debt free.

It is recommended that the Court of Common Council:

### **Capital expenditure**

- Note the proposed financing methodology of the capital programme in 2015/16 (paragraph 30).
- Approve the Prudential Code indicators (paragraph 31 and Appendix C).
- Approve the following resolutions for the purpose of the Local Government Act 2003 (paragraph 33) that:
  - at this stage the affordable borrowing limit (which is the maximum amount which the Corporation may have outstanding by way of borrowing) be zero.
  - the prudent amount of Minimum Revenue Provision is zero.
- Any potential borrowing requirement and associated implications will be subject to a further report to Finance Committee and the Court of Common Council.
- Note the continued pursuit of the approved financing methodology for the Corporation's funding commitment towards the cost of Crossrail, in particular each year's budget report will give an update on funding progress (Appendix A).

### **Chamberlain's assessment**

- Take account of the Chamberlain's assessment of the robustness of estimates and the adequacy of reserves (paragraphs 35 and 36)

## **Main Report**

### **Financial overview**

1. The Government recently issued the Local Government Finance Settlement for 2015/16 and the Policing Minister published the revenue allocations for police for 2015/16.
2. For City Fund, government funding cuts equating to £5.1m in 2015/16, and an assumed further £3m p.a. thereafter, have a significant impact. In addition, last year we entered the safety net under the business rates retention scheme which reduces our 2015/16 funding by a further £1.2m. However, the service based

review savings proposals bring in a balanced position for 2015/16, with small surpluses from 2016/17. There is of course the risk of delivering these savings.

3. The Police Settlement for 2015/16 is a reduction of £2.4m which is £660k worse than anticipated (£1.050m reduction in core grant partly offset by a £390k increase in Capital City Funding), with the Dedicated Security funding yet to be confirmed. We have assumed that funding will be £5.9m. Further funding reductions are anticipated to lead to a deficit of £7.6m by 2017/18. The strategy of draw down on reserves is as planned, however the extent of draw down is more than expected. The strategy was to retain £4m in reserves, but we are forecast to breach this level from 2016/17 onwards with reserves forecast to be fully utilised by early 2017/18. This position is to be addressed by the Commissioner in consultation with the Chamberlain and a financial strategy to maintain a minimum general reserve balance of £4m over the period to 2017/18 will be presented to the Police Committee before the summer recess.

(i) Revenue spending across planning period

4. This overview of the City Fund's financial position, covering the medium term period to 2018/19, is based on the annual in-depth survey of all revenue income and expenditure used to draft budgets approved by Committees.
5. Whilst the fundamental basis and approach underlying the previous forecast and the City Fund Medium Term Financial Strategy remains sound, it is proposed that certain key assumptions should be revised:

## Income

- a) Investment income outlook: The City has a key income stream from its property portfolio. Market rents appear to be performing strongly for the foreseeable future. Property rental income is forecast based on the expected rental for each individual property, allowing for anticipated vacancy levels. For City Fund there is a fall in rental income of £0.6m p.a. in 2016/17 due largely to the impact of a number of rent free periods and a further reduction of £1.1m in 2017/18 due to the end of a lease following which a void period and/or rent free period are expected.
- b) Interest rates: As the economic situation improves, it is likely that interest rates will rise at some point in the medium term. However, the general level of indebtedness in the economy and the proximity of a general election, means that it is difficult to predict when such an increase might occur. Accordingly, the average annual rate of 0.75% assumed for the current year has been reduced to 0.5% for 2015/16 and 2016/17. Thereafter an increase back to 0.75% has been included. However, since Resource Allocation Sub Committee decided to invest cash backed reserves into property (£110m of City Fund reserves), the income derived from cash balances has fallen. When interest rates do eventually increase, Members will need to take a view as to whether to utilise the additional revenue to support new priority schemes or to add back to the base to support current spending.

A 1% increase in interest rates in 2015/16 would equate to approximately £3.2m on City Fund.

## Expenditure

- c) Inflation/ cost increase allowance: The allowance was revised last year to 2% across the period. Inflation/cost increase is factored in for 2015/16 at 2% and then reducing year on year - 1.5% in 2016/17, 1% in 2017/18 and a budget freeze in 2018/19. On City Fund each 1% is approximately £850k. RPI has dropped recently to 1.6% and CPI to 0.5%. The Government's own measure - the GDP deflator - is presently 2.1% falling to 1.3% over the next two years and then increasing to 1.9% by 2018/19.

We have a policy to consider supporting exceptional cost increases on a case by case basis and anticipate that might be necessary for highways maintenance as reported to Policy and Resources Committee in December.

- d) London Living Wage: The City is supportive of the London Living Wage and as each contract expires and is tendered, or comes up for renewal, consideration is given to awarding it on the basis of the London Living Wage. Contingencies have been included in City Fund and City's Cash of £500k p.a. and £250k p.a. respectively across the period.
- e) The additional works programme and supplementary revenue projects: The annual provisions included for additional repairs and maintenance reflect detailed programmes for 2014/15 and 2015/16. For the years 2016/17 to 2018/19 an assumption has been included for additional works/supplementary revenue projects of £2.5m a year in City Fund. For City Fund this is a reduction of 19% on the provisions included for 2015/16.

## Service Based Review Savings

- f) The City Fund (non-Police) saving/income generation proposals have been reflected in the budgets; increasing from a £3.8m saving in 2015/16 to £10.8m in 2018/19.

## City Fund

6. The latest forecast position for City Fund, showing Police separately, and taking account of conclusions from the annual survey and the property rental income forecasts from the City Surveyor, is shown below:

	£m				
	<u>14/15</u>	<u>15/16</u>	<u>16/17</u>	<u>17/18</u>	<u>18/19</u>
<b>City Fund – non Police</b>					
March 2013 forecast	(6.8)	0.2	4.7	8.9	N/A
Current forecast	(3.4)	(0.2)	(0.9)	(0.2)	(0.5)
Uncommitted revenue reserves	(46.9)	(47.1)	(48.0)	(48.2)	(48.7)
<b>City Fund – Police</b>					
March 2013	4.6	4.7	6.7	N/A	N/A
Current forecast	8.5	1.7	3.9	7.6	N/A
Uncommitted revenue reserves	(5.9)	(4.2)	(0.3)	7.2	N/A

7. For City Fund, taking account of the service based review proposals, a very small surplus is forecast in 2015/16 with small surpluses also anticipated in the subsequent years. For Police the large deficit in 2014/15 makes a significant call on reserves and deficits are forecast across the period. However, the deficits forecast for 2015/16 and 2016/17 are an improvement from last year and the Commissioner is confident that the necessary savings can be made.
8. The key assumptions that underpin these latest projections for City Fund include the following:
- a. **Grant Settlement:** The City Fund financial forecast position includes the 2015/16 government funding settlement confirmed on the 3 February - broadly in line with previous forecasts and a £5.1m (15.8%) cash reduction compared to the 2014/15 grant level. For subsequent years, it has been assumed that the Revenue Support Grant element of Government Funding (£12m in 2015/16) will reduce to zero by 2019/20 – i.e. a cash reduction of some £3m a year. The other element of core Government Funding relates to retained business rates. This is known as the Baseline Funding Level and is £15.1m for 2015/16 (see paragraph c below). This sum is assumed to be unchanged across the forecast period (i.e. no growth or reduction anticipated).
  - b. **City Offset:** In addition to Formula Grant, the City Fund uniquely receives, under business rates' regulations, an Offset from the business rates collected in the Square Mile. The amount of the Offset is determined annually by DCLG and for 2015/16 is estimated to be £11m which is a £0.3m increase on 2014/15. Small inflationary increases have been assumed for the other years of the forecast period.
  - c. **Business rates:** The system of business rate retention remains broadly the same, with the City benefitting from 15% of any growth in business rates.<sup>1</sup> The assumptions in setting the starting point mean it is unlikely that the City will be able to share in business rate growth; rather the impact of future appeals means we are more likely to be concerned by the safety net which, at 7.5% of the baseline funding level, at least limits the City's share of future losses to £1.1m p.a. The City is at risk of calling on the safety net, as this would occur if there was a further decline in business rates of just 0.51%. The position relative to each year's baseline funding level cannot be finalised until after the end of the financial year.

The business rates multiplier is capped at 2% in 2015/16 for those properties subject to the small business multiplier.

- d. **Council Tax:** The City's council tax, expressed at band D and excluding the GLA precept is £857.31 for the current financial year, 2014/15. Councils that freeze or reduce council tax will receive a grant worth 1% of their council tax in 2015/16. For the City 1% equates to a figure of around £50,000. Freeze grant is subsequently rolled into formula funding where it is no longer

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<sup>1</sup> If the City can increase non domestic rate revenue above its baseline funding level, it can retain a proportion of that growth. The way in which the scheme works means that any growth is split between central Government 50%, the GLA 20% and the City 30%. This 30% is then subject to a 50% levy payable to central Government

separately identifiable. The forecast currently anticipates accepting the freeze grant. This would be in line with our policy of maintaining parity with London Boroughs most of whom will freeze, although some are considering a council tax increase below the 2% referendum limit.

## City Fund- Police

### 9. Funding assumptions include:

- a. **Grant funding:** As in previous years, City of London Police will receive formula funding from two sources: Home Office Police Grant and DCLG formula funding. The City Police will receive £52.4m for 2015/16. This is a reduction of £2.8m compared with 2014/15. This reduction equates to 5.1% which is the same reduction as for all police forces, but is £1.05m worse than we had anticipated for 2015/16.
- b. **Specific grants:** In addition to the main Police grant, the City Police receives many specific grants. The main one of these is for Dedicated Security funding and is yet to be confirmed. We have assumed that the funding will be £5.9m, an increase of 10% on 2014/15 levels. Capital City Funding has been advised as part of the provisional settlement at £2.8m which is a 16% increase on the prior year and £390k better than anticipated.
- c. **Business Rates Premium:** The City is uniquely able to raise additional income for the City Fund from its business rate premium. The current premium on City businesses has been unchanged since 2006/07 at 0.4p. In light of Police funding constraints and the likelihood of further grant reductions, Resource Allocation Sub Committee considered a potential increase, however, the Committee preferred to seek appropriate levels of funding for our national responsibilities rather than looking to raise the premium. Resource Allocation Sub Committee agreed last year that if Police experienced a shortfall in funding, the City of London Corporation would provide necessary temporary support from the City Fund. This wasn't needed in 2014/15. If needed in 2015/16, a fuller review of Police savings proposals would be needed. However, the Commissioner is confident that the necessary savings can be made.

Ratepayers will be advised of a possible increase to the business rates premium in 2016-17. However, we would need to show added value to support initiatives such as reducing cyber-crime and promoting better security of the City through the ring of steel, rather than try to offset a funding deficit. Based on the income generated during the past few years, an increase of 0.1p would generate approximately £1.7m a year for attribution between the Police & the City Fund (£1.3m & £0.4m respectively using the current proportions).

## Revenue Spending Proposals for 2015/16

10. The City Fund net budget requirement for 2015/16 is £101.8m, a decrease of £8.6m. The following table shows how this is financed and the resulting, unchanged, council tax requirement.

<b>Table 2: Setting the Council Tax requirement</b>		
	<b>2014/15 £m (original)</b>	<b>2015/16 £m</b>
Net Expenditure on Services	145.6	142.0
Supplementary Revenue Projects	1.6	2.7
<b>Total revenue requirement</b>	<b>147.2</b>	<b>144.7</b>
Estate rental income	(40.4)	(41.5)
Income on balances	(2.1)	(1.6)
Net requirement	104.7	101.6
Plus proposed contribution to/(from) reserves	5.7	0.2
<b>City Fund Net Budget Requirement</b>	<b>110.4</b>	<b>101.8</b>
<u>Financing sources</u>		
Formula Grant	(87.4)	(78.3)
City Offset	(10.7)	(11.0)
NNDR premium (net)	(6.5)	(6.5)
City's share of Collection Fund Surplus	(0.5)	(0.7)
<b>Council Tax Requirement</b>	<b>5.3</b>	<b>5.3</b>

11. A separate report on today's agenda "Revenue and Capital Budgets 2014/15 and 2015/16" includes the detailed net revenue budget requirements of the City Fund. Included within the net expenditure on services of £142m is provision for any levies issued to the City by relevant levying bodies such as the Environment Agency, the Lee Valley Regional Park Authority, London Pensions Fund Authority and London Council's Grant scheme. This also includes the following precepts anticipated for the year by the Inner and Middle temples (after allowing for the cost of highways, transportation planning, waste disposal, drains and sewers, open spaces and street lighting being declared as special expenses as in previous years).

<b>Table 3: Temple's Precepts</b>		
	<b>2014/15 £</b>	<b>2015/16 £</b>
Inner Temple	180,932	184,070
Middle Temple	152,273	152,242
<b>Total</b>	<b>333,205</b>	<b>336,312</b>

12. On financing, the table below analyses the change in formula grant:

<b>Analysis of the City's National Formula Grant</b>				
	2014/15	2015/16	Reduction on 2014/15	
	£m	£m	£m	%
Police	55.2	52.4	2.8	5.1
Non-Police	32.2	27.1	5.1	15.8
<b>Total before Rates Retention Scheme Reduction</b>	<b>87.4</b>	<b>79.5</b>	<b>7.9</b>	<b>9.0</b>
Rates Retention Scheme Reduction	0.0	1.2	1.2	-
<b>Total</b>	<b>87.4</b>	<b>78.3</b>	<b>9.1</b>	<b>10.4</b>

13. The City Offset of £11m is included in the new arrangements for Business Rates Retention.

## **Business Rates**

14. The Secretary of State has proposed a National Non-Domestic Rate multiplier of 49.3p and a Small Business Non-Domestic Rate Multiplier Rate of 48.0p for 2015/16. These multipliers represent an increase of 1.1p and 0.9p respectively over the 2014/15 levels. The actual amount payable by each business will depend upon its rateable value.

15. The business rate premium on City businesses has been unchanged since 2006/07 at 0.4p and it is proposed that this remain unchanged again this year. The proposed premium will result in a National Non-Domestic Rate multiplier of 49.7p and a Small Business Non-Domestic Rate of 48.4p for the City for 2015/16. It is anticipated that a premium of 0.4p will raise approximately £6.5m.

16. Likely appeals would also affect the premium income. However, as with business rates, we do not know the certainty or timing and it might be outside our current planning horizon.

17. The forecast assumes no increase in business rates premium and that the existing provision for appeals will be sufficient.

18. One final issue in relation to business rates: the Government has announced that the following reliefs will continue:

- small business rate relief to 31<sup>st</sup> March 2016;
- the retail relief introduced in 2014/15 will also continue and be increased to £1,500. As rateable values in the City are comparatively very high, more than half the retail premises do not qualify for the £1,500 relief;
- the discount for new occupiers of previously empty property;
- the exemption for empty property completed between October 2013 and March 2016.
- additionally, the Government has announced a new relief that will in effect extend the transitional relief scheme for two years for properties with a rateable value of up to and including £50,000. Small properties with a rateable value of less than £25,500 that would otherwise face bill increases above 15% and properties with a rateable value of £50,000 or less that would otherwise face bill increases above 25% will benefit. Although fully funded by central Government, all these discounts are to be delivered using Localism Act discounts and so technically will be discretionary.
- DCLG also announced a long term review of the structure of business rates.

19. As rateable values in the City are comparatively very high, more than half the retail premises do not qualify for the £1,500 relief. DCLG also announced a long term review of the structure of business rates. Additionally, the Government has announced a new relief that will in effect extend the transitional relief scheme for two years for properties with a rateable value up to and including £50,000. Small properties with a rateable value of less than £25,500 that would otherwise face bill increases above 15% and properties with a rateable value of £50,000 or less that would otherwise face bill increases above 25% will benefit. Although fully funded

by central Government, all these discounts are to be delivered using Localism Act discounts and so technically will be discretionary.

#### Business Rate Supplement

20. The Mayor for London is again proposing to levy a Business Rate Supplement of 2.0p in the £ on properties with a rateable value greater than £55,000, to raise funds towards Crossrail.

#### Determination of the Council Tax requirement

21. The 1992 Act prescribes detailed calculations that the City, as billing authority, has to make to determine Council Tax amounts. The four steps are shown in Appendix B. Although the process is somewhat laborious, it is a legislative requirement that these separate amounts be formally determined by resolutions of the Court of Common Council.

22. After allowing for a proposed contribution to reserves (to balance the revenue position over the planning period), the final City Fund council tax requirement for 2015/16 is £5.3m. In accordance with the provisions in the Localism Act 2011, the Council Tax requirement allows for the Formula Grant, the City Offset, the City's Rate Premium and the estimated surplus on the Collection Fund at 31 March 2015. As detailed in Appendix B, the City's proposed Council Tax for 2015/16 at band D is £857.31. Consequently it is proposed to freeze Council Tax for 2015/16 at £857.31 (band D property), before adding the Greater London Authority (GLA) precept. To determine the City's Council Tax for each property band, nationally-fixed proportions are applied to the average band D property.

23. The GLA's proposed precept for 2015/16 is £86.13 for a Band D property. This excludes the Metropolitan Police requirement and represents an increase of £1.65 (1.95%) compared with 2014/15.

24. The total amounts of Council Tax for each category must be set by the City before 11 March. The proposed amounts are shown in the table below:

	£							
	A	B	C	D	E	F	G	H
CoL	571.54	666.80	762.05	857.31	1,047.82	1,238.34	1,428.85	1,714.62
GLA	57.42	66.99	76.56	86.13	105.27	124.41	143.55	172.26
Total	628.96	733.79	838.61	943.44	1153.09	1362.75	1572.40	1886.88

25. One final issue in respect of the City's Council Tax relates to discounts:

- Currently vacant properties in the City, defined as being substantially unfurnished, that have been empty for more than 6 months still receive 50% discount and no changes have ever been made to this discount. However, following the change to discount for second homes, it was decided to review the discounts for vacant properties. All London Boroughs have removed the discount for long term empty properties. Finance Committee considered this issue at its June 2014 meeting and proposes to recommend to the Court of Common Council that the discount applying to vacant properties that have been empty for more than 6 months should be removed from 2015-2016.

26. It is anticipated that the City's total Council Tax will remain the third lowest in London. The Court of Common Council will be requested to formally determine

that the relevant (net of local precepts and levies) basic amount of Council Tax for 2015/16 will not be excessive in relation to the new referendum requirements for any Council Tax increases.

### **Council Tax Reduction (formerly Council Tax Benefit)**

27. From April 2013, council tax reduction replaced council tax benefit and local authorities had to make their own local schemes if not applying the Government default scheme. The City adopted the default scheme for 2013/14. In 2014/15 the scheme was not altered other than to apply the annual uprating of applicable amounts in line with housing benefit applicable amounts. There is no proposal to alter the scheme for 2015/16 other than to apply the annual uprating of applicable amounts in line with housing benefit applicable amounts to ensure that no claimants in respect of council tax reduction are worse off in 2015/16.
28. It is proposed therefore that the annual uprating of applicable amounts, premiums, disregarded income, or capital in relation to the Local Council Tax Reduction Scheme 2015-2016 as it applies to working age claimants, be in accordance with the uprating to be applied under the Housing Benefit Regulations which take effect from 1 April each year and the Council Tax Reduction Schemes (Prescribed Requirements) (England) (Amendment) (No. 2) Regulations 2014; and the annual uprating of non-dependent income and deductions, and income levels relating to Alternative Council Tax Reduction, or any other uprating as it applies to working age claimants, shall be adjusted in line with inflation levels by reference to relevant annual uprating in the Housing Benefit Scheme or The Prescribed Council Tax Reduction Scheme for Pensioners

### **Capital**

29. The Corporation has a significant programme of property investments and works to improve the operational property estate and the street scene. Spending on these types of activity is classified as capital expenditure. Key areas in the 2015/16 capital programme (including the indicative costs of implementing schemes still subject to approval) comprise:

	<b>£m</b>
Capital Contribution to Crossrail	200.0
Roads, Bridges, Street-scene (including Aldgate)	15.7
Dwelling Improvements	15.9
Affordable Housing Construction	7.6
New Police Accommodation	4.6
Barbican Podium	5.0
Old Bailey Enhancements	4.4

30. Capital expenditure is primarily financed from capital reserves derived from the sale of properties, earmarked reserves and grants or reimbursements from third parties. The City has not borrowed any money to finance these schemes. Financing is summarised in the table below:

<b>Table 6: Financing of 2015/16 City Fund Capital Expenditure</b>	
	£m
Estimated Capital Expenditure	269.2
Financing	
Internal	
• Earmarked reserves:	
Housing Revenue Account (HRA)	11.7
Highways Improvements	5.0
Crossrail	19.6
Other	1.0
• Capital Receipts	196.0
• Revenue Reserves	2.4
External	
• Grants and reimbursements	33.5
<b>Total</b>	<b>269.2</b>

31. The Local Government Act 2003 requires the City to set prudential indicators as part of the budget setting process. The indicators that the Court of Common Council will be asked to set are:

- Estimates of capital expenditure 2015/16 to 2017/18
- Estimates of the capital financing requirement 2015/16 to 2017/18
- Ratio of financing costs to net revenue stream (City Fund and HRA)
- Net debt and the capital financing requirement
- Estimate of the incremental impact on council tax and housing rents.

32. The prudential indicators listed above, together with some locally developed indicators, have been calculated in Appendix C. In addition, Treasury-related prudential indicators are required to be set and these are included within the 'Treasury Management Strategy and Annual Investment Strategy' at Appendix D.

33. The main point to highlight is that there is no underlying requirement at this stage to borrow for capital purposes and therefore the Corporation's Minimum Revenue Provision towards borrowing costs (MRP) is also zero. The Court of Common Council needs to formally approve these indicators.

#### Provision for future capital expenditure

34. In addition to the programmed capital schemes over the planning period, the Capital Programme allows £3m per annum for new schemes [of which £1m has been earmarked to provide capital funding for the Museum of London] which have not yet been identified. If schemes are identified in excess of these provisions, Resource Allocation Sub Committee will need to prioritise resources.

#### **Robustness of Estimates and Adequacy of Reserves**

35. Section 25 of the Local Government Act 2003 requires the Chamberlain to report on the robustness of estimates and the adequacy of reserves underpinning the budget proposals.

36. In coming to a conclusion on the robustness of estimates the Chamberlain needs to assess the risk of over or under spending the budget. To fulfil this requirement the following comments are made:
- a) provision has been made for all known liabilities, together with indicative costs (where identified) of capital schemes yet to be evaluated
  - b) the estimates and financial forecast have been prepared at this stage on the basis of the Corporation remaining debt free as no requirement to borrow is currently anticipated
  - c) prudent assessments have been made in regard to key assumptions
  - d) an annual capital envelope is in place seeking to ensure that capital expenditure is contained within affordable limits or, if on an exceptional basis funding is sought outside this envelope, it has to be demonstrated that the project is of the highest corporate priority.
  - e) although the City Fund financial position is vulnerable to rent levels and interest rates, it should be noted that:
    - the City Surveyor has carried out an in-depth review of rent incomes
    - the assumed interest rate has been lowered across the planning period
  - f) a strong track record in achieving budgets gives confidence on the robustness of estimates.
37. An analysis of usable City Fund Reserves is set out in Appendix E

## **Risks**

38. There are risks to the achievement of the latest forecasts:

Within the City of London Corporation's control

- a. The key risk we highlighted to the Resource Allocation Sub Committee in December for achieving the financial forecast lies in achieving the programme of asset sales needed to finance the City Fund capital programme.
- b. Delivery of the service based review savings proposals.

Outside the City of London Corporation's control

- c. The key risk on City Fund relates to the government funding streams for both Non-Police and Police services.
- d. The business rates retention system looks to present very little opportunity for growth, but there is a risk to our funding levels; we are forecasting a neutral position on this for the present.

## **Equalities Implications**

39. During the preparation of this report all Chief Officers have been asked to consider whether there would be any potential adverse impact of the various budget policy proposals on the equality of service with regard to service provision and delivery that affects people, or groups of people, in respect of disability, gender and racial equality. None are anticipated but they are expected to confirm this by the date of the Committee.

## **Conclusion**

40. Following the service based review, the funds are in a much healthier position across the medium term. There are still risks around the implementation of the

saving proposals, but the estimates are considered robust and the level of and polices relating to the City Fund reserves are considered reasonable.

## **Appendices**

Appendix A	Crossrail Funding Commitment; latest position
Appendix B	Calculating Council Tax
Appendix C	Prudential Code Indicators
Appendix D	Treasury Management Strategy and Annual Investment Strategy
Appendix E	City Fund Reserves 2014/15

All of which we submit to the judgement of this Honourable Court.

DATED this 17<sup>th</sup> day of February 2015.

SIGNED on behalf of the Committee.

**Roger Arthur Holden Chadwick**  
Chairman, Finance Committee

**Progress on City Fund Crossrail Funding Commitment  
Forecast position for 31/3/16**

The City of London Corporation is committed to a contribution of £200m from City Fund to the Crossrail Project. The earliest date for payment is estimated to be 31 March 2016. The latest forecast indicates that the Crossrail Funding Strategy is on track to deliver the £200m by 31 March 2016 as summarised in the total below.

<b>Resources Available for Funding the City Fund Crossrail Commitment</b>	
<b>Forecast for 31 March 2016</b>	
	£m
Capital receipts from sale of Crossrail investment properties or from substitute properties where it is more advantageous to retain the Crossrail properties.	125.2
General capital receipts reserve	
From planned disposals	51.0
Unused balance of £100m provision for Crossrail investment properties	4.2
Revenue reserve- Rental income from Crossrail investment properties and interest on cash balances held for Crossrail contribution purposes.	19.6
<b>Total forecast of resources available at 31 March 2016</b>	<b>200.0</b>

The realisation of this forecast level of resources is dependent upon the delivery by 31 March 2016 of £176.2m capital receipts (£125.2m + £51m) from the sale of investment properties of which £134.7m has been received to date. The City Surveyor has identified the properties which will deliver the balance of £41.5m by 31 March 2016.

## Calculating Council Tax

### Step One ('B1')

This requires calculation of the basic amount of Council Tax for a Band D dwelling for the whole of the City's area by applying the formula:

$$'B1' = \frac{R}{T}$$

Where

'B1' is the Basic Amount 'One':

R is the amount calculated by the authority as its council tax requirement for the year;

T is the amount which is calculated by the authority as its Council Tax base for the year. This amount was approved by the Chamberlain under the delegated authority of the City's Finance Committee (6,239.59) together with the Council Tax bases for each part of the City's area.

The above calculation is as follows:

$$\begin{aligned} 'B1' &= \frac{\underline{\pounds 5,349,263}}{6,239.59} \\ 'B1' &= \pounds 857.31 \end{aligned}$$

**Note:** Item R consists of the following components:

	£	£
City Fund Net Budget Requirement		101,840,901
Less:		
Formula Grant	(78,215,000)	
City's Offset	(11,040,000)	
Estimated Non-Domestic Rate Premium (Net)	(6,500,000)	
Estimated Collection Fund Surplus as at 31 March 2015 (City's share)	(736,638)	(96,491,638)
<b>TOTAL COUNCIL TAX REQUIREMENT (R)</b>		<b>5,349,263</b>

### Step Two ('B2')

This calculation is for the basic amount of tax for the area of the City excluding special items. The prescribed formula is:

$$'B2' = \frac{'B1' - A}{T}$$

Where:

'B2' is the Basic Amount 'Two';

'B1' is the Basic Amount of Council Tax (Basic Amount 'One')  
NB included with 'B1' is the aggregate of special items

A is the Aggregate of all special items;

T is the Council Tax base for the whole area

The above calculation is as follows:

$$\text{'B2'} = \frac{\pounds 857.31 - \pounds 13,574,312.09}{6,239.59}$$

$$\text{'B2'} = \pounds 1,318.20 \text{ CR}$$

**Note:** Item A consists of the following components:

	£	£
Highways Net Expenditure	7,819,000.00	
Waste Disposal Net Expenditure	1,348,000.00	
Open Spaces Net Expenditure	1,574,000.00	
Transportation Planning	993,000.00	
Drains and Sewers	433,000.00	
Street Lighting Net Expenditure	1,071,000.00	
Total City's Special Expenses		13,238,000.00
Inner Temple's Precept	184,069.90	
Middle Temple's Precept	152,242.19	336,312.09
Total Special Items		13,574,312.09

### Step Three 'B3'

The next calculation is for the basic amount of each of the three parts of the City (the Inner and the Middle Temples and the remainder of the City area) to which special items relate (Basic Amount 'Three'). The calculations for each of the areas are as follows:

$$\text{'B3'} = \text{'B2'} + \frac{S}{TP}$$

Where:

'B3' is the Basic Amount 'Three'

'B2' is the Basic Amount 'Two'

S is the amount of the special items for the part of the area

TP is the billing authority's Tax base for the part of the area to which the special items relate as determined by the Chamberlain under the delegated authority of the City of London Finance Committee.

### City Area Excluding the Temples

$$\text{'B3'} = \text{£}1,318.20 \text{ CR} + \frac{\text{£}13,238,000.00}{6,085.00}$$

$$\text{'B3'} = \text{£}857.31$$

### Inner Temple

$$\text{'B3'} = \text{£}1,318.20 \text{ CR} + \frac{\text{£}184,069.90}{84.61}$$

$$\text{'B3'} = \text{£}857.31$$

### Middle Temple

$$\text{'B3'} = \text{£}1,318.20 \text{ CR} + \frac{\text{£}152,242.19}{69.98}$$

$$\text{'B3'} = \text{£}857.31$$

### Step Four

Finally, Council Tax amounts have to be calculated for each valuation band (A to H) in each of the three areas (i.e. 24 Council Tax categories). The formula to be used is:

$$\text{Council Tax for particular category} = A \times \frac{N}{D}$$

A is the Basic Amount 'Three' ('B3') calculated for each part of its area;

N is the proportion applicable to dwellings listed in the particular valuation Band for which the calculation is being made;

D is the proportion applicable to dwellings listed in valuation Band D.

<b>Council Tax per Property Band: calculated by applying nationally fixed proportions from Band D.</b>								
	£							
	A	B	C	D	E	F	G	H
Prop- ortion	6	7	8	9	11	13	15	18
CoL	571.54	666.80	762.05	857.31	1,047.82	1,238.34	1,428.85	1,714.62
GLA	57.42	66.99	76.56	86.13	105.27	124.41	143.55	172.26
Total	628.96	733.79	838.61	943.44	1153.09	1362.75	1572.40	1886.88

## PRUDENTIAL INDICATORS

The following Prudential Indicators (and those included in Appendix D) have been calculated in accordance with the CIPFA Prudential Code for Capital Finance in Local Authorities. In addition a local indicator has been calculated to reflect the City's particular circumstances. Those indicators relating to estimates for the financial years 2015/16, 2016/17 and 2017/18 (values shown in bold) are required to be set by the Court of Common Council as part of the budget setting process, and should be taken into account when considering the affordability, prudence and sustainability of capital investments.

### Prudential Indicators for Affordability

#### Estimate of the ratio of financing costs to net revenue stream

**Table 1**

	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Revised	Estimate	Estimate	Estimate
HRA	0.18	0.21	0.20	0.22	0.23	0.24	0.24	0.26	<b>0.50</b>	<b>0.25</b>	<b>0.25</b>
Non-HRA	-0.44	-0.40	-0.29	-0.28	-0.37	-0.39	0.22	-0.40	<b>-0.39</b>	<b>-0.40</b>	<b>-0.40</b>
Total	-0.39	-0.36	-0.26	-0.25	-0.32	-0.33	0.22	-0.34	<b>-0.30</b>	<b>-0.33</b>	<b>-0.33</b>
<i>At this time last year</i>	<i>-0.39</i>	<i>-0.36</i>	<i>-0.26</i>	<i>-0.28</i>	<i>-0.26</i>	<i>-0.30</i>	<i>0.22</i>	<i>-0.34</i>	<i>-0.35</i>	<i>-0.31</i>	<i>-</i>

This ratio is intended to represent the extent to which the net revenue consequences of borrowing impact on the net revenue stream. Since the City Fund is a net lender in its Treasury operations and is in receipt of significant rental income from investment properties, the Non-HRA and Total ratios are usually negative, with the exception of a positive ratio in 2013/14 reflecting the one-off treasury decision to invest revenue reserves in property. The upward trend in HRA ratios reflects increased revenue contributions to the major repairs reserve which is used to fund the HRA programme of capital works necessary to retain the housing estates.

#### Estimate of the incremental impact of capital investment decisions on the Council Tax

**Table 2**

	2014/15	2015/16	2016/17	2017/18
	Revised	Estimate	Estimate	Estimate
	£	£	£	£
Incremental increase/(decrease) Per Band 'D' Equivalent	(189.00)	<b>19.00</b>	<b>(189.00)</b>	<b>(242.00)</b>
<i>At this time last year</i>	<i>(918.00)</i>	<i>(1,744.00)</i>	<i>(2,035.00)</i>	<i>-</i>

This ratio has been calculated to show the net incremental revenue impact of variations in the capital programme since the 2014/15 original estimates were prepared, expressed as a Band D equivalent. The variations generally reflect the impact on interest earnings and rental income arising from changes in the capital programme, with bracketed items representing a net revenue benefit. The indicators calculated at this time last year were exceptional, reflecting the beneficial impact of the treasury management decision to switch from cash to property investment in 2013/14. The new indicators show a net beneficial impact across the period, arising from increased rental returns generated through current capital investment plans. Whilst in

theory, this could be a strong indicator of affordability, in reality it is difficult to demonstrate a direct link between capital expenditure and its impact on the Council Tax, due to the special arrangements relating to the setting of the City's Council Tax.

### Estimate of the incremental impact of capital expenditure on housing rents

**Table 3**

	<b>2014/15</b>	<b>2015/16</b>	<b>2016/17</b>	<b>2017/18</b>
	<b>Revised</b>	<b>Estimate</b>	<b>Estimate</b>	<b>Estimate</b>
	<b>£</b>	<b>£</b>	<b>£</b>	<b>£</b>
Incremental increase/(decrease) on Average Weekly Rent	(1.91)	<b>2.84</b>	<b>4.04</b>	<b>4.10</b>
<i>At this time last year</i>	<i>1.04</i>	<i>(0.37)</i>	<i>(0.27)</i>	<i>-</i>

The current figures reflect the variations in annual capital costs associated with maintaining the decent homes standard and other improvements. Positive figures denote an increase and negative (bracketed) figures denote a decrease in the costs to be borne by the Housing Revenue Account. Councils' discretion to amend rents has, until recently, been largely removed by the Government's restrictions on the levels of rent chargeable, which previously made the above figures purely notional. As a result of Government reforms to council housing finance, the extent to which capital will impact on future rent levels is under review.

### Prudential Indicator of Prudence

#### Net Debt and the Capital Financing Requirement

**Table 4**

	<b>Period</b>
	<b>2014/15 to</b>
	<b>2017/18</b>
	<b>£m</b>
Net borrowing/(Net investments)	<b>(75.658)</b>
Capital Financing Requirement	<b>(1.942)</b>

To ensure that, over the medium term, net borrowing will only be for capital purposes, this indicator is intended to demonstrate that net debt does not exceed the capital financing requirement over the period 2014/15 to 2017/18. For this purpose, net debt is defined as the net total of external borrowing and investments. The existing financial plans assume that no external borrowing will be undertaken within the planning period, resulting in a 'net investment position', and this indicator has been calculated simply to comply with the Code.

### Prudential Indicators for Capital Expenditure and External Debt

#### Estimate of Capital Expenditure

**Table 5**

	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
	Actual	Revised	Estimate	Estimate	Estimate						
	£m	£m	£m								
HRA	0.444	1.755	1.000	3.541	12.910	3.502	2.502	7.789	22.532	5.056	0.200
Non-HRA	27.060	121.934	76.404	42.109	210.156	17.939	181.183	58.953	246.682	32.204	26.324
Total	27.504	123.689	77.404	45.650	223.066	21.441	183.685	66.742	269.214	37.260	26.524
<i>At this time last year</i>	27.504	123.689	77.404	45.650	99.681	32.373	193.843	73.587	234.804	21.275	-

This indicator is based on the capital budget, augmented to reflect the indicative cost of schemes which have been approved in principle but have yet to be evaluated. It should be noted that the figures represent gross expenditure and that a number of schemes are wholly or partially funded by external contributions. Comparisons with the figures calculated at this time last year are generally reflective of the re-phasing of capital works.

### Estimate of the Capital Financing Requirement

**Table 6**

	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
	Actual	Revised	Estimate	Estimate	Estimate						
	£m	£m	£m								
HRA	11.958	11.758	11.563	11.374	11.374	10.924	10.924	10.706	10.492	10.282	10.076
Non-HRA	-15.158	-14.558	-14.282	-14.016	-13.413	-12.852	-12.866	-12.648	-12.434	-12.224	-12.018
Total	-3.200	-2.800	-2.719	-2.642	-2.039	-1.928	-1.942	-1.942	-1.942	-1.942	-1.942
<i>At this time last year</i>	-3.200	-2.800	-2.719	-2.719	-2.642	-2.039	-1.928	-1.928	-1.928	-1.928	

The capital financing requirement reflects the underlying need to borrow; the overall negative figures are indicative of the City's debt-free status. The estimate is calculated by considering the capital expenditure and identifying all the financing options (e.g. capital receipts, grants) to be applied to finance it. In accordance with the guidance contained in the Prudential Code, the 'Actual' indicators are calculated directly from the Balance Sheet, whilst the method of calculating the HRA and Non-HRA elements is prescribed under Statute.

The remaining prudential indicators relating to external debt and treasury management are included within Appendix D.

### Local Indicator

The City has considerable reserves when compared to a typical local authority, and as a result, some of the standard indicators required under the Code are not directly relevant.

A local indicator which gives a useful measure of both sustainability and of the adequacy of revenue reserves has been developed.

### Times cover on unencumbered revenue reserves

**Table 7**

	2014/15	2015/16	2016/17	2017/18
Times cover on unencumbered revenue reserves	(10.4)	(30.2)	(16.2)	(5.5)
<i>At this time last year</i>	(7.7)	250.0	6.4	-

This indicator is calculated by dividing the balance of unencumbered general reserves by any annual revenue deficit/ (surplus). Compared with last year, the figures show a transformation from deficits to surpluses from 2015/16 onwards, as a result of the savings anticipated from the service based reviews.

**TREASURY MANAGEMENT  
STRATEGY STATEMENT**

**AND**

**ANNUAL INVESTMENT  
STRATEGY**

**2015/16**

[The main changes to the document from last  
year's version are highlighted in grey]

# **Treasury Management Strategy Statement, Minimum Revenue Provision (MRP) Strategy and Annual Investment Strategy 2015/16**

## **1. Introduction**

### **1.1 Background**

The City of London Corporation (the City) is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the City's low risk appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of capital expenditure plans. The City is not anticipating any borrowing at this time.

### **1.2 The Treasury Management Policy Statement**

The City defines its treasury management activities as:

The management of the organisation's investments and cash flows, its banking, money market and capital market transaction; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

The City regards the security of its financial investments through the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

The City acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

### **1.3 CIPFA Requirements**

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised November 2009) was adopted by the Court of Common Council (the Court) on 3 March 2010:

The primary requirements of the Code are as follows:

- (i) The City of London Corporation will create and maintain, as the cornerstones for effective treasury management:
  - A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities

- Suitable treasury management practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.
- (ii) This organisation (i.e. the Court of Common Council) will receive reports on its treasury management policies, practices and activities, including as a minimum an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close.
- (iii) The Court of Common Council delegates responsibility for the implementation and regular monitoring of its treasury management policies to the Finance Committee and the Financial Investment Board; the execution and administration of treasury management decisions is delegated to the Chamberlain, who will act in accordance with the organisation's policy statement and TMPs and, if he/she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.
- (iv) The Court of Common Council nominates the Audit and Risk Management Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

#### **1.4 Treasury Management Strategy for 2015/16**

The Local Government Act 2003 (the Act) and supporting regulations require the City to 'have regard to' the 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 City's capital investment plans are affordable, prudent and sustainable.

The Act therefore requires the Court of Common 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) (included in section 7 of this report); this sets out the City's policies for managing its investments and for giving priority to the security and liquidity of those investments.

The suggested strategy for 2015/16 in respect of the required aspects of the treasury management function is based upon the treasury officers' views on interest rates, supplemented with leading market forecasts provided by the City's treasury adviser, Capita Asset Services, Treasury Solutions.

The strategy covers:

- the current treasury position
- treasury indicators in force which will limit the treasury risk and activities of the City
- Treasury Indicators
- prospects for interest rates
- the borrowing strategy
- policy on borrowing in advance of need
- debt rescheduling
- the investment strategy
- creditworthiness policy
- policy on use of external service providers.

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

## 1.5 Balanced Budget Requirement

It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the City 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, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from:

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

## 2. Treasury Limits for 2015/16 to 2017/18

It is a statutory duty under Section 3 (1) of the Local Government Finance Act and supporting regulations, for the City to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Affordable Borrowing Limit". In England and Wales the Authorised Limit represents the legislative limit specified in the Act.

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

Whilst termed an "Affordable Borrowing Limit", the capital plans to be considered for inclusion in corporate financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years; details of the Authorised Limit can be found in Appendix 3.

## 3. Current Portfolio Position

The City's treasury portfolio position at 31 December 2014 comprised:

<b>Table 1</b>		<b>Principal</b>		<b>Ave. rate</b>
		<b>£m</b>	<b>£m</b>	<b>%</b>
Fixed rate funding	PWLB	0		
	Market	0	0	-
Variable rate funding	PWLB	0	0	-
	Market	0	0	-
Other long term liabilities			0	
<b>Gross debt</b>			<b>0</b>	<b>-</b>
<b>Total investments</b>			<b>650.2</b>	<b>0.87</b>
<b>Net Investments</b>			<b>650.2</b>	

#### 4. Treasury Indicators for 2015/16 – 2017/18

Treasury Indicators (as set out in Appendix 3) are relevant for the purposes of setting an integrated treasury management strategy.

The City is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. The original 2001 Code was adopted by the Court of Common Council on 9 March 2004 and the revised 2009 Code was adopted on 3 March 2010.

#### 5. Prospects for Interest Rates

The City of London has appointed Capita Asset Services (Capita) as its treasury advisor and part of their service is to assist the City to formulate a view on interest rates. Appendix 1 draws together a number of current City forecasts for short term (Bank Rate) and longer fixed interest rates and Appendix 2 provides a more detailed economic commentary. The following table and accompanying text below gives the Capita central view.

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)		
		5 year	25 year	50 year
Mar 2015	0.50	2.20	3.40	3.40
Jun 2015	0.50	2.20	3.50	3.50
Sep 2015	0.50	2.30	3.70	3.70
Dec 2015	0.75	2.50	3.80	3.80
Mar 2016	0.75	2.60	4.00	4.00
Jun 2016	1.00	2.80	4.20	4.20
Sep 2016	1.00	2.90	4.30	4.30
Dec 2016	1.25	3.00	4.40	4.40
Mar 2017	1.25	3.20	4.50	4.50
Jun 2017	1.50	3.30	4.60	4.60
Sep 2017	1.75	3.40	4.70	4.70
Dec 2017	1.75	3.50	4.70	4.70
Mar 2018	2.00	3.60	4.80	4.80

UK GDP growth surged during 2013 and the first half of 2014. Since then it appears to have subsided somewhat but still remains strong by UK standards and is expected to continue likewise into 2015 and 2016. There needs to be a significant rebalancing of the economy away from consumer spending to manufacturing, business investment and exporting in order for this recovery to become more firmly established. One drag on the economy has been that wage inflation has only recently started to exceed CPI inflation, so enabling disposable income and living standards to start improving. The plunge in the price of oil brought CPI inflation down to a low of 1.0% in November, the lowest rate since September 2002. Inflation is expected to stay around or below 1.0% for the best part of a year; this will help improve consumer disposable income and so underpin economic growth during 2015. However, labour productivity needs to improve substantially to enable wage rates to increase and further support consumer disposable income and economic growth. In addition, the encouraging rate at which unemployment has been falling must eventually feed through into

pressure for wage increases, though current views on the amount of hidden slack in the labour market probably means that this is unlikely to happen early in 2015.

The US, the biggest world economy, has generated stunning growth rates of 4.6% (annualised) in Q2 2014 and 5.0% in Q3. This is hugely promising for the outlook for strong growth going forwards and it very much looks as if the US is now firmly on the path of full recovery from the financial crisis of 2008. Consequently, it is now confidently expected that the US will be the first major western economy to start on central rate increases by mid 2015.

The current economic outlook and structure of market interest rates and government debt yields have several key treasury management implications:

- Greece: the general election on 25 January 2015 appears to have brought to power a political party which is anti EU and anti austerity. However, if this eventually results in Greece leaving the Euro, it is unlikely that this will directly destabilise the Eurozone as the EU has put in place adequate firewalls to contain the immediate fallout to just Greece. However, the indirect effects of the likely strengthening of anti EU and anti austerity political parties throughout the EU is much more difficult to quantify;
- As for the Eurozone in general, concerns in respect of a major crisis subsided considerably in 2013. However, the downturn in growth and inflation during the second half of 2014, and worries over the Ukraine situation, Middle East and Ebola, have led to a resurgence of those concerns as risks increase that it could be heading into deflation and prolonged very weak growth. Sovereign debt difficulties have not gone away and major concerns could return in respect of individual countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise to levels that could result in a loss of investor confidence in the financial viability of such countries. Counterparty risks therefore remain elevated. This continues to suggest the use of higher quality counterparties for shorter time periods;
- Investment returns are likely to remain relatively low during 2015/16 and beyond;
- Borrowing interest rates have been volatile during 2014 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. The closing weeks of 2014 saw gilt yields dip to historically remarkably low levels after inflation plunged, a flight to quality from equities (especially in the oil sector), and from the debt and equities of oil producing emerging market countries, and an increase in the likelihood that the ECB will commence quantitative easing (purchase of EZ government debt) in early 2015. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times, when authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt;
- There will remain a cost of carry to any new borrowing which causes an increase in investments as this will incur a revenue loss between borrowing costs and investment returns.

## **6. Borrowing Strategy**

It is anticipated that there will be no capital borrowings required during 2015/16.

## **7. Annual Investment Strategy**

### **7.1 Introduction: Changes to 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. More recently, in response to the evolving regulatory regime, the agencies have indicated they may remove these "uplifts". This process may commence during 2014/15 and / or 2015/16. The actual timing of the changes is still subject to discussion, but this does mean immediate changes to the credit methodology are required.

It is important to stress that the rating agency changes do not reflect any changes in the underlying status of the institution or credit environment, merely the implied level of sovereign support that has been built into ratings through the financial crisis. The eventual removal of implied sovereign support will only take place when the regulatory and economic environments have ensured that financial institutions are much stronger and less prone to failure in a financial crisis.

Both Fitch and Moody's provide "standalone" credit ratings for financial institutions. For Fitch, it is the Viability Rating, while Moody's has the Financial Strength Rating. Due to the future removal of sovereign support from institution assessments, both agencies have suggested going forward that these will be in line with their respective Long Term ratings. As such, there is no point monitoring both Long Term and these "standalone" ratings.

Furthermore, Fitch has already begun assessing its Support ratings, with a clear expectation that these will be lowered to 5, which is defined as "A bank for which there is a possibility of external support, but it cannot be relied upon." With all institutions likely to drop to these levels, there is little to no differentiation to be had by assessing Support ratings.

As a result of these rating agency changes, the credit element of our future methodology will focus solely on the Short and Long Term ratings of an institution. Rating Watch and Outlook information will continue to be assessed where it relates to these categories. This is the same process for Standard & Poor's that Capita have always taken, but a change to the use of Fitch and Moody's ratings. Furthermore, they will continue to utilise CDS prices as an overlay to ratings in their new methodology.

### **7.2 Investment Policy**

The City of London's investment policy will have regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectorial Guidance Notes ("the CIPFA TM Code"). The City's investment priorities are:

- (a) the security of capital and
- (b) the liquidity of its investments.

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

The borrowing of monies purely to invest or on-lend and make a return is unlawful and the City will not engage in such activity.

In accordance with the above guidance from the CLG Government and CIPFA, and in order to minimise the risk to investments, the City applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk

Continuing regulatory changes in the banking sector are designed to see greater stability, lower risk and the removal of expectations of Government financial support should an institution fail. This withdrawal of implied sovereign support is anticipated to have an effect on ratings applied to institutions. This will result in the key ratings used to monitor counterparties being the Short Term and Long Term ratings only. Viability, Financial Strength and Support Ratings previously applied will effectively become redundant. This change does not reflect deterioration in the credit environment but rather a change of method in response to regulatory changes.

As with previous practice, ratings will not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the City will engage with its advisors to maintain a monitor on market pricing such as “credit default swaps” and overlay that information on top of the credit ratings.

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

Investment instruments identified for use in the financial year are listed in Appendices 4 and 5 under the ‘specified’ and ‘non-specified’ investments categories. Counterparty limits are also set out in these appendices.

### **7.3 Creditworthiness policy**

The City uses the creditworthiness service provided by Capita. This service employs a sophisticated modelling approach utilising credit ratings from all three rating agencies - Fitch, Moody's and Standard and Poor's. However, it does not rely solely on the current credit ratings of counterparties but also uses the following as overlays:

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

The City will not specifically follow the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties but will have regard to the approach adopted by Capita's

creditworthiness service which incorporates ratings from all three agencies and uses a risk weighted scoring system, thereby not giving undue preponderance to just one agency's ratings.

All credit ratings will be monitored on a daily basis. The City is alerted to credit warnings and changes to ratings of all three agencies through its use of the Capita creditworthiness service.

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

Sole reliance will not be placed on the use of this external service. In addition the City will also use market data and market information, information on sovereign support for banks and the credit ratings of that government support. Regular meetings are held involving the Chamberlain, Financial Services Director, Corporate Treasurer and Members of the Treasury Team, when the suitability of prospective counterparties and the optimum duration for lending is discussed and agreed.

The primary principle governing the City's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the City will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security.
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the City's prudential indicators covering the maximum principal sums invested.

The Chamberlain will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to the Financial Investment Board as necessary. These criteria are separate to those which determine which types of investment instruments are classified as either specified or non-specified as it provides an overall pool of counterparties considered high quality which the City may use, rather than defining what types of investment instruments are to be used.

The criteria for providing a pool of high quality investment counterparties (both specified and non-specified investments) are:

- Banks 1 – good credit quality – the City will only use banks which:
  - (i) are UK banks; and/or
  - (ii) are non-UK and domiciled in a country which has a minimum sovereign long-term rating of AAA (Fitch rating) and have, as a minimum the following Fitch credit rating:

(i) Short-term	F1
(ii) Long-term	A

- Banks 2 – Part Nationalised UK banks – Lloyds Banking Group and Royal Bank of Scotland. These banks can be included if they continue to be part nationalised, or they meet the ratings in Banks 1 above.
- Banks 3 – The City’s own banker for transactional purposes if the bank falls below the above criteria, although in this case, balances will be minimised in both monetary size and duration.
- Bank subsidiary and treasury operation - The City will use these where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above. This criterion is particularly relevant to City Re Limited, the City’s Captive insurance company, which deposits funds with bank subsidiaries in Guernsey.
- Building Societies – The City may use all societies which:
  - (i) have assets in excess of £9bn; or
  - (ii) meet the ratings for banks outlined above
- Money Market Funds – with minimum credit ratings of AAA/mmf
- UK Government – including government gilts and the debt management agency deposit facility.
- Local authorities.

A limit of £200m will be applied to the use of non-specified investments.

#### 7.4 Country limits

The City has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AAA or equivalent from all three rating agencies. The counterparty list, as shown in Appendix 6, will be added to or deducted from by officers should individual country ratings change in accordance with this policy. It is proposed that the UK will be excluded from this stipulated minimum sovereign rating requirement.

#### 7.5 Investment Strategy

**In-house funds:** The City’s in-house managed funds are both cash-flow derived and also represented by core balances which can be made available for investment over a 2-3 year period. Investments will accordingly be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). The City does not currently have any term deposits which span the 2015/16 financial year.

**7.6 Investment returns expectations:** The Bank Rate has been unchanged from 0.50% since March 2009. Bank Rate is forecast by Capita Asset Services to remain unchanged at 0.5% before starting to rise from quarter 4 of 2015. Bank Rate forecasts for financial year ends (March) are as follows:

- 2015/16 0.75%
- 2016/17 1.25%
- 2017/18 2.00%

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

The Chamberlain and his Treasury Officers consider there to be a likelihood of interest rates remaining at very low levels for some considerable time, and in view of the importance of interest earnings included in forward financial forecasts, opportunities have been taken in the past to lock-in some of the 'core balances' cash holdings to 2 and 3 year deals when attractive interest rates have been available, having regard however to the alternative investment opportunities already agreed. The current returns on deposits for these lending periods is considered insufficient and so no new 2 or 3 year deposits have been placed.

For 2014/15 the City has budgeted for an average investment return of 0.75% on investments placed during the financial year and previously. Financial forecasts for the period 2015/16 to 2017/18 include interest earnings based on an average investment return of 0.50%.

For its cash flow generated balances, the City will seek to utilise its business reserve accounts, money market funds, and short-dated deposits (overnight to twelve months) in order to benefit from the compounding of interest until increases in the base rate are sufficient to lend funds for longer periods.

## 7.7 Investment Treasury Indicator and Limit

Total principal funds invested for greater than 364 days are subject to a limit, set with regard to the City's liquidity requirements and to reduce the need for an early sale of an investment, and are based on the availability of funds after each year end.

The Board is asked to approve the treasury indicator and limit:

Maximum principal sums invested for more than 364 days (up to three years)

<u>£M</u>	<u>2015/16 (£M)</u>	<u>2016/17 (£M)</u>	<u>2017/18 (£M)</u>
Principal sums invested >364 days	200	200	200

It should be emphasised that the City is prepared to lend monies out for periods of up to three years which is longer than most other local authorities who tend to opt for shorter durations.

## 7.8 End of year investment report

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

## 7.9 External fund managers

A proportion of the City's funds, amounting to £160.8m as at 31 December 2014, are externally managed on a discretionary basis by Ignis Asset Management, Invesco, Prime Rate, CCLA Liquidity Fund and Payden Global Funds Plc. The City's external fund managers will comply with the Annual Investment Strategy, and the agreements between the City and the fund managers additionally

stipulate guidelines and duration and other limits in order to contain and control risk. Investments made by the Money Market Fund Managers include a diversified portfolio of very high quality sterling-dominated investments, including gilts, supnationals, bank and corporate bonds, as well as other money market securities. The individual investments held within the Money Market Funds are monitored on a regular basis by Treasury staff.

The credit criteria to be used for the selection of the cash fund manager(s) are based on Fitch Ratings and is AAA/mmf. The Payden Sterling Reserve Fund is rated by Standard and Poor's at AAA/f.

#### **7.10 Policy on the use of external service providers**

The City uses Capita Asset Services, Treasury Solutions as its external treasury management advisers.

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

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

#### **7.11 Scheme of delegation**

Please see Appendix 7.

#### **7.12 Role of the Section 151 officer**

Please see Appendix 8.

## **APPENDICES**

1. Interest Rate Forecasts 2015-2018
2. Economic Background (Capita Asset Services)
3. Treasury Indicators
4. Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management
5. Current Approved Counterparties
6. Approved Countries for Investments
7. Treasury Management Scheme of Delegation
8. The Treasury Management Role of the Section 151 Officer

## APPENDIX 1: Interest Rates Forecasts 2015-2018

Capita Asset Services Interest Rate View													
	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
<b>Bank Rate View</b>	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.75%	1.75%	2.00%
3 Month LIBID	0.50%	0.50%	0.60%	0.80%	0.90%	1.10%	1.10%	1.30%	1.40%	1.50%	1.80%	1.90%	2.10%
6 Month LIBID	0.70%	0.70%	0.80%	1.00%	1.10%	1.20%	1.30%	1.50%	1.60%	1.70%	2.00%	2.10%	2.30%
12 Month LIBID	0.90%	1.00%	1.10%	1.30%	1.40%	1.50%	1.60%	1.80%	1.90%	2.00%	2.30%	2.40%	2.60%
5yr PW IB Rate	2.20%	2.20%	2.30%	2.50%	2.60%	2.80%	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.60%
10yr PW IB Rate	2.80%	2.80%	3.00%	3.20%	3.30%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%
25yr PW IB Rate	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
50yr PW IB Rate	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
<b>Bank Rate</b>													
Capita Asset Services	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.75%	1.75%	2.00%
Capital Economics	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	-	-	-	-	-
<b>5yr PW IB Rate</b>													
Capita Asset Services	2.20%	2.20%	2.30%	2.50%	2.60%	2.80%	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.60%
Capital Economics	2.20%	2.50%	2.70%	3.00%	3.10%	3.20%	3.30%	3.40%	-	-	-	-	-
<b>10yr PW IB Rate</b>													
Capita Asset Services	2.80%	2.80%	3.00%	3.20%	3.30%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%
Capital Economics	2.80%	3.05%	3.30%	3.55%	3.60%	3.65%	3.70%	3.80%	-	-	-	-	-
<b>25yr PW IB Rate</b>													
Capita Asset Services	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
Capital Economics	3.25%	3.45%	3.65%	3.85%	3.95%	4.05%	4.15%	4.25%	-	-	-	-	-
<b>50yr PW IB Rate</b>													
Capita Asset Services	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
Capital Economics	3.30%	3.50%	3.70%	3.90%	4.00%	4.10%	4.20%	4.30%	-	-	-	-	-

Please note – The current PWLB rates and forecast shown above have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012

## **APPENDIX 2: Economic Background**

### **THE UK ECONOMY**

**UK.** After strong UK GDP growth in 2013 at an annual rate of 2.7%, and then in 2014 0.7% in Q1, 0.9% in Q2 2014 (annual rate 3.2% in Q2), Q3 has seen growth fall back to 0.7% in the quarter and to an annual rate of 2.6%. It therefore appears that growth has eased since the surge in the first half of 2014 leading to a downward revision of forecasts for 2015 and 2016, albeit that growth will still remain strong by UK standards. For this recovery to become more balanced and sustainable in the longer term, the recovery needs to move away from dependence on consumer expenditure and the housing market to exporting, and particularly of manufactured goods, both of which need to substantially improve on their recent lacklustre performance. This overall strong growth has resulted in unemployment falling much faster than expected. The MPC is now focusing on how quickly slack in the economy is being used up. It is also particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back significantly above the level of inflation in order to ensure that the recovery will be sustainable. There also needs to be a major improvement in labour productivity, which has languished at dismal levels since 2008, to support increases in pay rates. Unemployment is expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in wage growth at some point during the next three years. However, just how much those future increases in pay rates will counteract the depressive effect of increases in Bank Rate on consumer confidence, the rate of growth in consumer expenditure and the buoyancy of the housing market, are areas that will need to be kept under regular review.

Also encouraging has been the sharp fall in inflation (CPI), reaching 1.0% in November 2014, the lowest rate since September 2002. Forward indications are that inflation is likely to remain around or under 1% for the best part of a year. The return to strong growth has helped lower forecasts for the increase in Government debt over the last year but monthly public sector deficit figures during 2014 have disappointed until November. The autumn statement, therefore, had to revise the speed with which the deficit is forecast to be eliminated.

**Eurozone (EZ).** The Eurozone is facing an increasing threat from weak or negative growth and from deflation. In November 2014, the inflation rate fell further, to reach a low of 0.3%. However, this is an average for all EZ countries and includes some countries with negative rates of inflation. Accordingly, the ECB took some rather limited action in June and September 2014 to loosen monetary policy in order to promote growth.

In addition to the circa €10bn of monthly bond purchases already carried out, the ECB announced in January that it would begin purchasing a further €50bn of bonds per month to bring its monthly asset purchases to €60bn. Although markets had been pricing in quantitative easing for quite some time, Draghi's announcement was at the top end of the range of market forecasts. The quantitative easing programme will begin in March 2015 and is expected to conclude in September 2016. However, should the need occur the programme will continue until inflationary targets of close

to 2% are met over the medium term. This caveat leaves the ECB with the flexibility to continue with quantitative easing past September 2016 if it finds it necessary

Concern in financial markets for the Eurozone subsided considerably after the prolonged crisis during 2011-2013. However, sovereign debt difficulties have not gone away and major issues could return in respect of any countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy, (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise for some countries. This could mean that sovereign debt concerns have not disappeared but, rather, have only been postponed. The ECB's pledge in 2012 to buy unlimited amounts of bonds of countries which ask for a bailout has provided heavily indebted countries with a strong defence against market forces. This has bought them time to make progress with their economies to return to growth or to reduce the degree of recession. However, debt to GDP ratios (2013 figures) of Greece 180%, Italy 133%, Portugal 129%, Ireland 124% and Cyprus 112%, remain a cause of concern, especially as some of these countries are experiencing continuing rates of increase in debt in excess of their rate of economic growth i.e. these debt ratios are likely to continue to deteriorate. Any sharp downturn in economic growth would make these countries particularly vulnerable to a new bout of sovereign debt crisis. It should also be noted that Italy has the third biggest debt mountain in the world behind Japan and the US.

**Greece:** the general election due to take place on 25 January 2015 is likely to bring a political party to power which is anti EU and anti-austerity. However, if this eventually results in Greece leaving the Euro, it is unlikely that this will directly destabilise the Eurozone as the EU has put in place adequate firewalls to contain the immediate fallout to just Greece. However, the indirect effects of the likely strengthening of anti EU and anti-austerity political parties throughout the EU is much more difficult to quantify. There are particular concerns as to whether democratically elected governments will lose the support of electorates suffering under EZ imposed austerity programmes, especially in countries which have high unemployment rates. There are also major concerns as to whether the governments of France and Italy will effectively implement austerity programmes and undertake overdue reforms to improve national competitiveness. These countries already have political parties with major electoral support for anti EU and anti-austerity policies. Any loss of market confidence in either of the two largest Eurozone economies after Germany would present a huge challenge to the resources of the ECB to defend their debt.

**USA.** The U.S. Federal Reserve ended its monthly asset purchases in October 2014. GDP growth rates (annualised) for Q2 and Q3 of 4.6% and 5.0% have been stunning and hold great promise for strong growth going forward. It is therefore confidently forecast that the first increase in the Fed. rate will occur by the middle of 2015.

**China.** Government action in 2014 to stimulate the economy appeared to be putting the target of 7.5% growth within achievable reach but recent data has indicated a marginally lower outturn for 2014, which would be the lowest rate of growth for many years. There are also concerns that the Chinese leadership has only started to address an unbalanced economy which is heavily over dependent on new

investment expenditure, and for a potential bubble in the property sector to burst, as it did in Japan in the 1990s, with its consequent impact on the financial health of the banking sector. There are also concerns around the potential size, and dubious creditworthiness, of some bank lending to local government organisations and major corporates. This primarily occurred during the government promoted expansion of credit, which was aimed at protecting the overall rate of growth in the economy after the Lehman's crisis.

**Japan.** Japan is causing considerable concern as the increase in sales tax in April 2014 has suppressed consumer expenditure and growth to the extent that it has slipped back into recession in Q2 and Q3. The Japanese government already has the highest debt to GDP ratio in the world.

## **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 2015. 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.

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.

The interest rate forecasts in this report are based on an initial assumption that there will not be a major resurgence of the EZ debt crisis. There is an increased risk that Greece could end up leaving the Euro but if this happens, the EZ now has sufficient fire walls in place that a Greek exit would have little immediate direct impact on the rest of the EZ and the Euro. It is therefore expected that there will be an overall managed, albeit painful and tortuous, resolution of any EZ debt crisis that may occur where EZ institutions and governments eventually do what is necessary - but only when all else has been tried and failed. Under this assumed scenario, growth within the EZ will be weak at best for the next couple of years with some EZ countries experiencing low or negative growth, which will, over that time period, see an increase in total government debt to GDP ratios. There is a significant danger that these ratios could rise to the point where markets lose confidence in the financial viability of one, or more, countries, especially if growth disappoints and / or efforts to reduce government deficits fail to deliver the necessary reductions. However, it is impossible to forecast whether any individual country will lose such confidence, or when, and so precipitate a sharp resurgence of the EZ debt crisis. While the ECB has adequate resources to manage a debt crisis in a small EZ country, if one, or

more, of the larger countries were to experience a major crisis of market confidence, this would present a serious challenge to the ECB and to EZ politicians.

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 strong 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: -

- An adverse reaction by financial markets to the result of the UK general election in May 2015 and the economic and debt management policies adopted by the new government
- ECB either failing to carry through on recent statements that it will soon start quantitative easing (purchase of government debt) or severely disappointing financial markets with embarking on only a token programme of minimal purchases which are unlikely to have much impact, if any, on stimulating growth in the EZ.
- The commencement by the US Federal Reserve of increases in the central rate in 2015 causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities, leading to a sudden flight from bonds to equities.
- A surge in investor confidence that a return to robust world economic growth is imminent, causing a flow of funds out of bonds into 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.

### APPENDIX 3 - Treasury Indicators

<b>TABLE 1: TREASURY MANAGEMENT INDICATORS</b>	<b>2013/14</b>	<b>2014/15</b>	<b>2015/16</b>	<b>2016/17</b>	<b>2017/18</b>
	<b>actual</b>	<b>probable outturn</b>	<b>estimate</b>	<b>estimate</b>	<b>estimate</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
<b>Authorised Limit for external debt -</b>					
borrowing	£0	£0	£0	£0	£0
other long term liabilities	£0	£0	£0	£0	£0
<b>TOTAL</b>	<b>£0</b>	<b>£0</b>	<b>£0</b>	<b>£0</b>	<b>£0</b>
<b>Operational Boundary for external debt -</b>					
borrowing	£0	£0	£0	£0	£0
other long term liabilities	£0	£0	£0	£0	£0
<b>TOTAL</b>	<b>£0</b>	<b>£0</b>	<b>£0</b>	<b>£0</b>	<b>£0</b>
<b>Actual external debt</b>	£0	£0	£0	£0	£0
<b>Upper limit for fixed interest rate exposure</b>					
expressed as either:-					
Net principal re fixed rate borrowing / investments OR:-	100%	100%	100%	100%	100%
Net interest re fixed rate borrowing / investments	100%	100%	100%	100%	100%
<b>Upper limit for variable rate exposure</b>					
expressed as either:-					
Net principal re variable rate borrowing / investments OR:-	100%	100%	100%	100%	100%
Net interest re variable rate borrowing / investments	100%	100%	100%	100%	100%
<b>Upper limit for total principal sums invested for over 364 days</b>	£300m	£200m	£200m	£200m	£200m
(per maturity date)					

<b>TABLE 2: Maturity structure of fixed rate borrowing during 2013/14</b>	upper limit	lower limit
under 12 months	0%	0%
12 months and within 24 months	0%	0%
24 months and within 5 years	0%	0%
5 years and within 10 years	0%	0%
10 years and above	0%	0%

## APPENDIX 4 – Treasury Management Practice (TMP1) - Credit and Counterparty Risk Management, Specified and Non-Specified Investments and Limits

**SPECIFIED INVESTMENTS:** All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum ‘high’ quality criteria where appropriate.

**NON-SPECIFIED INVESTMENTS:** These are any investments which do not meet the Specified Investment criteria. A maximum of £200m will be held in aggregate in non-specified investment.

A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the above categories.

The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

### **SPECIFIED INVESTMENTS:**

(All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum ‘high’ rating criteria where applicable)

	<b>* Minimum ‘High’ Credit Criteria</b>	<b>Use</b>
Debt Management Agency Deposit Facility	--	In-house
Term deposits – local authorities	--	In-house
Term deposits – banks and building societies, including part nationalised banks	Short-term F1, Long-term A,	In-house
Term deposits – banks and building societies, including part nationalised banks	Short-term F1, Long-term A,	Fund Managers
Money Market Funds	AAA/mmf	In-house & Fund Managers
UK Government Gilts	UK Sovereign Rating	In-house & Fund Managers
Treasury Bills	UK Sovereign Rating	Fund Managers
Sovereign Bond issues (other than the UK government)	AAA	Fund Managers

**NON-SPECIFIED INVESTMENTS:** These are any investments which do not meet the Specified Investment Criteria with maturities in excess of 1 year. A maximum of £200m will be held in aggregate in non-specified investments.

	<b>* Minimum Credit Criteria</b>	<b>Use</b>	<b>Maximum</b>	<b>Maximum Maturity Period</b>
Term deposits - other LAs (with maturities in excess of one year)	-	In-house	£25m per LA	Three years
Term deposits, including callable deposits - banks and building societies (with maturities in excess of one year)	Long-term A, Short-term F1,	In-house and Fund Managers	£200m overall	Three years
Certificates of deposits issued by banks and building societies with maturities in excess of one year	Long-term A, Short-term F1,	In-house on a buy-and-hold basis and fund managers	£50m overall	Three years
UK Government Gilts with maturities in excess of one year	AAA	In-house on a buy-and-hold basis and fund managers	£50m overall	Three years

**APPENDIX 5 – Approved Counterparties**

**BANKS AND THEIR WHOLLY OWNED SUBSIDIARIES**

<b>FITCH RATINGS</b>	<b>BANK CODE</b>	<b>LIMIT OF £100M PER GROUP (£150m for Lloyds TSB Bank)</b>	<b>Duration</b>
<b>AA - F1 +</b>	40.53.7 1	HSBC -----	Up to 3 years
<b>A F1</b>	20.00.0 0 20.00.5 2	BARCLAYS CAPITAL BARCLAYS BANK -----	Up to 3 years
<b>A F1</b>	30.15.5 7	LLOYDS TSB BANK incl. Bank of Scotland -----	Up to 3 years
<b>A F1</b>	16.75.7 5	ROYAL BANK OF SCOTLAND RBOS SETTLEMENTS	Up to 3 years

**BUILDING SOCIETIES**

<b>FITCH RATINGS</b>	<b>GROUP</b>	<b>ASSETS £BN</b>	<b>LIMIT £M</b>	<b>Duration</b>
<b>A F1</b>	Nationwide	189	120	Up to 3 years
<b>A – F1</b>	Yorkshire	34	20	Up to 1 year
<b>A F1</b>	Coventry	28	20	Up to 1 year
<b>BBB – F2</b>	Skipton	14	20	Up to 1 year
<b>A – F1</b>	Leeds	11	20	Up to 1 year

### MONEY MARKET FUNDS

FITCH RATINGS	MONEY MARKET FUNDS Overall Limit £250m	DURATION
AAA/mmf	Goldman Sachs Sterling Liquidity Reserve Fund	Liquid
AAA/mmf	CCLA	Liquid
AAA/mmf	Prime Rate Liquidity Fund	Liquid
AAA/mmf	Ignis Asset Management Liquidity Fund	Liquid
AAA/mmf	Invesco	Liquid
AAA / f	Payden Sterling Reserve Fund	Liquid

### FOREIGN BANKS

(with a presence in London)

FITCH RATINGS	BANK CODE		LIMIT £M	Duration
<b>AA- F1+</b>	20.32.53	<b><u>AUSTRALIA</u></b> AUSTRALIA & NZ BANKING GROUP	25	Up to 3 years
<b>AA- F1+</b>	16.55.90	NATIONAL AUSTRALIA BANK	25	Up to 3 years
<b>AA- F1+</b>	40.51.62	<b><u>SWEDEN</u></b> SVENSKA HANDELSBANKEN	25	Up to 3 years

### LOCAL AUTHORITIES

<b>LIMIT OF £25M PER AUTHORITY</b>
Any UK local authority

## **APPENDIX 6 - Approved Countries for Investments – Based on ratings of the three rating agencies**

### **AAA**

- Australia
- Canada
- Denmark
- Finland
- Germany
- Luxembourg
- Norway
- Singapore
- Sweden
- Switzerland

### **AA+**

- United Kingdom

## **APPENDIX 7 – Treasury Management Scheme of Delegation**

The roles of the various bodies of the City of London Corporation with regard to treasury management are:

### **(i) Court of Common Council**

- receiving and reviewing reports on treasury management policies, practices and activities
- approval of annual strategy.

### **(ii) Financial Investment Board and Finance Committee**

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices
- budget consideration and approval
- approval of the division of responsibilities
- receiving and reviewing regular monitoring reports and acting on recommendations
- approving the selection of external service providers and agreeing terms of appointment.

### **(iii) Audit & Risk Management Committee**

- Reviewing the treasury management policy and procedures and making recommendations to the responsible body.
- Working closely with and considering recommendations of the Section 151 officer on the compliance with legal statute and statements of recommended practice.

## **APPENDIX 8 - The Treasury Management Role of the Section 151 Officer**

### **The Chamberlain**

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance
- submitting regular treasury management policy reports
- submitting budgets and budget variations
- 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 of internal audit, and liaising with external audit
- recommending the appointment of external service providers.

## Reserves

<b>Forecast Movements in City Fund Usable Reserves 2015/16</b>				
	Notes	Estimated Opening Balance 1 April 15 £m	Forecast Net Movement in Year £m	Estimated Closing Balance 31 March 16 £m
<b><u>Revenue Usable Reserves</u></b>				
General	a	(46.9)	0.0	(46.9)
<b>Earmarked:</b>				
Crossrail	b	(22.8)	19.6	(3.2)
Police future expenditure	c	(5.9)	1.7	(4.2)
Highway improvements	d	(7.6)	3.7	(3.9)
Business Rates Safety Net Equalisation	e	(14.3)	14.3	0.0
VAT Reserve	f	(4.2)	0.0	(4.2)
Proceeds of Crime Act	g	(3.7)	0.5	(3.2)
Judges Pensions	h	(1.4)	0.0	(1.4)
Central Criminal Court	i	(0.6)	0.4	(0.2)
Renewals and Repairs	j	(0.7)	0.0	(0.7)
Maintenance of Graves	k	(0.5)	0.5	0.0
Service Projects	l	(2.5)	0.3	(2.2)
<b>Total Revenue Earmarked</b>		<b>(64.2)</b>	<b>41.0</b>	<b>(23.2)</b>
Housing Revenue Account		(7.7)	5.3	(2.4)
<b>Total Revenue Usable Reserves</b>		<b>(118.8)</b>	<b>46.3</b>	<b>(72.5)</b>
<b><u>Capital Usable Reserves</u></b>				
General Capital Receipts Reserve		(35.9)	(4.8)	(40.7)
Crossrail Capital Receipts Reserve		(132.6)	132.6	0.0
HRA Major Repairs Reserve		(4.0)	4.0	0.0
<b>Total Capital Usable Reserves</b>		<b>(172.5)</b>	<b>131.8</b>	<b>(40.7)</b>
<b>Total Usable Reserves</b>		<b>(291.3)</b>	<b>178.1</b>	<b>(113.2)</b>

## Notes

- (a) General Reserve – The accumulated balance from annual surpluses or deficits on the City Fund Revenue Account less any transfers to, or plus any transfers from, earmarked reserves.
- (b) Crossrail – Revenue funds set aside to contribute towards the City’s £200m commitment towards the Crossrail project, currently anticipated in 2016.
- (c) Police Future Expenditure - Revenue expenditure for the City Police service is cash limited. Underspendings against this limit may be carried forward as a reserve to the following financial year and overspendings are required to be met from this reserve.
- (d) Highway Improvements - Created from on-street car parking surpluses to finance future highways related expenditure and projects as provided by section 55 of the Road Traffic Regulation Act 1984, as amended by the Road Traffic Act 1991.
- (e) Business Rates Safety Net Equalisation - Safety net arrangements are in place to protect local authorities from the impact of any reductions below 7.5% in their retained business rates baseline funding level. Under these arrangements the maximum loss the City can suffer is £1.1m against the baseline funding level. Due to the impact of the provision for rating appeals the City did suffer a reduction in retained rates income for 2013/14. However, under statutory arrangements, the shortfall will not be charged against the City Fund unallocated reserve until 2015/16 and is held temporarily in the Collection Fund Adjustment Account as a negative reserve. This liability will be largely offset by a payment from the Government to bring the City’s retained rates income up to its safety net level. This payment from the Government has therefore been set aside to partly compensate for the shortfall when it is subsequently recognised.
- (f) VAT Reserve – Should the City of London Corporation no longer be able to recover VAT incurred on exempt services as a result of exceeding the 5% partial exemption threshold, this reserve will be the first call for meeting the associated costs.
- (g) Proceeds of Crime Act – Cash forfeiture sums awarded to the City. Under the guidelines of the scheme, the funds must be ring-fenced for crime reduction initiatives.
- (h) Judges Pensions - Sums set aside to assist with the City of London’s share of liabilities.
- (i) Central Criminal Court Plant Replacement – Sums set aside to assist with financing the net cost up to design report stage.
- (j) Renewals and Repairs – Sums obtained on the surrender of headleases and set aside to fund cyclical maintenance and repair works to the properties and void costs.
- (k) Maintenance of Graves - to help fund the maintenance of graves and memorial gardens so that current income is not the sole source of finance for the maintenance of old graves. Any surpluses made by the Cemetery and Crematorium are transferred to the Reserve at year end.

- (l) A number of reserves for service specific projects and activities where the balance on each individual reserve is less than £0.5m have been aggregated under this generic heading.