

Report to Overview and Scrutiny Performance & Value for Money Select Committee

**Treasury Management Strategy Statement
2019/20**

Including the Minimum Revenue Provision Policy Statement, Annual Investment Strategy and Prudential Indicators

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Reason for Decision

To present to Overview and Scrutiny Performance & Value for Money (PVFM) Select Committee, the strategy for 2019/20 Treasury Management activities including the Minimum Revenue Provision Policy Statement, the Annual Investment Strategy and Prudential Indicators together with linkages to the Capital Strategy.

Executive Summary

The report outlines the Treasury Management Strategy for 2019/20 including the Minimum Revenue Provision Policy Statement, Annual Investment Strategy and Prudential Indicators together with linkages to the Capital Strategy.

The Strategy for 2019/20 covers two main areas.

Capital Issues

- The Capital Strategy and the Prudential Indicators
- The Minimum Revenue Provision (MRP) Policy Statement

Treasury Management Issues:

- The Current Treasury Position
- Treasury Indicators which limit the treasury risk and activities of the Council
- Prospects for Interest Rates
- The Borrowing Strategy
- The Policy on Borrowing in Advance of Need
- Debt Rescheduling
- The Investment Strategy
- The Creditworthiness Policy
- The Policy regarding the use of external service providers.

The report therefore outlines the implications and key factors in relation to each of the above Capital and Treasury Management issues and makes recommendations with regard to the Treasury Management Strategy for 2019/20.

Recommendation

That PVFM Select Committee considers the:

- 1 Capital Expenditure Estimates as per paragraph 2.1.2;
- 2 MRP policy and method of calculation as per Appendix 1;
- 3 Capital Financing Requirement (CFR) Projections as per paragraph 2.2.4;
- 4 Projected treasury position as at 31/03/2018 as per paragraph 2.4.4;
- 5 Treasury Limits as per section 2.4;
- 6 Borrowing Strategy for 2019/20 as per section 2.6;
- 7 Annual Investment Strategy as per section 2.10 including risk management and the creditworthiness policy at section 2.11.
- 8 Level of investment in specified and non-specified investments detailed at Appendix 5

Treasury Management Strategy Statement 2019/20 Including the Minimum Revenue Provision Policy Statement, Annual Investment Strategy and Prudential Indicators

1 Background

- 1.1 The Council 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 Council's low investment risk appetite, providing adequate liquidity initially before considering investment return.
- 1.2 The second main function of the Treasury Management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.
- 1.3 The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.
- 1.4 Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities, (arising usually from capital expenditure), and are separate from the day to day treasury management activities.
- 1.5 Treasury management is defined as:
- “The management of the local authority's borrowing, 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.”
- Source: CIPFA Treasury Management in the Public Service's Code of Practice.*
- 1.6 Revised reporting is required for the 2019/20 reporting cycle due to revisions of the Ministry of Housing, Communities and Local Government (MHCLG) Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the CIPFA Prudential Code and the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management Code. The primary reporting changes include the introduction of a capital strategy, to provide a longer-term focus to the capital plans, and greater reporting requirements surrounding any commercial activity undertaken under the Localism Act 2011. The Council has traditionally prepared a Capital Strategy in line with good practice, however additional disclosures have been added to ensure it is compliant with all the revised guidance and aligns fully with the issued outlined in the Treasury Management Strategy.

1.7 Reporting Requirements – Capital Strategy

- 1.7.1 The CIPFA revised 2017 Prudential and Treasury Management Codes require, for 2019/20, all Local Authorities to prepare an additional report, a capital strategy report, which will provide the following:
- a high-level long term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
 - an overview of how the associated risk is managed
 - the implications for future financial sustainability
- 1.7.2 The capital strategy is therefore prepared to ensure that all Council Members are presented with the overall long term capital investment policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.
- 1.7.3 This capital strategy is reported separately from the Treasury Management Strategy Statement; non-treasury investments will be reported through the former. This ensures the separation of the core treasury function under security, liquidity and yield principles, and the policy and commercialism investments, usually driven by expenditure on an asset. Specifically in relation to non-treasury investments, the capital strategy includes, where appropriate:
- The corporate governance arrangements;
 - Any service objectives relating to the investments;
 - The expected income, costs and resulting contribution to support the Councils budget;
 - The debt related to the activity and the associated interest costs;
 - The payback period (MRP policy);
 - For non-loan type investments, the cost against the current market value;
 - The risks associated with each activity.
- 1.7.4 Where a physical asset is being bought, details of market research, advisers used, (and their monitoring), ongoing costs and investment requirements and any credit information will be disclosed, including the ability to sell the asset and realise the investment cash.
- 1.7.5 Should the Council borrow to fund any non-treasury investment, there will be an explanation of why borrowing was required and why the MHCLG Investment Guidance and CIPFA Prudential Code have not been adhered to (note, to date there has been no such borrowing).
- 1.7.6 If any non-treasury investment sustains a loss during the final accounts and audit process, the strategy and revenue implications will be reported through the same procedure as the capital strategy (again, to date there have been no such losses).
- 1.7.7 To demonstrate the proportionality between the treasury operations and the non-treasury operation, high-level comparators are shown throughout this report.

1.8 Treasury Management reporting

- 1.8.1 The Council is currently required to receive and approve, as a minimum, three main treasury reports each year, which incorporate a variety of policies, estimates and actuals.
- a. Prudential and treasury indicators and treasury strategy (this report)
- The first, and most important report is forward looking and covers:

- the capital plans, (including prudential indicators);
- a minimum revenue provision (MRP) policy, (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy, (how the investments and borrowings are to be organised), including treasury indicators; and
- an investment strategy, (the parameters on how investments are to be managed).

b. A mid-year treasury management report

This is primarily a progress report and will update Members on the capital position, amending prudential indicators as necessary, and whether any policies require revision.

c. An annual treasury report

This is a backward looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

1.8.2 The above reports are required to be adequately scrutinised before being recommended to the Council. The Overview and Scrutiny Performance and Value for Money (PVFM) Select Committee scrutinises the Treasury Management Strategy Statement report together with all the other reports which are presented to the annual Budget Council meeting. The Audit Committee, the body charged with the detailed scrutiny of Treasury Management activities will also consider this report and the mid-year and annual review reports.

1.9 Treasury Management Strategy for 2019/20

1.9.1 The strategy for 2019/20 covers two main areas:

1.9.2 Capital issues:

- the capital expenditure plans and the associated prudential indicators;
- the minimum revenue provision (MRP) policy.

1.9.3 Treasury management issues:

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

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

1.10 Training

- 1.10.1 The CIPFA Code requires the responsible officer to ensure that Members with responsibility for treasury management receive adequate training in treasury management. This especially applies to Members responsible for scrutiny. Training was provided to Cabinet Members and Senior Council Officers on 22 October 2018. The Audit Committee receive regular updates regarding any issues that affect Treasury Management. Further training will be arranged as required.
- 1.10.2 The training needs of treasury management officers are periodically reviewed. The team is staffed by professionally qualified accountants with extensive Local Government finance experience. Team members attend all relevant training courses, workshops and events to ensure that their knowledge and skills are up to date and the Council is in a position to address all new technical developments. They all follow a Continuous Professional Development Plan (CPD) as part their individual accounting body accreditation. The overall responsibility for capital and treasury activities lies with the Council's Section 151 officer who, in accordance with statute, is professionally qualified and is suitably experienced to hold the post.

1.11 Treasury Management Consultants

- 1.11.1 The Council uses Link Asset Services, Treasury solutions as its external treasury management advisors.
- 1.11.2 The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon the services of our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.
- 1.11.3 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 Council 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.
- 1.11.4 Commercial type investments will require specialist advice that Link Asset Services do not provide. Prior to any commercial investments being made external advice will be sought and due diligence will be undertaken.

2 Capital Plans & Prudential Indicators 2019/20 – 2021/22

2.1 Capital Plans

- 2.1.1 The Council's capital expenditure plans are the key driver of Treasury Management activity. The output of the capital expenditure plans is reflected in Prudential Indicators, which are designed to assist Members' overview and confirm capital expenditure plans. These indicators as per the Capital Programme include previous years' actual expenditure, forecast expenditure for this current year 2018/19 and estimates for the next three year period, the timeframe required by CIPFA's guidance.

Capital Expenditure Estimates

- 2.1.2 This first Prudential Indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. The PVFM Select Committee is asked to consider the capital expenditure forecasts included the table below:

Table 1 - Capital Expenditure Estimates

Capital Expenditure	2017/18 Actual £'000	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000
Corporate and Commercial Services *	1,463	14,174	9,212	1,583	1,719
Health and Wellbeing	1,493	0	0	0	0
Health & Adult Social Care					
Community Services	0	1,894	2,682	1,400	400
Economy, Skills and Neighbourhoods	22,058	0	0	0	0
People & Place	0	31,265	54,403	63,081	70,544
Reform	0	216	100	100	700
Funds yet to be allocated	0	306	5,000	3,000	1,500
General Fund Services	25,014	47,855	71,397	69,164	74,863
Housing Revenue Account (HRA)	789	1,097	4,235	1,632	922
HRA	789	1,097	4,235	1,632	922
Commercial Activities / Non-Financial Investments **	0	0	6,180	7,750	6,680
Commercial Activities / Non-Financial Investments	0	0	6,180	7,750	6,680
Total	25,803	48,952	81,812	78,546	82,465

* Excludes commercial activities which are which are included in the Corporate and Commercial Services capital programme

** Relate to areas such as capital expenditure on investment properties, loans to third parties etc.

2.1.3 The capital expenditure shown above excludes other long term liabilities, such as Private Finance Initiative (PFI) and leasing arrangements which already include borrowing instruments. It should be noted that any new expenditure commitments are likely to increase the borrowing requirement.

2.1.4 Table 2 below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding need (borrowing).

2.1.5 The borrowing need for capital expenditure in 2019/20 is currently expected to be £24.193m. This will however change if there is a revision to the spending profile of the capital programme.

2.1.6 As at the present time the Council has not invested in any property purchases solely for the generation of additional income. To date the Council's property acquisitions have been undertaken for the regeneration of the borough with income generation a secondary consideration. The commercial activities/non-financial investment in table 1 above from 2019/20 relates to current estimated spend in the capital programme.

Table 2 - Funding of the Capital Programme

Capital Expenditure	2017/18 Actual £'000	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000
General Fund Services	25,014	47,855	71,397	69,164	74,863
HRA	789	1,097	4,235	1,632	922
Commercial Activities			6,180	7,750	6,680
Total	25,803	48,952	81,812	78,546	82,465
Financed by:					
Capital receipts	(6,780)	(5,793)	(19,042)	(4,306)	(8,629)
Capital grants	(10,821)	(16,068)	(34,661)	(25,375)	(17,776)
Revenue	(7,458)	(8)	(67)	(73)	0
HRA Resources	(744)	(88)	(3,849)	(4,033)	(5,822)
Net financing need for the year	0	26,995	24,193	44,759	50,238

2.1.7 All other prudential indicators included within this report are based on the above capital estimates.

2.2 The Council's Borrowing Need - the Capital Financing Requirement (CFR)

2.2.1 The second Prudential Indicator is the Council's CFR. The CFR represents total historic outstanding capital expenditure which has not yet been financed from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been financed from cash backed resources, will increase the CFR.

2.2.2 The CFR does not increase indefinitely, as the Council makes 'prudent' provision for debt repayment which broadly reduces indebtedness in line with each asset's life and so charges the economic consumption of capital assets as they are used. The approach to making prudent provision is set out in the MRP Policy Statement at Appendix 1.

2.2.3 The MRP policy for 2019/20 has not been amended since its inclusion at 1.4.2 in Appendix 1 in the 2018/19 Treasury Management Strategy report approved at Council on 28 February 2018.

2.2.4 The CFR includes other long term liabilities (e.g. Private Finance Initiative (PFI) schemes, finance leases etc.). Whilst these arrangements increase the CFR, and therefore the Council's borrowing requirement, such schemes also include a 'loan' facility meaning the Council is not required to make separate borrowing arrangements. The Council currently has a net figure of £235.396m of such schemes within the CFR for 2019/20, decreasing to £213.263m in 2021/22.

Table 3 Capital Financing Requirement (CFR)

	2017/18 Actual £'000	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000
Capital Financing Requirement (CFR)					
CFR - Services	505,049	519,540	517,485	534,822	562,302
CFR - Commercial Activities			5,000	10,000	10,000
Total CFR	505,049	519,540	522,485	544,822	572,302
Movement in CFR	(16,741)	14,491	2,945	22,337	27,480
Movement in CFR represented by					
Net financing need for the year	0	26,995	24,193	44,759	50,238
PFI Additions	379				
Less MRP/VRP and other financing movements	(17,120)	(12,504)	(21,248)	(22,422)	(22,758)
Movement in CFR	(16,741)	14,491	2,945	22,337	27,480

2.3 Borrowing

2.3.1 The capital expenditure plans set out in section 2.1 to a large extent drive the borrowing estimates included in this report. The Treasury Management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity and the Council's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant Treasury and Prudential Indicators, the current and projected debt positions and the Annual Investment Strategy.

Current Borrowing Portfolio Position

2.3.2 The overall treasury management portfolio as at 31 March 2018 and for the position as at 2 January 2019 are shown below for both borrowing and investments.

Table 4 Current Treasury Position

Treasury Investments	Actual 31/03/2018 £'000	Actual 31/03/2018%	Current 02/01/2019 £'000	Current 02/01/2019 %
Banks	20,000	27.16%	26,500	32.03%
Building Societies Rated	0	0.00%	0	0.00%
Local Authorities	25,000	33.94%	26,000	31.42%
Public Bodies	0	0.00%	0	0.00%
Money Market Funds	13,650	18.53%	12,740	15.40%
Certificates of Deposit	0	0.00%	2,500	3.02%
Total Managed in House	58,650	79.63%	67,740	81.87%
Property Funds	15,000	20.37%	15,000	18.13%
Total Managed Externally	15,000	20.37%	15,000	18.13%
Total Treasury Investments	73,650	100.00%	82,740	100.00%
Treasury External Borrowing				
PWLB	15,482	10.47%	15,482	10.47%
LOBO'S	85,500	57.83%	85,500	57.83%
Market	46,601	31.52%	46,601	31.52%
Temporary other	268	0.18%	266	0.18%
Total Treasury External Borrowing	147,851	100.00%	147,849	100.00%
Net Treasury Investments / (Borrowing)	(74,201)		(65,109)	

2.3.3 The Council's forward projections for borrowing are summarised below. The table shows the actual external debt, the Treasury Management operations, against the underlying capital borrowing need, the CFR, highlighting any over or under borrowing.

2.3.4 Table 5 shows the forecast position of gross borrowing as at 31 March 2019 at £393.992m and an under borrowed position of £125.549m. The PVFM Select Committee is asked to note the expected year end position.

Table 5 Current and Forecast Treasury Portfolio

	2017/18 Actual £'000	Forecast position as at 31/3/19 £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000
External Debt					
Debt at 1st April	147,866	147,851	147,849	167,849	200,349
Expected change in debt	(15)	(2)	20,000	32,500	58,500
Other long-term liabilities	263,947	256,115	246,143	235,395	224,125
Expected change in OLTL*	(7,832)	(9,972)	(10,747)	(11,270)	(10,862)
Actual gross debt at 31 March	403,966	393,992	403,245	424,474	472,112
The Capital Financing Requirement	505,049	519,540	522,485	544,822	572,302
Under / (over) borrowing	101,083	125,548	119,240	120,348	100,190

* Other Long Term Liabilities

2.3.5 Table 5 above shows the Council will need to undertake significant additional borrowing in future years if capital programme expenditure matches the anticipated spending profile. The borrowing requirement is a key driver of the borrowing strategy as set out in section 2.6 below. However, the Council has yet to draw down additional borrowing and the timing of the borrowing is being closely monitored. Members will recall that capital spending plans have been reprofiled year on year and it is possible that the trend could be repeated in 2019/20.

2.3.6 Included within the figures in Table 5 is the level of debt relating to commercial activities / non-financial investment this is shown in Table 6 below. This is a new requirement and shows a minimal impact to date on debt of potential investments in commercial activities.

Table 6 Commercial Activities Debt

	2017/18 Actual £'000	Forecast position as at 31/3/19 £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000
External Debt for commercial activities / non-financial investments	0	0	1,180	8,930	15,610
Actual Debt at 31 March	147,851	147,849	167,849	200,349	258,849
Percentage of total external debt	0%	0.00%	0.70%	4.46%	6.03%

2.3.7 There are a number of key Prudential Indicators to ensure that the Council operates its activities within well-defined limits. The Council must ensure that gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2019/20 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes. It is clear from the table above that the Council's gross borrowing position remains within these limits.

2.3.8 The Council has complied with this Prudential Indicator in the current year and does not envisage any difficulties with compliance in the future. This view takes into account current commitments, existing plans, and the proposals set out in this report.

2.4 Treasury Limits for 2019/20 to 2021/22

- 2.4.1 The Council is required to determine its operational boundary and authorised limit for external debt for the next three financial years.

Operational Boundary

- 2.4.2 The forecast operational boundary for 2018/19 together with the proposed operational boundaries for 2019/20 to 2021/22 are set out in Table 7 below. The boundary reflects the maximum anticipated level of external debt which is not expected to be exceeded. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on levels of actual debt and the ability to fund under-borrowing by other cash resources. This boundary will be used as a management tool for ongoing monitoring of external debt, and may be breached temporarily due to unusual cash flow movements. However a sustained or regular trend above the operational boundary should trigger a review of both the operational boundary and the authorised limit.

Table 7 Operational Boundary

Operational boundary	2018/19 Forecast £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000
Borrowing	280,000	285,000	312,000	345,000
Other long term liabilities	245,000	235,000	225,000	215,000
Commercial activities / non-financial investments	0	5,000	10,000	15,000
Total	525,000	525,000	547,000	575,000

Authorised Limit

- 2.4.3 A further key Prudential Indicator, the Authorised Limit controls the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit may only be determined by the full Council. It reflects the level of external debt which, while not desirable, is affordable in the short term, but is not sustainable in the longer term. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all Councils' plans, or those of a specific Council, although this power has not yet been exercised.
- 2.4.4 The PVFM Select Committee is asked to note and comment on the proposed Operational Boundary for each financial year from 2018/19 to 2021/22 as set out in Table 7 above and Authorised Limit as set out in Table 8 below:

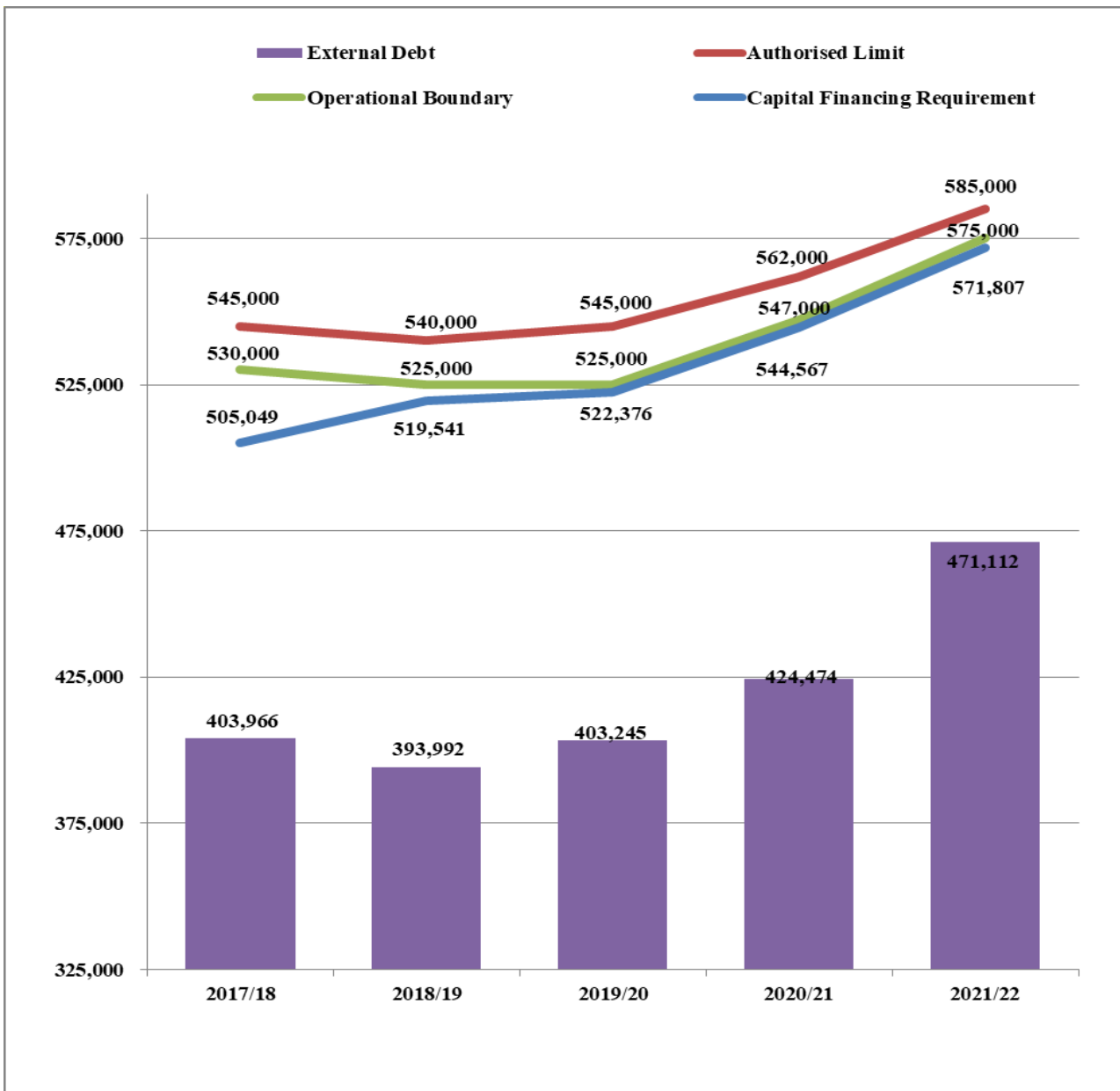
Table 8 Authorised Limit

Authorised Limit	2018/19 Forecast £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000
Borrowing	290,000	290,000	317,000	350,000
Other long term liabilities	250,000	240,000	230,000	220,000
Commercial activities / non-financial investments	0	15,000	15,000	15,000
Total	540,000	545,000	562,000	585,000

2.4.5 The graphs below disclose how the two indicators above, the Operational Boundary and the Authorised Limit compare to actual external debt and the CFR.

Table 9 Estimate Capital Financing Requirement

Capital Financing Requirement (CFR) including PFI and finance leases	Actual 2017/18 £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
General Fund CFR	505.0	520.0	517.0	535.0	562.0
Commercial activity / non-financial investments	0.0	0.0	5.0	10.0	10.0
Total CFR	505.0	519.5	522.5	544.8	572.3
External Borrowing	147.9	147.8	167.8	200.3	258.8
Other long term liabilities	256.1	246.1	235.4	224.1	213.3
Total Debt	404.0	394.0	403.2	424.5	472.1
Operational Boundary	530.0	525.0	525.0	547.0	575.0
Authorised Limit	545.0	540.0	545.0	562.0	585.0



2.5 Prospects for Interest Rate

2.5.1 The Council has appointed Link Asset Services as its Treasury Adviser and part of its service is to assist the Council to formulate a view on interest rates. The table below gives Link Asset Services central view of interest rates from December 2018 to March 2019.

Table 10 Interest Rate Forecast

Timeline	Bank Rate	PWLB Borrowing Rates %			
	%	5 year	10 year	25 year	50 year
March 2019	0.75	2.10	2.50	2.90	2.70
June 2019	1.00	2.20	2.60	3.00	2.80
September 2019	1.00	2.20	2.60	3.10	2.90
December 2019	1.00	2.30	2.70	3.10	2.90
March 2020	1.25	2.30	2.80	3.20	3.00
June 2020	1.25	2.40	2.90	3.30	3.10
September 2020	1.25	2.50	2.90	3.30	3.10
December 2020	1.50	2.50	3.00	3.40	3.20
March 2021	1.50	2.60	3.00	3.40	3.20
June 2021	1.75	2.60	3.10	3.50	3.30
September 2021	1.75	2.70	3.10	3.50	3.30
December 2021	1.75	2.80	3.20	3.60	3.40
March 2022	2.00	2.80	3.20	3.60	3.40

- 2.5.2 The flow of generally positive economic statistics after the quarter ended 30 June meant that it came as no surprise that the Monetary Policy Committee (MPC) came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, from 0.5% to 0.75%.
- 2.5.3 Growth has been healthy since that meeting, but is expected to weaken somewhat during the last quarter of 2018. At its November meeting, the MPC left Bank Rate unchanged, but expressed some concern at the Chancellor's fiscal stimulus in his Budget, which could increase inflationary pressures.
- 2.5.4 However, it is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. The next increase in Bank Rate is therefore forecast to be in May 2019, followed by increases in February and November 2020, before ending up at 2.0% in February 2022.
- 2.5.5 The overall longer run future trend is for gilt yields, and consequently Public Works Loan Board (PWLB) rates, to rise, albeit gently. However, over about the last 25 years, there has been a period of falling bond yields as inflation subsided to, and then stabilised at, much lower levels than before, and supported by central banks implementing substantial quantitative easing purchases of Government and other debt after the financial crash of 2008.
- 2.5.6 Quantitative easing, conversely, also caused a rise in equity values as investors searched for higher returns and purchased riskier assets. In 2016, there was the start of a reversal of this trend with a sharp rise in bond yields after the US Presidential election in November 2016, with yields then rising further as a result of the big increase in the US Government deficit aimed at stimulating even stronger economic growth.
- 2.5.7 That policy change also created concerns around a significant rise in inflationary pressures in an economy which was already running at remarkably low levels of unemployment. Unsurprisingly, the US Federal Reserve (Fed) has continued on its series of robust

responses to combat its perception of rising inflationary pressures by repeatedly increasing the Fed rate to reach 2.00 – 2.25% in September 2018.

- 2.5.8 It has also continued its policy of not fully reinvesting proceeds from bonds that it holds as a result of quantitative easing, when they mature. US 10 year bond Treasury yields rose above 3.2% during October 2018 and investors have caused a sharp fall in equity prices as they sold out of holding riskier assets.
- 2.5.9 Rising bond yields in the US have also caused some upward pressure on bond yields in the UK and other developed economies. However, the degree of that upward pressure has been dampened by how strong or weak the prospects for economic growth and rising inflation are in each country, and on the degree of progress towards the reversal of monetary policy away from quantitative easing and other credit stimulus measures.
- 2.5.10 From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.
- 2.5.11 Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year.
- 2.5.12 Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

Investment and borrowing rates

- 2.5.13 Investment returns are likely to remain low during 2019/20 but to be on a gently rising trend over the next few years.
- 2.5.14 Borrowing interest rates have been volatile so far in 2018/19 and have increased modestly since the summer. 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 the future when Authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt. The Council will be mindful of this in considering its borrowing arrangements.
- 2.5.15 There will remain a cost of carry (the difference between higher borrowing costs and lower investment returns), to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

2.6 Borrowing strategy

2.6.1 The factors that influence the 2019/20 strategy are:

- The movement in CFR as set out in Table 3 above;
- Forthcoming 'Option' dates on £44m of Lender Option Borrower Option loans (LOBO's) in 2019/20;
- The interest rate forecasts (set out in Table 10 above);
- Aiming to minimise revenue costs to reduce the impact on the Council Tax Requirement;
- The impact of the Council's Capital and Property Investment Programmes.

- 2.6.2 The Council is currently maintaining an under-borrowed position. This means that the CFR has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered. However, as interest rates are low, as advised in 2.5.13-15 consideration will be given to taking advantage of this by securing fixed rate funding and reducing the under borrowed position.
- 2.6.3 Against this background and the risks within the economic forecast, caution will be adopted with the 2019/20 treasury operations. The Treasury Management team will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances so that:
- if it was considered that there was a significant risk of a sharp fall in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowing will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.
 - if it was considered that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised. The likely action would be that fixed rate funding will be drawn whilst interest rates are still lower than they will be in the next few years.
- 2.6.4 The gross borrowing requirement in Table 5 at 2.3.4 above shows, based on current estimates, that the Council will need to drawdown a significant amount of new borrowing, to support the capital programme. Any additional borrowing will be completed with regard to the limits, indicators and interest rate forecasts set out above. As noted previously, estimates of borrowing have changed in previous years due to the reprofiling of the capital programme.
- 2.6.5 During 2019/20, £44m of LOBO (Lender Option Borrower Option) debt will reach the option renewal date. Table 11 below, sets out the maturity structure of fixed rate debt. At the renewal date the loans will either:
- Move to the option rate of interest, which in all cases will be the same as the current rate or:
 - Be offered at a rate above the option rate, in which case the Council has the option to repay. This would then require refinancing at the prevailing market rates.

Table 11 Maturity Structure of Fixed Rate Debt

Maturity Structure of fixed interest rate debt	2019/20 Actual
under 12 months	29.94%
12 months and within 24 months	10.31%
24 months and within 5 years	22.39%
5 years and within 10 years	5.07%
10 years to 20 years	5.24%
20 years to 30 years	0.00%
30 years to 40 years	3.38%
40 years to 50 years	10.15%
50 years to 60 years	13.53%
60 years and above	0.00%

- 2.6.6 Due to the current interest rate forecast it is not anticipated that any of these LOBO loans will be called.
- 2.6.7 The 2019/20 capital programme now shows anticipated prudential borrowing of £119.190m with £24.193m in 2019/20, £44.759m in 2020/21 and £50.238m in 2021/22. These figures have been reflected in this report and factored into the borrowing strategy for 2019/20 and future years.
- 2.6.8 Members are advised that indicators for interest rate exposure are no longer a requirement under the new Treasury Management Code however as interest rate exposure risk is an important issue. Officers will monitor the balance between fixed and variable interest rates for borrowing and investments. This will aim to ensure the Council is not exposed to adverse fluctuations in fixed or variable rate interest rate movements.
- 2.6.9 This is likely to reflect higher fixed interest rate borrowing if the borrowing need is high or fixed interest rates are likely to increase, or a higher variable rate exposure if fixed interest rates are expected to fall. Conversely if shorter term interest rates are likely to fall, investments may be fixed earlier, or kept shorter if short term investments are expected to rise.
- 2.6.10 The balance between variable rate debt and variable rate investments will be monitored as part of the overall treasury function in the context of the overall financial instruments structure and any under or over borrowing positions.
- 2.7 Policy on Borrowing in Advance of Need
- 2.7.1 The Council will not borrow more than or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved CFR estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.
- 2.7.2 Borrowing in advance will be made within the constraint that the Council would not look to borrow more than 24 months in advance of need.
- 2.7.3 Risks associated with any borrowing in advance of activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

2.8 Debt Rescheduling

- 2.8.1 As short term borrowing rates are considerably lower than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the prevailing treasury position and the size of the cost of debt repayment (premiums incurred).
- 2.8.2 The reasons for any rescheduling to take place will include:
- the generation of cash savings and/ or discounted cash flow savings;
 - helping to fulfil the treasury strategy;
 - enhancing the balance of the portfolio (amending the maturity profile and/or the balance of volatility).
- 2.8.3 Consideration will also be given to identifying if there is any residual potential for making savings by reducing investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.
- 2.8.4 All re-scheduling will be reported to Cabinet and Council at the earliest meeting following its action.

2.9 Local Capital Finance Company (originally Municipal Bond Agency)

- 2.9.1 It is possible that Local Capital Finance Company will be offering loans to Local Authorities in the future. It is also hoped that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB).
- 2.9.2 The Council has currently invested £0.100m in the Company and intends to make use of this new source of borrowing as and when appropriate.

2.10 Annual Investment Strategy

Investment Policy – Management of Risk

- 2.10.1 The MHCLG and CIPFA have extended the meaning of ‘investments’ to include both financial and non-financial investments. This report deals solely with financial investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy.

The Council's investment policy has regard to the following: -

- MHCLG's Guidance on Local Government Investments (“the Guidance”)
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 (“the Code”)
- CIPFA Treasury Management Guidance Notes 2018

- 2.10.2 The Council's investment priorities will be:

- firstly, the security of capital;
- secondly, the liquidity of its investments;
- thirdly, the optimum return on its investments commensurate with proper levels of security and liquidity;
- finally, ethical investments.

- 2.10.3 The above guidance from the MHCLG and CIPFA place a high priority on the management of risk. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -

- Minimum acceptable credit criteria are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.
- Other information: ratings will not be the sole determinant of the quality of an institution; 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 achieve this consideration the Council 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.

2.10.4 This Council has defined the list of types of investment instruments that the treasury management team are authorised to use. There are two lists in Appendix 5 under the categories of ‘specified’ and ‘non-specified’ investments.

- Specified investments are those with a high level of credit quality and subject to a maturity limit of one year.
- Non-specified investments are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.

2.10.5 For non-specified investments, the Council has determined that it will limit the maximum total exposure to non-specified investments as being 50% of the total investment portfolio.

2.10.6 Lending limits, (amounts and maturity), for each counterparty will be set through applying the matrix table in paragraph 2.11.3.

2.10.7 Transaction limits are set for each type of investment in 2.11.3.

2.10.8 The Council has set a limit for the amount of its investments which are invested for longer than 365 days, (see paragraph 2.13.7.)

2.10.9 Investments will only be placed with counterparties from countries with a specified minimum sovereign rating, (see paragraph 2.12.3) and Appendix 6.

2.10.10 The Council has engaged external consultants, (see paragraph 1.11), to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this Authority in the context of the expected level of cash balances and need for liquidity throughout the year.

2.10.11 All investments will be denominated in sterling.

2.10.12 As a result of the change in accounting standards for 2018/19 under IFRS 9, consideration will be given to the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, MHCLG concluded a consultation for a temporary

override to allow English Local Authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years commencing from April 2018).

2.10.13 However, the Council will also pursue value for money in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see paragraph 2.14). Regular monitoring of investment performance will be carried out during the year.

2.10.14 The above risk management criteria are unchanged from last year.

2.11 Creditworthiness policy

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

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

2.11.2 This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the duration and maximum investment value for each counterparty.

2.11.3 Institutions are split into colour bandings and the Council will therefore use counterparties within these colours, durational bands and investment limits. Table 12 below shows these limits.

Table 12 Investment Criteria

Counter Party	Link Colour Band and Long Term Rating where applicable	Maximum Duration	Maximum Principal Invested per Counterparty
Banks	Yellow (Note 1)	5 Years	£10m
Banks	Dark Pink (Note 2)	5 Years	£10m
Banks	Light Pink (Note 3)	5 Years	£10m
Banks	Purple	2 Years	£20m
Banks	Blue (Note 4)	1 Year	£20m
Banks	Orange (Note 5)	1 Year	£15m
Banks	Red	6 months	£10m
Banks	Green	100 days	£10m
Banks	No Colour	Not to be used	Not to be used
Local Authorities/ Public Bodies	Internal Due Diligence	5 Years	£10m
GMCA	Internal Due Diligence (Note 6)	5 Years	£30m
Debt Management Account Deposit Facility (DMADF)	UK Sovereign rating	6 months	£20m
	Fund Rating	Maximum Duration	Maximum Principal Invested per Counterparty
Money Market Fund			
Constant	AAA	Liquid	£20m
Low Volatile	AAA	Liquid	£20m
Variable	AAA	Liquid	£20m

Note 1 – UK Government debt or equivalent

Note 2 – Enhanced money market funds (EMMF) with a credit score of 1.25

Note 3 – Enhanced money market funds (EMMF) with a credit score of 1.5

Note 4 – Blue Institutions only applies to nationalised or semi nationalised UK Banks, which currently include the RBS Group (Royal Bank of Scotland, NatWest Bank and Ulster Bank).

Note 5 - Includes the Council's banking provider (currently Barclays), if it currently falls into category below this colour band.

Note 6 – The higher maximum principal is to facilitate joint initiatives and activities related to the devolution agenda.

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

2.11.5 Typically the minimum credit ratings criteria the Council uses will be a Short Term rating (Fitch or equivalents) of F1 and a Long Term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but

may still be used. In this instance consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

2.11.6 All credit ratings will be monitored on a weekly basis. The Council is alerted to changes to ratings of all three agencies through its use of the Link Asset Services creditworthiness service.

- If a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn or notice given to withdraw immediately.
- In addition to the use of credit ratings the Council will be advised of information in movements in the Credit Default Swap Index against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link Asset Services. Extreme market movements may result in the downgrading of an institution or its removal from the Council's lending list.

2.11.7 Sole reliance will not be placed on the use of this external service. In addition the Council will also use market data and market information, information on any external support banks to help support the decision making process.

UK banks – ring fencing

2.11.8 The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1 January 2019. This is known as "ring-fencing". Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future.

2.11.9 Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and "riskier" activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity's core activities are not adversely affected by the acts or omissions of other members of its group.

2.11.10 While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

2.12 Country and Sector Limits

2.12.1 It is not proposed to restrict the Council's investment policy to only UK banks and building societies, however in addition to the credit rating criteria set out above consideration will be given to the sovereign rating of the country before any investment is made.

2.12.2 In February 2013 the UK lost its AAA rating and moved to an AA rating. The Council will continue to invest with UK Banks, providing the individual institutions still meet the relevant criteria.

2.12.3 The Council has determined that it will only use approved counterparties from non UK countries with a minimum sovereign credit rating of AAA from Fitch (or equivalent). The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 6. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy, therefore for illustrative purposes the appended list is extended to also show AA- i.e. the countries currently assessed to be in the rating below those that currently qualify. It is important to note that although able to, the Council has chosen not to invest overseas in recent years.

2.13 Investment Strategy

2.13.1 Investments will 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). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required to manage the ups and downs of cash flow, any cash identified that could be invested for longer periods will be carefully assessed.

- If it is thought that bank rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.
- Conversely, if it is thought that bank rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

2.13.2 The Council currently has investments totalling £14m which span the financial year as shown in Table 13. These investments are current as at December 2018.

Table 13 Investments maturing in 2019/20

Counterparty	Amount	Maturity Date	Rate
Surrey Heath Borough Council	£1,000,000	17/04/2019	0.90%
Goldman Sachs International Bank	£3,000,000	01/05/2019	0.95%
Thurrock Council	£2,500,000	26/09/2019	1.07%
Thurrock Council	£2,500,000	04/10/2019	1.07%
North Tyneside Council	£5,000,000	10/10/2019	1.07%
Total	£14,000,000		

2.13.3 The Bank Rate is forecast to increase steadily but slowly over the next few years to reach 2.00% by quarter 1 2022. Bank rates forecasts for financial year ends are:

- 2018/19 0.75%
- 2019/20 1.25%
- 2020/21 1.50%
- 2021/22 2.00%

2.13.4 The suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year are as follows.

- 2018/19 0.75%
- 2019/20 1.00%

- 2020/21 1.50%
- 2021/22 1.75%
- 2022/23 1.75%
- 2023/24 2.00%
- 2024/25 2.50%

2.13.5 The overall balance of risks to economic growth in the UK is probably neutral.

2.13.6 The balance of risks to increases in bank rate and shorter term PWLB rates, are also even and are dependent on how strong Gross Domestic Product (GDP) growth turns out, how slowly inflation pressures subside and how quickly the Brexit negotiations move forward positively.

Investment Treasury Indicator and Limit

2.13.7 This indicator considers total principal funds invested for greater than 365 days. These limits have regard to the Council's liquidity requirements and to reduce the need for the early redemption of investments, and are based on the availability of funds after each year end.

Table 14 – Maximum principal sum invested greater than 365 days

Upper Limit for principal sums invested for longer than 365 days	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Principal sums invested for longer than 365 days	£50m	£50m	£50m	£50m
Current investments as at 2 January 2019 in excess of 1 year	£15m	£15m	£15m	£15m

2.13.8 For its cash flow generated balances, the Council will seek to utilise its business reserve instant access and notice accounts, money market funds and short dated deposits, in order to benefit from the compounding of interest.

2.14 Investment Risk Benchmarking

2.14.1 These benchmarks provide simple guides to maximum risk, and may be breached from time to time, depending on movements in interest rates and counterparty criteria. These benchmarks provide officers with a baseline against which current and trend positions can be monitored. It may be necessary to amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the mid-year or Annual Report to Members.

Liquidity – in respect of this area the Council seeks to maintain:

- Bank overdraft facility of £0.100m
- Liquid short term deposits of at least £10m available with a week's notice.

Yield - local measures of yield benchmarks are:

- Investments – internal returns above the 7 day LIBID (London Interbank Bid Rate) rate multiplied by 5%
- Investments – internal returns above the 1 month LIBID rate multiplied by 5%
- Investments – internal returns above the 3 month LIBID rate multiplied by 5%
- Investments – internal returns above the 6 month LIBID rate multiplied by 5%
- Investments – internal returns above the 12 month LIBID rate multiplied by 5%

2.14.2 At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report, which is in accordance with required practice and is presented to Cabinet and then Council for approval.

2.15 Other Treasury Management Issues

2.15.1 The Council is currently involved in legal action against Barclays Bank with regards to certain Lender Option Borrower Option (LOBO) transactions. This is based on the Bank's involvement in manipulation of the LIBOR benchmark rate and the subsequent impact on the Council's financial position. This matter is on-going.

2.15.2 Brexit

The Council is mindful of the Brexit timetable and will ensure that treasury activity is managed to minimise any risk to the Council as 29 March 2019 approaches.

3 Options/Alternatives

3.1 In order to comply with the CIPFA Code of Practice on Treasury Management, the Council has no option other than to consider and approve the contents of the report. Therefore no options/alternatives have been presented.

4 Preferred Option

4.1 The preferred option is that the contents of this report are considered by the PVFM Select Committee.

5 Consultation

5.1 There has been consultation with Link Asset Services, Treasury Management Advisors. The consideration of the Treasury Management Strategy for 2019/20 by the Overview and Scrutiny Performance and Value for Money Select Committee is a key strand in the consultation process.

6 Financial Implications

6.1 Financial Implications are detailed within the report.

7 Legal Services Comments

7.1 There are no legal implications.

8 Co-operative Agenda

8.1 The Treasury Management strategy embraces the Council's cooperative agenda. The Council will develop its investment framework to ensure it complements the co-operative ethos of the Council.

9 Human Resources Comments

9.1 There are no Human Resource Implications.

10 Risk Assessments

- 10.1 There are considerable risks to the security of the Authority's resources if appropriate Treasury Management strategies and policies are not adopted and followed. The Council has established good practice in relation to Treasury Management which has previously been acknowledged in the Internal and External Auditors' reports presented to the Audit Committee. An issue dependent upon market developments which may need to be considered in the future is refinancing some of the long term loans. This can be mitigated by effective monitoring of the market.

11 IT Implications

- 11.1 There are no IT Implications

12 Property Implications

- 12.1 There are no Property Implications.

13 Procurement Implications

- 13.1 There are no Procurement Implications.

14 Environmental and Health & Safety Implications

- 14.1 There are no Environmental and Health & Safety Implications.

15 Equality, community cohesion and crime implications

- 15.1 There are no Equality, community cohesion and crime implications.

16 Equality Impact Assessment Completed?

- 16.1 No

17 Key Decision

- 17.1 Yes

18 Key Decision Reference

- 18.1 FCR -17 -18

19 Background Papers

- 19.1 The following is a list of background papers on which this report is based in accordance with the requirements of Section 100(1) of the Local Government Act 1972. It does not include documents which would disclose exempt or confidential information as defined by the Act:

File Ref: Background papers are provided in Appendices 1 - 8
Officer Name: Lee Walsh / Talei Whitmore
Contact No: 0161 770 6608/ 4924

20 **Appendices**

- Appendix 1 Minimum Revenue Provision (MRP) Policy Statement
- Appendix 2 Prudential and Treasury Indicators 2019/20 – 2021/22
- Appendix 3 Link Asset Services - Treasury Advisor's Interest Rate Forecast 2018-2021
- Appendix 4 Economic Background
- Appendix 5 Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management
- Appendix 6 Approved Countries for Investments
- Appendix 7 Treasury Management Scheme of Delegation
- Appendix 8 Treasury Management Role of the Statutory Chief Finance Officer (Director of Finance)

Appendix 1 – Minimum Revenue Provision (MRP) Policy Statement

1.1 General Principles and Practices

1.1.1 Local Authorities are required to set aside ‘prudent’ provision for debt repayment where they have used borrowing or credit arrangements to finance capital expenditure. Ministry for Housing, Communities and Local Government (MHCLG) regulations require the full MRP Statement to be decided upon at least annually and reported to the Council Meeting. The Council has to ensure that the chosen options are prudent.

1.2 Link to Asset Life/Economic Benefit

1.2.1 Where capital expenditure on an asset is financed wholly or partly by borrowing or credit arrangements, MRP will normally be determined by reference to asset life, economic benefit or MHCLG Guidance.

1.2.2 To the extent that expenditure cannot be linked to the creation/enhancement of an asset and is of a type that is subject to estimated life periods that are referred to in the MHCLG guidance (paragraph 24), these periods will generally be adopted by the Council.

1.2.3 Where certain types of capital expenditure incurred by the Council are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure.

1.2.4 Whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

1.3 Methods for Calculating MRP

1.3.1 Any of the methods for calculating MRP that are set out below may be used. MRP will commence in the financial year after the completion of assets rather than when expenditure is incurred. All methods, with the exception of the approach taken to Previously Supported General Fund Borrowing are based on Asset Life/Economic Benefit. These methods include but are not limited to:

The Annuity Method

1.3.2 This calculation seeks to ensure the revenue account bears an equal annual charge (for principal and interest) over the life of the asset by taking account of the time value of money. Since MRP relates only to ‘principal’, the amount of provision made annually gradually increases during the life of the asset. The interest rate used in annuity calculations will be referenced to either prevailing or average PWLB rates.

Equal Instalments of Principal

1.3.3 MRP is an equal annual charge calculated by dividing the original amount of borrowing by the useful life of the asset.

Previously Supported General Fund Borrowing

1.3.4 General Fund Borrowing that was previously supported through the Revenue Support Grant (RSG) system will be provided for in equal annual instalments over a 50 year period commencing 1 April 2016. As at 1 April 2016, the value of this borrowing equalled £134,376,866 and results in an equal annual minimum revenue provision of £2,742,385; the final instalment of which will be provided for by no later than 31 March 2066. In the event of:

- transfers of Capital Financing Requirement between the General Fund element and Housing element;
- additional voluntary revenue provision being made

the annual MRP charge will be adjusted to ensure that full provision will continue to be made by no later than 31 March 2066.

Bespoke Repayment Profiles:

1.3.5 With regard to credit arrangements that are implicit in Finance Lease or PFI arrangements, any 'debt' repayment element (notional or otherwise) included in charges associated with these arrangements will be classified as MRP.

1.4 Voluntary Revenue Provision

1.4.1 The Council has the option of making additional Voluntary Revenue Provision (VRP) in addition to MRP. The Council may treat VRP as 'up-front' provision (having a similar impact to the early repayment of debt) and thus recalculate future MRP charges accordingly. Where the Council has made additional VRP's for debt repayment in previous years, in year MRP charges may be adjusted to reflect this provided it does not result in a negative MRP charge. To the extent charges are adjusted, current and future year's charges will be recalculated to ensure the Council continues to make prudent provision for debt repayment in relation to historic capital expenditure. The Council may in some circumstances apply VRP to relatively short-life assets/expenditure in order to facilitate a reduction in the future base revenue budget needed to fund capital financing costs.

1.5 Local Exceptions to the Guidance

1.5.1 The Council reserves the right to determine useful life periods and prudent MRP in certain circumstances or where the recommendations of the MHCLG guidance are not appropriate to local circumstances. Examples include:

Assets under Construction

1.5.2 No MRP charge will be made until the financial year after that in which an item of capital expenditure is fully incurred and, in the case of a new asset, comes into service use.

Local Authority Mortgage Scheme (LAMS)

- 1.5.3 The Council currently operates a Local Authority Mortgage Scheme (LAMS) using the cash backed option. The mortgage lenders require a five year deposit from the Local Authority to match the five year life of the indemnity. The deposit placed with the mortgage lender provides an integral part of the mortgage lending and is treated as capital expenditure and a loan to a third party. The CFR will increase by the amount of the total indemnity. The cash advance is due to be returned in full at maturity, with interest paid annually. Once the cash advance matures and funds are returned to the Local Authority, the returned funds are classed as a capital receipt, which will be applied to reduce the CFR. As this is a temporary (five years) arrangement and the funds will be returned in full, there is no need to set aside MRP to repay the debt liability in the interim period.

Loans to third parties

- 1.5.4 The Council has considered the Statutory Guidance, which recommends a 25 year repayment charge for loans to third parties, and concluded that provision is not necessary. The Council considers an MRP charge is not necessary in respect of any loans made to third parties as the debt liability is covered by the existence of a debtor and the associated obligation to make repayments.

1.6 Borrowing in Lieu of Capital Receipts

- 1.6.1 The Council has concluded that MRP provision is not necessary for capital expenditure incurred in lieu of capital receipts. Any such schemes will be classified by the Capital Investment Programme Board (CIPB) as 'Borrowing in Lieu of Capital Receipts'. CIPB will also determine which capital receipts will be allocated to the scheme and as the receipts are achieved they will be applied to repay the debt.

The Application of Capital Receipts in Lieu of MRP

- 1.6.2 Where the Council has received uncommitted and unapplied Capital Receipts, it retains the option to set aside those Capital Receipts as part of its arrangements for making 'prudent' provision for debt repayment rather than using them for capital financing purposes.
- 1.6.3 As Capital Receipts may form part of the Councils arrangements for making 'prudent' provision, setting aside Capital Receipts in this manner can be carried out in lieu of MRP whereby the MRP charge will be reduced by an amount equal to that set aside from Capital Receipts.

1.7 HRA Capital Financing Requirement (CFR)

- 1.7.1 MRP will equal the amount determined in accordance with the former regulations 28 and 29 of the 2003 Regulations (SI 2003/3146) as if they had not been revoked. This approach is consistent with paragraph 7 of the MHCLG Guidance on MRP.
- 1.7.2 The basic MRP charge relating to the HRA CFR is therefore nil. However, the Council may make 'Voluntary Revenue Provision' provided such an approach is prudent and appropriate in the context of financing the HRA capital programme and is consistent with the delivery of the HRA Business Plan.

Appendix 2 Prudential and Treasury Indicators 2019/2020 – 2021/22

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

Capital expenditure

Capital Expenditure	2017/18 Actual £'000	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000
Corporate and Commercial Services *	1,463	14,174	9,212	1,583	1,719
Health and Wellbeing	1,493	0	0	0	0
Health & Adult Social Care					
Community Services	0	1,894	2,682	1,400	400
Economy, Skills and Neighbourhoods	22,058	0	0	0	0
People & Place	0	31,265	54,403	63,081	70,544
Reform	0	216	100	100	700
Funds yet to be allocated	0	306	5,000	3,000	1,500
General Fund Services	25,014	47,855	71,397	69,164	74,863
Housing Revenue Account (HRA)	789	1,097	4,235	1,632	922
HRA	789	1,097	4,235	1,632	922
Commercial Activities / Non-Financial Investments **	0	0	6,180	7,750	6,680
Commercial Activities / Non-Financial Investments	0	0	6,180	7,750	6,680
Total	25,803	48,952	81,812	78,546	82,465

* Excludes commercial activities which are included in the Corporate and Commercial Services capital programme

** Relate to areas such as capital expenditure on investment properties, loans to third parties etc.

Affordability prudential indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The PVFM Select Committee is asked to consider the following indicators:

Ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital, (borrowing and other long term obligation costs net of investment income), against the net revenue stream.

	2017/18 Actual £'000	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000
General Fund excluding DSG*	11.52%	12.68%	12.88%	12.75%	13.41%

*Dedicated Schools Grant

The estimates of financing costs include current commitments and the proposals in the budget report.

Maturity structure of borrowing

Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

The PVFM Select Committee is asked to consider the following treasury indicators and limits:

Maturity Structure of fixed interest rate debt 2019/20	Lower Limit	Upper Limit
Under 12 months	0.00%	40.00%
12 months and within 24 months	0.00%	40.00%
24 months and within 5 years	0.00%	40.00%
5 years and within 10 years	0.00%	40.00%
10 years to 20 years	0.00%	50.00%
20 years to 30 years	0.00%	50.00%
30 years to 40 years	0.00%	50.00%
40 years to 50 years	0.00%	50.00%
50 years to 60 years	0.00%	50.00%
60 years and above	0.00%	50.00%

Control of interest rate exposure

Members are advised that indicators for interest rate exposure are no longer a requirement under the new Treasury Management Code however as interest rate exposure risk is an important issue. Officers will monitor the balance between fixed and variable interest rates for borrowing and investments. This will aim to ensure the Council is not exposed to adverse fluctuations in fixed or variable rate interest rate movements.

This is likely to reflect higher fixed interest rate borrowing if the borrowing need is high or fixed interest rates are likely to increase, or a higher variable rate exposure if fixed interest rates are expected to fall. Conversely if shorter term interest rates are likely to fall, investments may be fixed earlier, or kept shorter if short term investments are expected to rise.

The balance between variable rate debt and variable rate investments will be monitored as part of the overall treasury function in the context of the overall financial instruments structure and any under or over borrowing positions.

Appendix 3 – Link Asset Services Interest rate forecast 2018 – 2021

PWLB rates and forecast shown below take into account the 20 basis point certainty rate reduction effective as of the 1st November 2018 for 2018/19 and 2019/20.

Bank Rate											
	Now	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Link Asset Services	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%
Capital Economics	0.75%	0.75%	0.75%	1.00%	1.25%	1.50%	1.50%	1.75%	1.75%	2.00%	-
5yr PWLB Rate											
	Now	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Link Asset Services	1.76%	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%
Capital Economics	1.76%	1.95%	2.03%	2.15%	2.40%	2.65%	2.70%	2.75%	2.80%	2.85%	-
10yr PWLB Rate											
	Now	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Link Asset Services	2.18%	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%
Capital Economics	2.18%	2.30%	2.43%	2.55%	2.80%	3.05%	3.05%	3.05%	3.05%	3.05%	-
25yr PWLB Rate											
	Now	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Link Asset Services	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%
Capital Economics	2.80%	2.83%	2.96%	3.08%	3.33%	3.58%	3.53%	3.48%	3.43%	3.38%	-
50yr PWLB Rate											
	Now	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Link Asset Services	2.68%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%
Capital Economics	2.68%	2.65%	2.78%	2.90%	3.15%	3.40%	3.40%	3.40%	3.40%	3.40%	-

Link Asset Services Interest Rate View												
	Now	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21
Bank Rate	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%
3 Month LIBID	0.68%	0.80%	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%	1.50%	1.50%	1.60%	1.70%
6 Month LIBID	0.78%	0.90%	1.00%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%	1.90%
12 Month LIBID	0.95%	1.10%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%

Appendix 4: Economic Background

Set out below is a more detailed analysis of the Economic background used to support the preparation of the 2019/20 Treasury Management Strategy Statement.

Global Outlook

World growth has been doing reasonably well, aided by strong growth in the US. However, US growth is likely to fall back in 2019 and, together with weakening economic activity in China, overall world growth is likely to weaken.

Inflation has been weak during 2018 but, at long last, unemployment falling to remarkably low levels in the US and UK has led to a marked acceleration of wage inflation which is likely to prompt central banks into a series of increases in central rates. The EU is probably about a year behind in a similar progression.

Key Risks - central bank monetary policy measures

Looking back on ten years since the financial crash of 2008 when liquidity suddenly dried up in financial markets, it can be assessed that central banks' monetary policy measures to counter the sharp world recession were successful. The key monetary policy measures they used were a combination of lowering central interest rates and flooding financial markets with liquidity, particularly through unconventional means such as quantitative easing (QE), where central banks bought large amounts of central government debt and smaller sums of other debt.

The key issue now is that that period of stimulating economic recovery and warding off the threat of deflation, is coming towards its close. A new period has already started in the US, and more recently in the UK, of reversing those measures i.e. by raising central rates and, (for the US), reducing central banks' holdings of Government and other debt. These measures are now required in order to stop the trend of a reduction in spare capacity in the economy, and of unemployment falling to such low levels that the re-emergence of inflation is viewed as a major risk. It is, therefore, crucial that central banks get their timing right and do not cause shocks to market expectations that could destabilise financial markets. In particular, a key risk is that because QE-driven purchases of bonds drove up the price of Government debt, and therefore caused a sharp drop in income yields, this also encouraged investors into a search for yield and into investing in riskier assets such as equities. Consequently, prices in both bond and equity markets rose to historically high valuation levels simultaneously. This now means that both asset categories are vulnerable to a sharp downward correction. It is important, therefore, that central banks only gradually unwind their holdings of bonds in order to prevent destabilising the financial markets. It is also likely that the timeframe for central banks unwinding their holdings of QE debt purchases will be over several years. They need to balance their timing to neither squash economic recovery, by taking too rapid and too strong action, nor, conversely, let inflation run away by taking action that was too slow and/or too weak. The potential for central banks to get this timing and strength of action wrong are now key risks.

The world economy also needs to adjust to a sharp change in liquidity creation over the last five years where the US has moved from boosting liquidity by QE purchases, to reducing its holdings of debt. In addition, the European Central Bank has cut back its QE purchases substantially and is likely to end them completely by the end of 2018.

United Kingdom

The flow of positive economic statistics since the end of the first quarter this year has shown that pessimism was overdone about the poor growth in quarter 1 when adverse weather caused a temporary downward blip. Quarter 1 at 0.1% growth in GDP was followed by a return to 0.4% in

quarter 2; quarter 3 is expected to be robust at around +0.6% but quarter 4 is expected to weaken from that level.

At their November meeting, the MPC once again advised that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary or contractionary), than before the crash; indeed they gave a figure for this of around 2.5% in ten years' time but declined to give a medium term forecast. However, with so much uncertainty around Brexit, they warned that the next move could be up or down, even if there was a disorderly Brexit. While it would be expected that Bank Rate could be cut if there was a significant fall in GDP growth as a result of a disorderly Brexit, so as to provide a stimulus to growth, they warned they could also raise Bank Rate in the same scenario if there was a boost to inflation from a devaluation of sterling, increases in import prices and more expensive goods produced in the UK replacing cheaper goods previously imported, and so on. In addition, the Chancellor has held back some spare capacity to provide a further fiscal stimulus if needed.

It is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. Getting parliamentary approval for a Brexit agreement on both sides of the Channel will take the early part of 2019. However, in view of the hawkish stance of the MPC at their November meeting, the next increase in Bank Rate is now forecast to be in May 2019. The following increases are then forecast to be in February and November 2020 before ending up at 2.0% in February 2022.

Inflation

The Consumer Price Index (CPI) measure of inflation has been falling from a peak of 3.1% in November 2017 to 2.4% in October. In the November Bank of England quarterly inflation report, inflation was forecast to still be marginally above its 2% inflation target two years ahead, (at about 2.1%), given a scenario of minimal increases in Bank Rate. This inflation forecast is likely to be amended upwards due to the Bank's inflation report being produced prior to the Chancellor's announcement of a significant fiscal stimulus in the Budget; this is likely to add 0.3% to GDP growth at a time when there is little spare capacity left in the economy, particularly of labour.

As for the labour market figures in September, unemployment at 4.1% was marginally above a 43 year low of 4% on the Independent Labour Organisation measure. A combination of job vacancies hitting an all-time high, together with negligible growth in total employment numbers, indicates that employers are now having major difficulties filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to 3.2%, (3 month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates less CPI inflation), earnings are currently growing by about 0.8%, the highest level since 2009. This increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. This tends to confirm that the MPC was right to start on a cautious increase in Bank Rate in August as it views wage inflation in excess of 3% as increasing inflationary pressures within the UK economy.

In the political arena, there is a risk that the current Conservative minority Government may be unable to muster a majority in the Commons over Brexit. However, the current view is that our central position is that Prime Minister May's Government will endure, despite various setbacks, along the route to reaching an orderly Brexit in March 2019. If, however, the UK faces a general election in the next 12 months, this could result in a potential loosening of monetary and fiscal policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up.

United States of America

President Trump's massive easing of fiscal policy is fuelling a, (temporary), boost in consumption which has generated an upturn in the rate of strong growth which rose from 2.2%, (annualised rate), in quarter 1 to 4.2% in quarter 2 and 3.5%, (3.0% year on year (y/y)), in quarter 3, but also an upturn in inflationary pressures. In particular, wage rates were increasing at 3.1% y/y in October and heading higher due to unemployment falling to a 49 year low of 3.7%. With CPI inflation over the target rate of 2% and on a rising trend towards 3%, the Fed increased rates another 0.25% in September to between 2.00% and 2.25%, this being the fourth increase in 2018. They also indicated that they expected to increase rates four more times by the end of 2019. The dilemma, however, is what to do when the temporary boost to consumption wanes, particularly as the recent imposition of tariffs on a number of countries' exports to the US, (China in particular), could see a switch to US production of some of those goods, but at higher prices. Such a scenario would invariably make any easing of monetary policy harder for the Fed in the second half of 2019. However, a combination of an expected four increases in rates of 0.25% by the end of 2019, together with a waning of the boost to economic growth from the fiscal stimulus in 2018, could combine to depress growth below its potential rate, i.e. monetary policy may prove to be too aggressive and lead to the Fed having to start on cutting rates. The Fed has also been unwinding its previous quantitative easing purchases of debt by gradually increasing the amount of monthly maturing debt that it has not been reinvesting.

The tariff war between the US and China has been generating a lot of heat during 2018, but it is not expected that the current level of actual action would have much in the way of a significant effect on US or world growth. However, there is a risk of escalation. The results of the mid-term elections are not expected to have a material effect on the economy.

Eurozone

Growth was 0.4% in quarters 1 and 2 but fell back to 0.2% in quarter 3, though this is probably just a temporary dip. In particular, data from Germany has been mixed and it could be negatively impacted by US tariffs on a significant part of manufacturing exports e.g. cars. For that reason, although growth is still expected to be in the region of nearly 2% for 2018, the horizon is less clear than it seemed just a short while ago. Having halved its quantitative easing purchases of debt in October 2018 to €15bn per month, the European Central Bank (ECB) has indicated it was likely to end all further purchases in December 2018. Inflationary pressures are starting to build gently so it is expected that the ECB will start to increase rates towards the end of 2019.

China

Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems. Progress has been made in reducing the rate of credit creation, particularly from the shadow banking sector, which is feeding through into lower economic growth. There are concerns that official economic statistics are inflating the published rate of growth.

Japan

Has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy. It is likely that loose monetary policy will endure for some years yet to try to stimulate growth and modest inflation.

Emerging countries

Argentina and Turkey are currently experiencing major headwinds and are facing challenges in external financing requirements well in excess of their reserves of foreign exchange. However, these countries are small in terms of the overall world economy, (around 1% each), so the fallout from the expected recessions in these countries will be minimal.

Interest Rate Forecasts

The interest rate forecasts provided by Link Asset Services in paragraph 2.5.1 are predicated on an assumption of an agreement being reached on Brexit between the UK and the EU. In the event of an orderly non-agreement exit, it is likely that the Bank of England would take action to cut Bank Rate from 0.75% in order to help economic growth deal with the adverse effects of this situation. This is also likely to cause short to medium term gilt yields to fall. If there was a disorderly Brexit, then any cut in Bank Rate would be likely to last for a longer period and also depress short and medium gilt yields correspondingly. It is also possible that the government could act to protect economic growth by implementing fiscal stimulus.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably neutral.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are broadly dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

One risk that is both an upside and downside risk, is that all central banks are now working in very different economic conditions than before the 2008 financial crash as there has been a major increase in consumer and other debt due to the exceptionally low levels of borrowing rates that have prevailed for ten years since 2008. This means that the neutral rate of interest in an economy, (i.e. the rate that is neither expansionary nor deflationary), is difficult to determine definitively in this new environment, although central banks have made statements that they expect it to be much lower than before 2008. Central banks could therefore either over or under do increases in central interest rates.

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

- **Brexit** – if it were to cause significant economic disruption and a major downturn in the rate of growth.
- **Bank of England monetary policy** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the **Eurozone sovereign debt crisis**, possibly in **Italy**, due to its high level of Government debt, low rate of economic growth and vulnerable banking system, and due to the election in March of a Government which has made a lot of anti-austerity noise. At the time of writing, the EU has rejected the proposed Italian budget and has demanded cuts in Government spending which the Italian Government has refused. The rating agencies have started on downgrading Italian debt to one notch above junk level. If Italian debt were to fall below investment grade, many investors would be unable to hold it. Unsurprisingly, investors are becoming increasingly concerned by the actions of the Italian Government and consequently, Italian bond yields have risen sharply – at a time when the Government faces having to refinance large amounts of debt maturing in 2019.
- Weak capitalisation of some **European banks**. Italian banks are particularly vulnerable; one factor is that they hold a high level of Italian Government debt - debt which is falling in

value. This is therefore undermining their capital ratios and raises the question of whether they will need to raise fresh capital to plug the gap.

- **German minority Government.** In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the support of the SPD party. Then in October 2018, the results of the Bavarian and Hesse state elections radically undermined the SPD party and showed a sharp fall in support for the CDU. As a result, the SPD is reviewing whether it can continue to support a coalition that is so damaging to its electoral popularity. After the result of the Hesse state election, Angela Merkel announced that she would not stand for re-election as CDU party leader at her party's convention in December 2018. However, this makes little practical difference as she is still expected to aim to continue for now as the Chancellor. However, there are five more state elections coming up in 2019 and EU parliamentary elections in May/June; these could result in a further loss of electoral support for both the CDU and SPD which could also undermine her leadership.
- **Other minority eurozone Governments.** Spain, Portugal, Netherlands and Belgium all have vulnerable minority Governments dependent on coalitions which could prove fragile. Sweden is also struggling to form a Government due to the anti-immigration party holding the balance of power, and which no other party is willing to form a coalition with.
- **Austria, the Czech Republic and Hungary** now form a strongly anti-immigration bloc within the EU while **Italy**, this year, has also elected a strongly anti-immigration Government. Elections to the EU parliament are due in May/June 2019.
- Further increases in interest rates in the US could spark a sudden flight of investment **funds** from more risky assets e.g. shares, into bonds yielding a much improved yield. In October 2018, there was a sharp fall in equity markets but this has been limited, as yet. Emerging countries which have borrowed heavily in dollar denominated debt, could be particularly exposed to this risk of an investor flight to safe havens e.g. UK gilts.
- There are concerns around the level of US corporate debt which has swollen massively during the period of low borrowing rates in order to finance mergers and acquisitions. This has resulted in the debt of many large corporations being downgraded to a BBB credit rating, close to junk status. Indeed, 48% of total investment grade corporate debt is now rated at BBB. If such corporations fail to generate profits and cash flow to reduce their debt levels as expected, this could tip their debt into junk ratings which will increase their cost of financing and further negatively impact profits and cash flow.
- **Geopolitical risks**, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

Upside risks to current forecasts for UK gilt yields and PwLB rates

- **Brexit** – if both sides were to agree a compromise that removed all threats of economic and political disruption.
- **The Fed causing a sudden shock in financial markets** through misjudging the pace and strength of increases in its Fed. Funds Rate and in the pace and strength of reversal of QE, which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.
- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- **UK inflation**, whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

Appendix 5: Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

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

Non-specified Investments: These are any investments which do not meet the specified investment criteria. A maximum of 50% 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

	Minimum credit criteria / colour band	** Max % of total investments/ £ limit per institution	Max. maturity period
DMADF – UK Government Debt Management Account Deposit Facility	N/A	100%	6 months
UK Government gilts	UK sovereign rating	£20m	12 months
UK Government Treasury bills	UK sovereign rating	£20m	12 months
Bonds issued by multilateral development banks	AAA	£10m	6 months
Money Market Funds	AAA	£20m	Liquid
Enhanced Cash Funds with a credit score of 1.25	AAA	£20m	Liquid
Enhanced Cash Funds with a credit score of 1.5	AAA	£20m	Liquid
Public Bodies	N/A	£20m	12 months
Term deposits with banks and building societies	Blue Orange Red Green No Colour	£20m £15m £10m £10m Not for use	12 months 12 months 6 months 100 days Not for use
CDs or corporate bonds with banks and building societies	Blue Orange Red Green No Colour	£20m £15m £10m £10m Not for use	12 months 12 months 6 months 100 days Not for use
Gilt funds	UK sovereign rating	£10m	12 months
REPO's (Collateralised deposit)	100% Collateral	£5m	12 months
GMCA	Internal Due Diligence	£30m	12 months
GM Public Bodies	Internal Due Diligence	£30m	5 years

Accounting treatment of investments. The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by the Council. To ensure that the Council is protected from any adverse revenue implications, which may arise from these differences, the accounting implications of new transactions will be reviewed before they are undertaken.

Non-specified Investments: A maximum of 50% will be held in aggregate in non-specified investments

Maturities in excess of 1 year

	* Minimum Credit Criteria	Use	£ limit per institution	Max. maturity period
Term deposits – local authorities and other public institutions	--	In-house	£10m	5 years
Term deposits – banks and building societies	Yellow Purple	In-house	£10m £10m	5 years 2 years
Certificates of deposit issued by banks and building societies	Yellow Purple	In-house	£10m £10m	5 years 2 years
Certificates of deposit issued by banks and building societies	Short-term F1 Long-term AA	Fund Managers	£5m	2 years
Collateralised deposit	UK sovereign rating	In-house and Fund Managers	£5m	2 years
UK Government Gilts	UK sovereign rating	In-house and Fund Managers	£10m	5 years
Bonds issued by multilateral development banks	AAA	In-house and Fund Managers	£10m	3 years
Sovereign bond issues (other than the UK Government)	AAA	In-house and Fund Managers	£5m	2 years
Corporate bonds	Short-term F1 Long-term AA	In-house and Fund Managers	£5m	5 years
Green Energy Bonds	Internal Due Diligence	In-house and Fund Managers	£10m	10 years
Property Funds	Internal Due Diligence	In-house	£30m	10 years
Floating Rate Notes	Long Term A	In-house	£5m	5 years
REPO's (Collateralised deposit)	100% Collateral	In-house	£5m	5 years
GMCA	Internal Due Diligence	In-house	£30m	5 years
Covered Bonds	Long term A	In-house	£5m	5 years
Local Capital Finance Company (Municipal Bonds Agency)	Internal Due Diligence	In-house	£1m	10 years
Local Authority Fixed Income Fund	Internal Due Diligence	In-house	£5m	10 years
Unrated Bonds, backed by securitised Assets	Internal Due Diligence	In-house and fund managers	£5m	5 years
Asset Backed Pooled Investment Funds	Internal Due Diligence	In-house and fund managers	£5m	5 years
Fixed term deposits with variable rate and variable maturities	Internal Due Diligence	In-house and External Advice	£20m	50 years

Appendix 6: Approved Countries for Investments (as at December 2018)

AAA

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Sweden
- Switzerland

AA+

- Finland
- U.S.A.

AA

- France
- U.K.

AA-

- Belgium

Appendix 7: Treasury Management Scheme of Delegation

The scheme of delegation is as follows:

Full Council is the responsible body for:

- receiving and reviewing reports on Treasury Management policies, practices and activities;
- the approval of the annual strategy, mid-year review and outturn report.
- approval of/amendments to the organisation's 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;

Cabinet is the responsible body for:

- considering the Treasury Management Policy and Procedures and making recommendations to the responsible body.
- considering Treasury Management reports and commending to Council.

Audit Committee is responsible for scrutiny:

- reviewing the Treasury Management Policy and Procedures and making recommendations to the responsible body.
- Reviewing Treasury Management reports and making recommendations to the responsible body.

Cabinet Member for Finance and and Corporate Services is responsible for:

- approving the selection of external service providers and agreeing terms of appointment

Note : The Overview and Scrutiny Performance and Value for Money Select Committee reviews and scrutinises the Annual Treasury Management Strategy report along with the suite of other budget reports (including the Capital Strategy)

Appendix 8: The Treasury Management Role of the Statutory Chief Finance Officer (Director of Finance)

The Statutory Chief Financial Officer will discharge the Treasury Management role by:

- recommending 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 Treasury 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 processes, and liaising with external audit;
- recommending the appointment of external service providers.
- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority
- ensures that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing
- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities
- the provision to Members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees
- ensuring that Members are adequately informed and understand the risk exposures taken on by an authority
- ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above
- the creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed, to include the following -
 - Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;
 - Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;
 - Decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;

- Reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken;
- Ensuring appropriate training and qualifications (TMP10 and schedules), including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.