

## **COUNCIL 11<sup>th</sup> October 2016**

### **ANNUAL TREASURY REPORT 2015/16**

#### **1. Background**

- 1.1. The Council's treasury management activity is underpinned by CIPFA's Code of Practice on Treasury Management ('the Code') which requires local authorities to produce annually Prudential Indicators and a Treasury Management Strategy Statement on the likely financing and investment activity. The Code also recommends that members are informed of treasury management activities at least twice a year. Scrutiny of treasury policy, strategy and activity is delegated to the Audit and Accounts Committee.
- 1.2. Treasury management is defined as: 'The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.'
- 1.3. Overall responsibility for treasury management remains with the Council. No treasury management activity is without risk; the effective identification and management of risk are integral to the Council's treasury management strategy.

#### **2. Economic Background**

- 2.1. The UK economy slowed in 2015 with GDP growth falling to 2.3% from a robust 3.0% the year before. CPI inflation hovered around 0.0% through 2015 with deflationary spells in April, September and October. The prolonged spell of low inflation was attributed to the continued collapse in the price of oil, the appreciation of sterling since 2013 pushing down import prices and weaker than anticipated wage growth resulting in subdued unit labour costs.
- 2.2. CPI picked up to 0.3% year/year in February, but this was still well below the Bank of England's 2% inflation target. The labour market continued to improve through 2015 and the latest figures (Jan 2016) showing the employment rate at 74.1% (the highest rate since comparable records began in 1971) and the unemployment rate at a 12 year low of 5.1%.

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

A more detailed economic and interest rate forecast provided by Arlingclose is attached at ***Appendix A***.

2.3. The United Kingdom's vote to leave the European Union brought turbulence in UK and European markets. Arlingclose have been keeping us up to date with regular emails. A summary of the impact is shown in **Appendix B**.

### 3. Local Context

3.1. At 31/03/2016 the Council's underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) was £123m, while usable reserves and working capital which are the underlying resources available for investment were £42.5m.

3.2. At 31/03/2016, the Council had £92m of borrowing and £15m of investments. The Council's current strategy is to maintain borrowing below the underlying level indicated by the CFR, and to use internal resources to cover the gap. This is referred to as internal borrowing.

3.3. The Council has an increasing CFR over the next 2 years due to the capital programme and there may be a requirement to borrow up to £7.5m over the forecast period. However, if reserve levels permit, internal borrowing will be considered.

### 4. Borrowing Strategy

4.1. Borrowing Activity in 2015/16

	<b>Balance 1/4/15 £000</b>	<b>New Borrowing £000</b>	<b>Debt Maturing £000</b>	<b>Balance 31/3/16 £000</b>
CFR	122,145			123,584
Short Term Borrowing	3,827	11,792	11,983	3,636
Long Term Borrowing	90,159	0	2,017	88,142
<b>Total Borrowing</b>	<b>93,986</b>	<b>11,792</b>	<b>14,000</b>	<b>91,778</b>
Other Long Term Liabilities	224	0	0	224
<b>Total External Debt</b>	<b>94,210</b>	<b>11,792</b>	<b>14,000</b>	<b>92,002</b>
Increase/(Decrease) in Borrowing £000				(2,208)

4.2. The Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

4.3. Affordability remained an important influence on the Council's borrowing strategy alongside the "cost of carry" - consideration that, for any borrowing undertaken ahead of need, the proceeds would have to be invested in the money markets at rates of interest significantly lower than the cost of borrowing. As short-term interest rates have remained, and are likely to remain lower than long-term rates, at least over the forthcoming two years, the Council determined it was more cost effective in the short-term to use internal resources instead of borrowing.

4.4. The benefits of internal borrowing were monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise. Arlingclose assists the Council with this 'cost of carry' and breakeven analysis.

- 4.5. **LOBOs:** The Council holds £16.5m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. £3.5m of these LOBOS had options during the year, none of which were exercised by the lender.
- 4.6. **Debt Rescheduling:** The premium charge for early repayment of PWLB debt remained relatively expensive for the loans in the Council's portfolio and therefore unattractive for debt rescheduling activity. No rescheduling activity was undertaken as a consequence.
- 4.7. **Abolition of the PWLB:** In January 2015 the Department of Communities and Local Government (CLG) confirmed that HM Treasury (HMT) would be taking the necessary steps to abolish the Public Works Loans Board. HMT has confirmed however that its lending function will continue unaffected and local authorities will retain access to borrowing rates which offer good value for money. The Council intends to consider using the PWLB's replacement as a potential source of borrowing if required.

## 5. Investment Activity

### 5.1. Investment Activity in 2015/16

	<b>Balance 1/4/15 £000</b>	<b>New Investments £000</b>	<b>Investments Redeemed £000</b>	<b>Balance 31/3/16 £000</b>
Short Term Investments	17,088	135,425	137,961	14,552
Long Term Investments	0	0	0	0
<b>Total Investments</b>	<b>17,088</b>	<b>135,425</b>	<b>137,961</b>	<b>14,552</b>
Increase/(Decrease) in Investments £000				(2,536)

- 5.2. The Council has held invested funds, representing income received in advance of expenditure plus balances and reserves held. During 2015/16 the Council's investment balances have ranged between £13.6 and £29.3 million. The Guidance on Local Government Investments in England gives priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles.
- 5.3. Security of capital remained the Council's main objective. This was maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2015/16.
- 5.4. Counterparty credit quality is assessed and monitored by Arlingclose, the Council's treasury advisors, with reference to credit ratings; credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. Arlingclose provide recommendations for suitable counterparties and maximum investment periods.

A more detailed counterparty update has been provided by Arlingclose and is attached at **Appendix C**.

5.5. **Investments with Icelandic Banks** – Following a partial repayment in 2012, a further final amount of £297,943.62 was received on 24th September 2015. The Council has recovered 96.9% of its original investment of £2,000,000.

## 6. **Compliance with Prudential Indicators**

6.1. The Council can confirm that it has complied with its Prudential Indicators for 2015/16, which were set on 10<sup>th</sup> March 2015 as part of the Council's Treasury Management Strategy Statement.

6.2. **Interest Rate Exposure:** These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates for both borrowing and investments. The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on our portfolio of investments. The figure shown below for the variable rate for investments has exceeded the limit, although the Net effect is within the limit. All our investments are short term and there were no fixed rates that were comparable to variable rates, over the short term.

	<b>Approved Limit for 2015/16 £m</b>	<b>Maximum during 2015/16 £m</b>
<b><u>Fixed Rate</u></b>		
Borrowing	118.7	90.2
Investments	-5.3	0
<b>Net Upper Limit for Fixed Rate Exposure</b>	<b>113.4</b>	<b>90.2</b>
<i>Compliance with Limit</i>		<i>Yes</i>
<b><u>Variable Rate</u></b>		
Borrowing	29.6	4.4
Investments	-24.7	-29.3
<b>Net Upper Limit for Variable Rate Exposure</b>	<b>4.9</b>	<b>-24.9</b>
<i>Compliance with Limit</i>		<i>Yes</i>

6.3. **Maturity Structure of Fixed Rate Borrowing.** This indicator is to limit large concentrations of fixed rate debt and control the Council's exposure to refinancing risk.

	<b>Upper Limit %</b>	<b>Fixed Rate Borrowing 31/03/16 £m</b>	<b>Fixed Rate Borrowing 31/3/16 %</b>	<b>Compliance?</b>
Under 12 months	15%	10.5	11.9%	Yes
12 months to 2 years	15%	4.5	5.1%	Yes
2 years to 5 years	30%	10.6	12%	Yes
5 years to 10 years	100%	23.2	26.3%	Yes
10 years and above	100%	39.4	44.7%	Yes

6.4. **Principal Sums Invested for over 364 Days.** All investments were made on a short-term basis and there were no investments for more than 364 days.

6.5. **Authorised Limit and Operational Boundary for External Debt.** The Local Government Act 2003 requires the Council to set an Affordable Borrowing Limit, irrespective of their

indebted status. This is a statutory limit which should not be breached. The Operational Boundary is based on the same estimates as the Authorised Limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included within the Authorised Limit. The s151 Officer confirms that there were no breaches to the Authorised Limit and the Operational Boundary during 2015/16; borrowing at its peak was £94.6m.

	<b>Approved Operational Boundary 2015/16 £m</b>	<b>Authorised Limit 2015/16 £m</b>	<b>Actual External Debt 31/03/16 £m</b>
Borrowing	128.3	148.3	91.7
Other Long Term Liabilities	0.4	0.6	0.2
<b>Total</b>	<b>128.7</b>	<b>148.9</b>	<b>91.9</b>

- 6.6. In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary of the treasury management activity during 2015/16. None of the Prudential Indicators have been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield.
- 6.7. The Council also confirms that during 2015/16 it complied with its Treasury Management Policy Statement and Treasury Management Practices.

## **7. RECOMMENDATION**

**That the Treasury outturn position for 2015/16 be noted.**

For further information please contact Tara Beesley, Accountant, on extn 5328.

Nicky Lovely  
Business Manager & Chief Financial Officer – Financial Services

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

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

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

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

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

**Market reaction:** From June 2015 gilt yields were driven lower by the weakening in Chinese growth, the knock-on effects of the fall in its stock market, the continuing fall in the price of oil and commodities and acceptance of diminishing effectiveness of central bankers' unconventional policy actions. Added to this was the heightened uncertainty surrounding the outcome of the UK

referendum on its continued membership of the EU as well as the US presidential elections which culminated in a significant volatility and in equities and corporate bond yields.

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

## Money Market Data and PWLB Rates

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

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

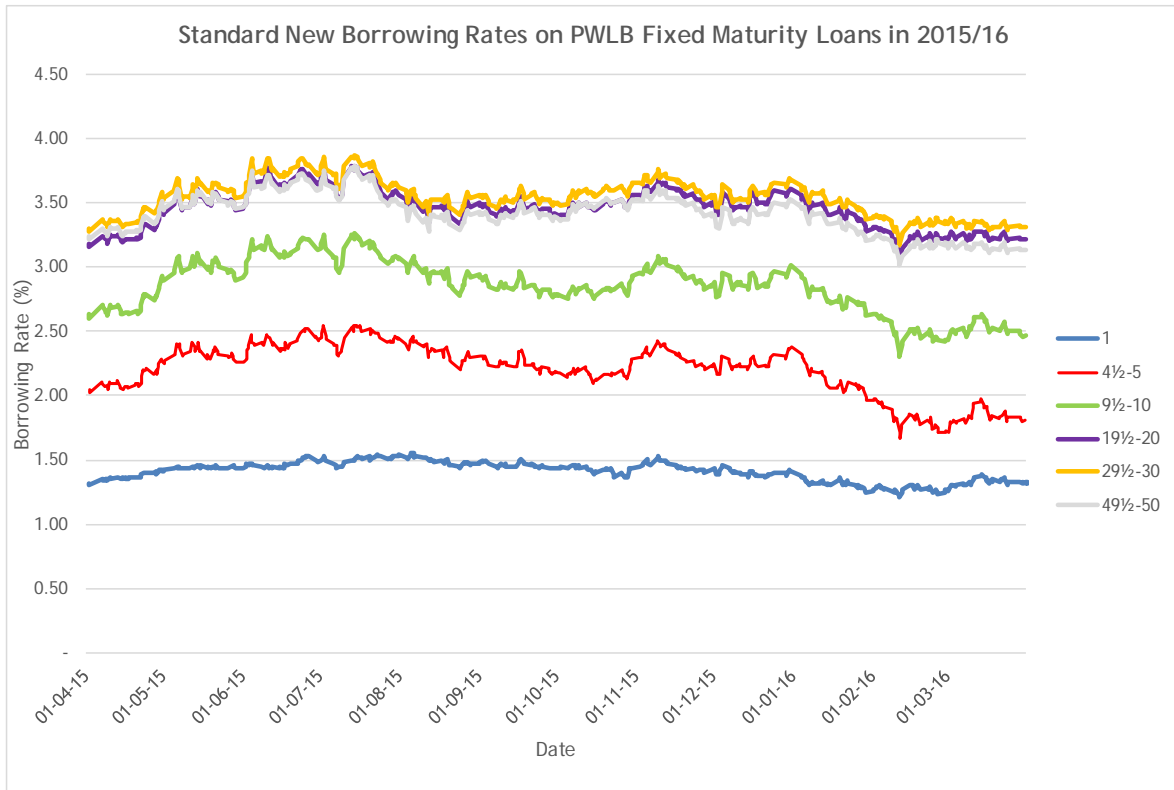
**Table 1: Bank Rate, Money Market Rates**

Date	Bank Rate	O/N LIBID	7-day LIBID	1-month LIBID	3-month LIBID	6-month LIBID	12-month LIBID	2-yr SWAP Bid	3-yr SWAP Bid	5-yr SWAP Bid
01/04/2015	0.50	0.35	0.46	0.43	0.51	0.76	0.97	0.87	1.05	1.32
30/04/2015	0.50	0.35	0.48	0.43	0.52	0.74	0.98	1.00	1.21	1.51
31/05/2015	0.50	0.43	0.50	0.43	0.52	0.75	0.98	0.97	1.18	1.49
30/06/2015	0.50	0.35	0.45	0.43	0.52	0.79	0.99	1.09	1.35	1.68
31/07/2015	0.50	0.32	0.43	0.43	0.53	0.79	1.01	1.10	1.33	1.66
31/08/2015	0.50	0.42	0.40	0.43	0.54	0.82	1.02	1.03	1.24	1.61
30/09/2015	0.50	0.37	0.41	0.43	0.54	0.74	1.00	0.93	1.11	1.41
31/10/2015	0.50	0.36	0.41	0.43	0.54	0.77	1.00	0.97	1.16	1.49
30/11/2015	0.50	0.30	0.42	0.43	0.54	0.88	1.00	0.93	1.10	1.39
31/12/2015	0.50	0.43	0.35	0.43	0.54	0.76	1.01	1.09	1.30	1.58
31/01/2016	0.50	0.43	0.42	0.43	0.54	0.71	0.99	0.77	0.89	1.14
29/02/2016	0.50	0.25	0.43	0.43	0.54	0.73	0.99	0.71	0.74	0.85
31/03/2016	0.50	0.30	0.44	0.52	0.62	0.71	0.93	0.79	0.84	1.00
<b>Average</b>	0.50	0.38	0.45	0.43	0.54	0.76	0.99	0.96	1.14	1.43
<b>Maximum</b>	0.50	0.48	0.58	0.57	0.66	0.92	1.02	1.17	1.44	1.81
<b>Minimum</b>	0.50	0.17	0.35	0.43	0.51	0.55	0.84	0.68	0.73	0.85
<b>Spread</b>	--	0.31	0.23	0.14	0.15	0.37	0.18	0.49	0.71	0.96

**Table 2: PWLB Borrowing Rates - Fixed Rate, Maturity Loans**

Change Date	Notice No	1 year	4½-5 yrs	9½-10 yrs	19½-20 yrs	29½-30 yrs	39½-40 yrs	49½-50 yrs
01/04/2015	127/15	1.33	2.10	2.69	3.24	3.37	3.32	3.31
30/04/2015	166/15	1.41	2.27	2.90	3.44	3.55	3.50	3.48
31/05/2015	204/15	1.44	2.26	2.90	3.44	3.54	3.48	3.45
30/06/2015	248/15	1.48	2.44	3.13	3.65	3.72	3.64	3.60
31/07/2015	294/15	1.54	2.45	3.07	3.56	3.62	3.54	3.49
31/08/2015	334/15	1.47	2.30	2.92	3.47	3.54	3.44	3.40
30/09/2015	379/15	1.44	2.19	2.79	3.42	3.50	3.42	3.39

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



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

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



	Average	1.76	2.25	2.88	3.24	3.47	3.55
	High	1.99	2.60	3.28	3.61	3.79	3.87

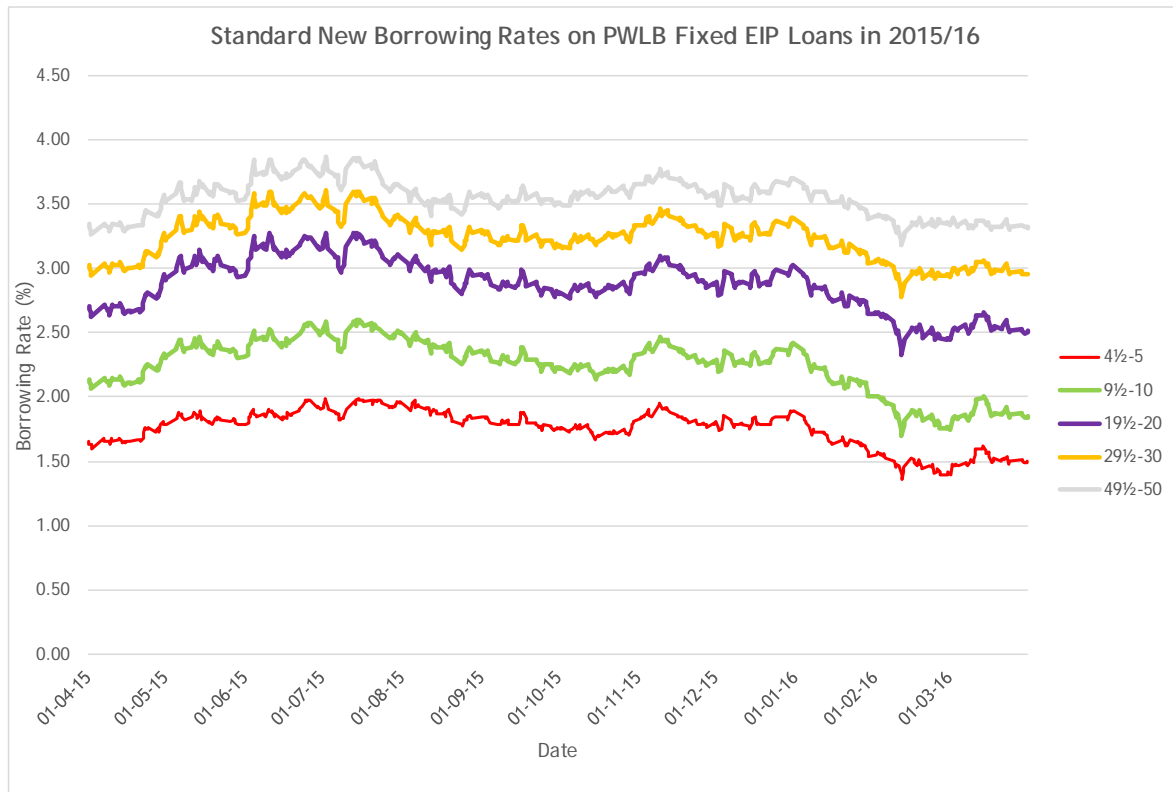


Table 4: PWLB Variable Rates

	1-M Rate	3-M Rate	6-M Rate	1-M Rate	3-M Rate	6-M Rate
	Pre-CSR	Pre-CSR	Pre-CSR	Post-CSR	Post-CSR	Post-CSR
01/04/2015	0.62	0.63	0.66	1.52	1.53	1.56
30/04/2015	0.62	0.64	0.67	1.52	1.54	1.57
31/05/2015	0.62	0.65	0.68	1.52	1.55	1.58
30/06/2015	0.62	0.66	0.70	1.52	1.56	1.60
31/07/2015	0.62	0.66	0.72	1.52	1.56	1.62
31/08/2015	0.62	0.66	0.70	1.52	1.56	1.60
30/09/2015	0.66	0.67	0.76	1.56	1.57	1.66
31/10/2015	0.66	0.67	0.76	1.46	1.56	1.57
30/11/2015	0.64	0.67	0.72	1.54	1.57	1.62
31/12/2015	0.63	0.65	0.72	1.53	1.55	1.62
31/01/2016	0.64	0.66	0.69	1.54	1.56	1.59
29/02/2016	0.63	0.65	0.68	1.53	1.55	1.58
31/03/2016	0.61	0.65	0.67	1.51	1.55	1.57
Low	0.61	0.61	0.66	1.51	1.51	1.56
Average	0.63	0.66	0.71	1.53	1.56	1.61
High	0.67	0.69	0.78	1.57	1.59	1.68

**Brexit Update**

Underlying assumptions:

The economic trajectory for the UK has been immeasurably altered following the vote to leave the EU. The long-term position of the UK economy will be largely dependent on the agreements the government is able to secure with the EU and other countries.

The short to medium-term outlook is somewhat more downbeat due to the uncertainty generated by the result and the forthcoming negotiations (notwithstanding the Olympic and summer feel-good effects). The rapid installation of a new prime minister and cabinet lessened the political uncertainty, and the government/Bank of England have been proactive in tackling the economic uncertainty.

PMI data, and consumer and business confidence surveys published for July showed a significant downturn in business activity. An overreaction was always expected due to the unexpected result and confidence indicators, particularly consumer confidence, have experienced a limited recovery.

Over the medium term, economic and political uncertainty will likely dampen investment intentions and tighten credit availability, prompting lower activity levels and potentially a rise in unemployment. These effects will dampen economic growth through the second half of 2016.

UK CPI inflation (currently 0.6% year/year) will rise close to target over the coming year as previous rises in commodity prices and the sharp depreciation in sterling begin to drive up imported material costs for companies.

The rise in inflation is highly unlikely to prompt monetary tightening by the Bank of England, with policymakers looking through import-led CPI spikes to the negative effects of Brexit on economic activity and, ultimately, inflation.

There is a debatable benefit to further interest rate cuts (particularly with regard to financial stability). Negative Bank Rate is currently perceived by policymakers to be counterproductive, but there is a possibility of close-to-zero Bank Rate. QE will be used to limit the upward movement in bond yields.

Following significant global fiscal and monetary stimulus, the short term outlook for the global economy is somewhat brighter than a few months ago. However, financial market volatility is likely at various points because the stimulus has only delayed the fallout from the build-up of public and private sector debt (particularly in developing economies, e.g. China).

Arlingclose remains comfortable with clients making unsecured investments in UK institutions for the periods outlined in our counterparty packs.

**Counterparty Update**

The transposition of two European Union directives into UK legislation placed the burden of rescuing failing EU banks disproportionately onto unsecured institutional investors which include local authorities and pension funds. During the year, all three credit ratings agencies reviewed their ratings to reflect the loss of government support for most financial institutions and the potential for loss given default as a result of new bail-in regimes in many countries. Despite reductions in government support many institutions saw upgrades due to an improvement in their underlying strength and an assessment that the level of loss given default is low.

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

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

S&P reviewed UK and German banks in June, downgrading the long-term ratings of Barclays, RBS and Deutsche Bank. S&P also revised the outlook of the UK as a whole to negative from stable, citing concerns around the referendum on EU membership and its effect on the economy.

At the end of July 2015, Arlingclose advised an extension of recommended durations for unsecured investments in certain UK and European institutions following improvements in the global economic situation and the receding threat of another Eurozone crisis. A similar extension was advised for some non-European banks in September, with the Danish Danske Bank being added as a new recommended counterparty and certain non-rated UK building societies also being extended.

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

In January 2016, Arlingclose supplemented its existing investment advice with a counterparty list of high quality bond issuers, including recommended cash and duration limits. As part of this, Bank Nederlandse Gemeeten was moved to the list of bond issuers from the unsecured

bank lending list and assigned an increased recommended duration limit of 5 years. The Council did not make use of these long-term investment options during 2015/16.

The first quarter of 2016 was characterised by financial market volatility and a weakening outlook for global economic growth. In March 2016, following the publication of many banks' 2015 full-year results, Arlingclose advised the suspension of Deutsche Bank and Standard Chartered Bank from the counterparty list for unsecured investments. Both banks recorded large losses and despite improving capital adequacy this will call 2016 performance into question, especially if market volatility continues. Standard Chartered had seen various rating actions taken against it by the rating agencies and a rising CDS level throughout the year. Arlingclose will continue to monitor both banks.

The end of bank bail-outs, the introduction of bail-ins, and the preference being given to large numbers of depositors other than local authorities means that the risks of making unsecured deposits continues to be elevated relative to other investment options. The Authority therefore increasingly favoured pooled funds over unsecured bank and building society deposits.