BEDFORD BOROUGH COUNCIL

TREASURY MANAGEMENT STRATEGY STATEMENT

2019-2020

1. BACKGROUND

1.1 The Council has adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition (*the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year.

1.2 This Strategy fulfils the Authority's legal obligation under the *Local Government Act 2003* to have regard to the CIPFA code and the Ministry of Housing, Communities and Local Government (MHCLG) Guidance.

1.3 The purpose of this Treasury Management Strategy Statement (TMSS) is, therefore to approve:

- Treasury Management Strategy for 2019/2020
- Treasury Management Indicators for 2019/2020

1.4 The Council has borrowed and invested substantial sums of money and, therefore, has potential exposures to financial risks including the loss of invested funds and the effect of changing interest rates. The successful identification, monitoring and control of risk, is therefore central to the Council's Treasury Management Strategy.

1.5 Treasury risk management at the Authority is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition* (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year. This report fulfils the Authority's legal obligation under the *Local Government Act 2003* to have regard to the CIPFA Code.

Investments held for service purposes or for commercial profit are considered in a different report called the Commercial and Service Investment Strategy which will be considered by Executive on 23rd January 2019 for onward approval by Full Council on.

2. POLICY OBJECTIVES

2.1 To set a balanced General Fund Revenue Budget in accordance with Section 33 of the Local Government Act 1992.

2.2 Having regard to affordability considerations manage the Council's long term debt. Variable rate and fixed rate borrowing and debt rescheduling will be considered as appropriate and as variations in interest rates occur.

2.3 To invest Council capital and revenue balances until they are used/spent in order that the Council gains investment income to help finance its annual revenue expenditure.

2.4 To keep within the Council's approved Treasury Management Policy and Practices.

2.5 The Council's primary objective in relation to its investments is to ensure that long term capital is not put at risk but that within acceptable risk parameters the portfolio is managed to ensure that interest is maximised. Liquidity is managed through the use of money market funds with additional access to the liquid PWLB and Local Authority borrowing market.

3. ROLE OF TREASURY MANAGEMENT ADVISORY PANEL

3.1 The Treasury Management Advisory panel is responsible for the scrutiny of treasury management policies and strategies.

3.2 The Panel receives reports from the Section 151 Officer on treasury management policies and strategies.

3.3 Members of the Panel are responsible for ensuring that they have the necessary skills and training to properly discharge their responsibilities to the Council's treasury management function.

4. ROLE OF SECTION 151 OFFICER

4.1 The Assistant Chief Executive (Enabling Services), as Section 151 Officer, has delegated responsibility to implement and monitor the Treasury Management Policy and Treasury Management Strategy Statement approved by the Council.

4.2 All Monies in the hands of the Council is controlled by the Assistant Chief Executive (Enabling Services).

4.3 Decisions on borrowing, investment or financing are taken by the Assistant Chief Executive (Enabling Services).

4.4 The Assistant Chief Executive (Enabling Services) is responsible for reporting to the Council on treasury management issues. The following shall be the minimum:

- An annual report on the policy adopted and strategy to be pursued in the coming year for Treasury Investments, to include treasury management indicators.
- An annual report on the performance of the treasury management function, for the previous year.
- Mid-year review of the Treasury Management Strategy including a review of current year performance.

4.5 To ensure that members and officers with treasury management responsibilities have access to training relevant to their needs and responsibilities.

5. EXTERNAL CONTEXT

5.1 **Economic background:** The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Authority's treasury management strategy for 2019/20.

UK Consumer Price Inflation (CPI) for October was up 2.4% year/year, slightly below the consensus forecast and broadly in line with the Bank of England's November Inflation Report. The most recent labour market data for October 2018 showed the unemployment rate edged up slightly to 4.1% while the employment rate of 75.7% was the joint highest on record. The 3-month average annual growth rate for pay excluding bonuses was 3.3% as wages continue to rise steadily and provide some pull on general inflation. Adjusted for inflation, real wages grew by 1.0%, a level still likely to have little effect on consumer spending.

The rise in quarterly GDP growth to 0.6% in Q3 from 0.4% in the previous quarter was due to weather-related factors boosting overall household consumption and construction activity over the summer following the weather-related weakness in Q1. At 1.5%, annual GDP growth continues to remain below trend. Looking ahead, the BoE, in its November Inflation Report, expects GDP growth to average around 1.75% over the forecast horizon, providing the UK's exit from the EU is relatively smooth.

Following the Bank of England's decision to increase Bank Rate to 0.75% in August, no changes to monetary policy has been made since. However, the Bank expects that should the economy continue to evolve in line with its November forecast, further increases in Bank Rate will be required to return inflation to the 2% target. The Monetary Policy Committee continues to reiterate that any further increases will be at a gradual pace and limited in extent.

While US growth has slowed over 2018, the economy continues to perform robustly. The US Federal Reserve continued its tightening bias throughout 2018, pushing rates to the current 2%-2.25% in September. Markets continue to expect one more rate rise in December, but expectations are fading that the further hikes previously expected in 2019 will materialise as concerns over trade wars drag on economic activity.

5.2 **Credit outlook**: The big four UK banking groups have now divided their retail and investment banking divisions into separate legal entities under ringfencing legislation. Bank of Scotland, Barclays Bank UK, HSBC UK Bank, Lloyds Bank, National Westminster Bank, Royal Bank of Scotland and Ulster Bank are the ringfenced banks that now only conduct lower risk retail banking activities. Barclays Bank, HSBC Bank, Lloyds Bank Corporate Markets and NatWest Markets are the investment banks. Credit rating agencies have adjusted the ratings of some of these banks with the ringfenced banks generally being better rated than their non-ringfenced counterparts.

The Bank of England released its latest report on bank stress testing, illustrating that all entities included in the analysis were deemed to have passed the test once the levels of capital and potential mitigating actions presumed to be taken by management were factored in. The BoE did not require any bank to raise additional capital.

European banks are considering their approach to Brexit, with some looking to create new UK subsidiaries to ensure they can continue trading here. The credit strength of these new banks remains unknown, although the chance of parental support is assumed to be very high if ever needed. The uncertainty caused by protracted negotiations between the UK and EU is weighing on the creditworthiness of both UK and European banks with substantial operations in both jurisdictions.

5.3 **Interest rate forecast**: Following the increase in Bank Rate to 0.75% in August 2018, the Authority's treasury management adviser Arlingclose is forecasting two more 0.25% hikes during 2019 to take official UK interest rates to 1.25%. The Bank of England's MPC has maintained expectations for slow and steady rate rises over the forecast horizon. The MPC continues to have a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. Arlingclose believes that MPC members consider both that ultra-low interest rates result in other economic problems, and that higher Bank Rate will be a more effective policy weapon should downside Brexit risks crystallise when rate cuts will be required.

The UK economic environment remains relatively soft, despite seemingly strong labour market data. Arlingclose's view is that the economy still faces a challenging outlook as it exits the European Union and Eurozone growth softens. While assumptions are that a Brexit deal is struck and some agreement reached on transition and future trading arrangements before the UK leaves the EU, the possibility of a "no deal" Brexit still hangs over economic activity (at the time of writing this commentary in mid-December). As such, the risks to the interest rate forecast are considered firmly to the downside.

Gilt yields and hence long-term borrowing rates have remained at low levels but some upward movement from current levels is expected based on Arlingclose's interest rate projections, due to the strength of the US economy and the ECB's forward guidance on higher rates. 10-year and 20-year gilt yields are forecast to remain around 1.7% and 2.2% respectively over the interest rate forecast horizon, however volatility arising from both economic and political events are likely to continue to offer borrowing opportunities.

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

For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 1%, and that new long-term loans will be borrowed at an average rate of 1%.

6. LOCAL CONTEXT

6.1 On 31st October 2018 the Authority held £72.572miliion of borrowing and £70.244million of investments. This is set out in further detail at **Appendix B**. Forecast changes in these sums are shown in the balance analysis in **Appendix C.**

6.2 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

6.3 CIPFA's prudential code for Capital Finance in Local Authorities recommends that the Authority's total debt should be lower than its highest forecast CRF over the next three years. **Appendix C** shows that the Authority expects to comply with the recommendation during 2019/20.

7. LIABILITY BENCHMARK

7.1 To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing at **Appendix D**. This assumes the same forecasts as **Appendix C**, but that cash and investment balances are kept to a minimum level of £10m at each year end to maintain sufficient liquidity but minimise credit risk.

7.2 Following on from the medium term forecasts in **Appendix C**, the long term liability benchmark assumes no debt funded capital expenditure per year and income, expenditure and reserves all increasing by inflation of 2% a year. This is shown in **Appendix E.**

7.3 The Graph shows that the Authority has significant long term funding available, shown in the grey area above the continuous red line. This shaded area is effectively the value that the Authority is over borrowed against its actual minimum cash requirement. This allows the Authority to be comfortable in the funds allocated long term into pooled funds.

8. BORROWING STRATEGY

8.1 The Authority is forecast to hold £70.922million of long term loans with scheduled repayments of £3.3million during the year. Based on the Capital Programme approved at Full Council on 10th October 2018 there is no requirement to undertake any borrowing for capital financing purposes however there may at time to time be an operational cash flow need that requires short term borrowing to be taken. The Authority could borrow in addition to this to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £165 million.

8.2 **Objectives:** The Authority's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest rates and achieving cost certainty over the period for which funds are required. The flexibility to renegotiate loans should the Authority's long-term plans change is a secondary objective.

8.3 **Strategy:** Given the significant cuts to public expenditure and in particular to local government funding, the Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources or to borrow short-term loans instead.

By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. The council's treasury adviser will assist the Authority with this 'cost of carry' and breakeven analysis. This may determine whether the Authority borrows additional sums at long-term fixed rates in 2019/2020 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

Alternatively, the Authority may arrange forward starting loans during 2019/2020, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

In addition, the Authority may borrow short-term loans to cover unexpected cash flow shortages.

8.4 **Sources:** The approved sources of long-term and short-term borrowing are:

- Public Works Loan Board (PWLB) and any successor body.
- any institution approved for investments (see below)

- any other bank or building society authorised to operate in the UK
- any other UK public sector body
- UK public and private sector pension funds (except Bedfordshire Pension Fund)
- Municipal Bond Agency
- Capital Market Bond Investors
- Local Capital Finance Company and other special purpose companies created to enable local authority bond issues

In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- leasing
- hire purchase
- sale and leaseback

The Council has previously raised the majority of its long-term borrowing from the PWLB but it continues to investigate other sources of finance, such as local authority loans and bank loans that may be available at more favourable rates.

8.5 **Municipal Bond Agency:** UK Municipal Bonds Agency was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for three reasons:

- Borrowing authorities may be required to provide bond investors to guarantee the risk that other local authority borrowers default on their loans.
- There will be a lead time of several months between committing to borrow and knowing the interest rate payable
- Up to 5% of the loan proceeds will be withheld from the Authority and used to bolster the Agency's capital strength.

Any decision to borrow from the Agency will therefore be the subject of a separate report to Full Council.

8.6 **LOBOs:** The Council holds £7.96 million of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. £7.96 million of these LOBOS have options during 2019/2020, and although the Authority understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The Authority will take the option to repay LOBO loans at no cost if it has the opportunity to do so. Total borrowing via LOBO loans will be limited to £20 million.

8.7 **Short-term and Variable Rate loans:** These loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below.

8.8 **Debt Rescheduling:** The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

9. INVESTMENT STRATEGY

9.1 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council's investment balance has ranged between £41.7 million and £87.3 million, and similar levels are expected to be maintained in the forthcoming year.

9.2 **Objectives:** The CIPFA Code requires the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

The portfolio will target as a whole to achieve a return above the Bank of England Consumer Price Inflation (CPI) target in order to maintain the spending power of the sum invested.

Where balances are expected to be invested for more than one year, the Authority will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

9.3 **Negative Interest Rates:** If the UK enters into a recession in 2019/20, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

9.4 **Strategy:** To achieve the objective above the Authority has set a target based on CPI inflation (This can be seen in the prudential indicators). To achieve this target the authority will increase its exposure to higher yielding pooled funds to £60million (from £30million), to reflect that these funds have higher price volatility the Authority will increase its Money Market Fund limit to £30million (from £20 million) allowing it to manage all liquidity in low volatility price risk funds. This will also allow the Authority to cease the use of unsecured bank deposits. The remaining funds will be assessed against the evolving cash flow outlook and invested as applicable in the approved counterparties.

9.5 **Business Model:** Under the new IFRS 9 standard, the accounting for certain investments depends on the Authority's "business model" for managing them. The Authority aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

9.6 **Approved Counterparties:** The Authority may invest its surplus funds with any of the counterparty types in **Appendix F**, subject to the cash limits (per counterparty) and the time limits shown. A more detailed breakdown of this can be seen in **Appendix G**.

9.7 **Credit Rating:** Investment limits are set decisions and made by reference to the lowest published long-term credit rating from a selection of external rating agencies. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

9.8 **Banks Unsecured:** Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. Unsecured investment with banks rated BBB or BBB- are restricted to overnight deposits at the Authority's current account bank National Westminster Bank plc.

9.9 **Banks Secured:** Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

9.10 **Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

9.11 **Corporates:** Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made following an external credit or to the value of £1million per company as part of a diversified pool in order to spread the risk widely.

9.12 **Registered Providers:** Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are tightly regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

9.13 **Pooled Funds:** Shares or units in diversified investment vehicles consisting of any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short Term Money Market Funds that offer same-day liquidity and that offer very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

9.14 **Bond, equity and property funds:** Offers enhanced returns over the longer term, but are more volatile in the short term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.

9.15 **Real estate investment trusts:** Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.

9.16 **<u>Operational Bank Accounts:</u>** The Authority may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £1million per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Authority maintaining operational continuity.

9.17 **<u>Risk Assessment and Credit Ratings:</u>** Credit ratings are obtained and monitored by the Authority's treasury advisor, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

9.18 **<u>Other Information on the Security of Investments:</u>** The Authority understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisation's in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press and advice from the Council's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Authority will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Authority's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

9.20 **Investment Limits:** The Authority's revenue reserves available to cover investment losses are forecast to be £41.1 million on 31 March 2019. In order that no more than 7% of available reserves will be put at risk for unsecured investments in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £3million on unsecured investments. For secured investments a limit of 12% or £5million has been set per organisation. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as per **Appendix H.** Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

9.21 **Liquidity Management:** The Authority uses purpose-built cash flow forecasting spreadsheets to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis, with receipts under-estimated and payments over-estimated to minimise the risk of the Authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Authority's medium term financial plan and cash flow forecast.

10. TREASURY MANAGEMENT INDICATORS

10.1 The Authority measures and manages its exposures to treasury management risks using the following indicators.

A. Interest Rate Exposures: This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rate will be:

Interest rate risk indicator	Limit
Upper limit on one-year revenue impact of a 1% rise in interest rates	£0.2million
Upper limit on one-year revenue impact of a 1% fall in interest rates	£(0.2million)

B. Maturity Structure of Borrowing: This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing will be:

Refinancing rate risk indicator	Upper limit	Lower limit
Under 12 months	20%	0%
12 months and within 24 months	20%	0%
24 months and within 5 years	20%	0%
5 years and within 10 years	30%	0%
10 years and within 20 years	30%	0%
20 years and within 30 years	30%	0%
30 years and above	30%	20%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

C. Principal Sums Invested for Periods Longer than a year: The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long term principal sum invested to final maturities beyond the end of the period will be:

Price risk indicator	2019/2020	2020/2021	2021/2022
Limit on principal invested beyond year end	£10million	£7million	£5million

D. Security: The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value and time-weighted average or credit score of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk. Therefore the lower the score calculated indicates a lower credit risk has been taken by the Council for its internal investments. The Council aims to perform at a level less than or equal to the target:

Credit risk indicator	Target
Portfolio value weighted average credit score	3.5
Portfolio time weighted average credit score	3.0

E. Liquidity: The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period, without additional borrowing.

Liquidity risk indicator	Target
Total cash available within 3 months	£25million

F. Yield: The Authority in order to maintain the spending power of the money it invests has adopted a voluntary yield target for the portfolio of the Bank of England Consumer Price Inflation (CPI) target. This will be also be measured against year on year CPI Inflation as part of the Annual Review.

Inflation risk indicator	Target
Minimum Yield on Portfolio	2%

11. OTHER ITEMS

11.1 The CIPFA code requires the Authority to include the following in its treasury management strategy.

11.2 **Policy on Use of Financial Derivatives:** Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

The Authority will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Authority is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transaction, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

11.3 **Markets in Financial Instruments Directive**: The Authority has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Authority's treasury management activities, the Chief Financial Officer believes this to be the most appropriate status.

12. OTHER OPTIONS CONSIDERED

The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Financial Officer having consulted the Finance Portfolio holder, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses will be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses will be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs will be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long term costs will be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs will be less certain

Arlingclose Economic & Interest Rate Forecast December 2018

Underlying assumptions:

- Our central interest rate forecasts are predicated on there being a transitionary period following the UK's official exit from the EU.
- The MPC has a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. We believe that MPC members consider that: 1) tight labour markets will prompt inflationary pressure in the future, 2) ultra-low interest rates result in other economic problems, and 3) higher Bank Rate will be a more effective policy weapon if downside risks to growth crystallise.
- Both our projected outlook and the increase in the magnitude of political and economic risks facing the UK economy means we maintain the significant downside risks to our forecasts, despite the potential for slightly stronger growth next year as business investment rebounds should the EU Withdrawal Agreement be approved. The potential for severe economic outcomes has increased following the poor reception of the Withdrawal Agreement by MPs. We expect the Bank of England to hold at or reduce interest rates from current levels if Brexit risks materialise.
- The UK economic environment is relatively soft, despite seemingly strong labour market data. GDP growth recovered somewhat in the middle quarters of 2018, but more recent data suggests the economy slowed markedly in Q4. Our view is that the UK economy still faces a challenging outlook as the country exits the European Union and Eurozone economic growth softens.
- Cost pressures are easing but inflation is forecast to remain above the Bank's 2% target through most of the forecast period. Lower oil prices have reduced inflationary pressure, but the tight labour market and decline in the value of sterling means inflation may remain above target for longer than expected.
- Global economic growth is slowing. Despite slower growth, the European Central Bank is conditioning markets for the end of QE, the timing of the first rate hike (2019) and their path thereafter. More recent US data has placed pressure on the Federal Reserve to reduce the pace of monetary tightening – previous hikes and heightened expectations will, however, slow economic growth.

- Central bank actions and geopolitical risks have and will continue to produce significant volatility in financial markets, including bond markets.

Forecast:

- The MPC has maintained expectations of a slow rise in interest rates over the forecast horizon, but recent events around Brexit have dampened interest rate expectations. Our central case is for Bank Rate to rise twice in 2019, after the UK exits the EU. The risks are weighted to the downside.
- Gilt yields have remained at low levels. We expect some upward movement from current levels based on our central case that the UK will enter a transitionary period following its EU exit in March 2019. However, our projected weak economic outlook and volatility arising from both economic and political events will continue to offer borrowing opportunities.

	31.10.2018 Actual Portfolio £m
External borrowing:	
Public Works Loan Board	-64,612
LOBO loans from banks	-7,961
Total external borrowing	**-72,573**
Other long-term liabilities:	
Finance Leases	-206
Total other long-term liabilities	**-206**
Total gross external debt	**-72,779**
Treasury investments:	
Banks & building societies (unsecured)	3
Covered bonds & repo (secured)	2,000
Government (incl.local authorities)	26,300
Money Market Funds	9,924
Pooled Funds:	
Equity Funds	8,000
Bond Funds	9,017
Multi-Asset Funds	5,000
Property Funds	10,000
Total treasury investments	**70,244**
Net debt	**-2,535**

Note: all values are on a principal/nominal basis

Appendix C

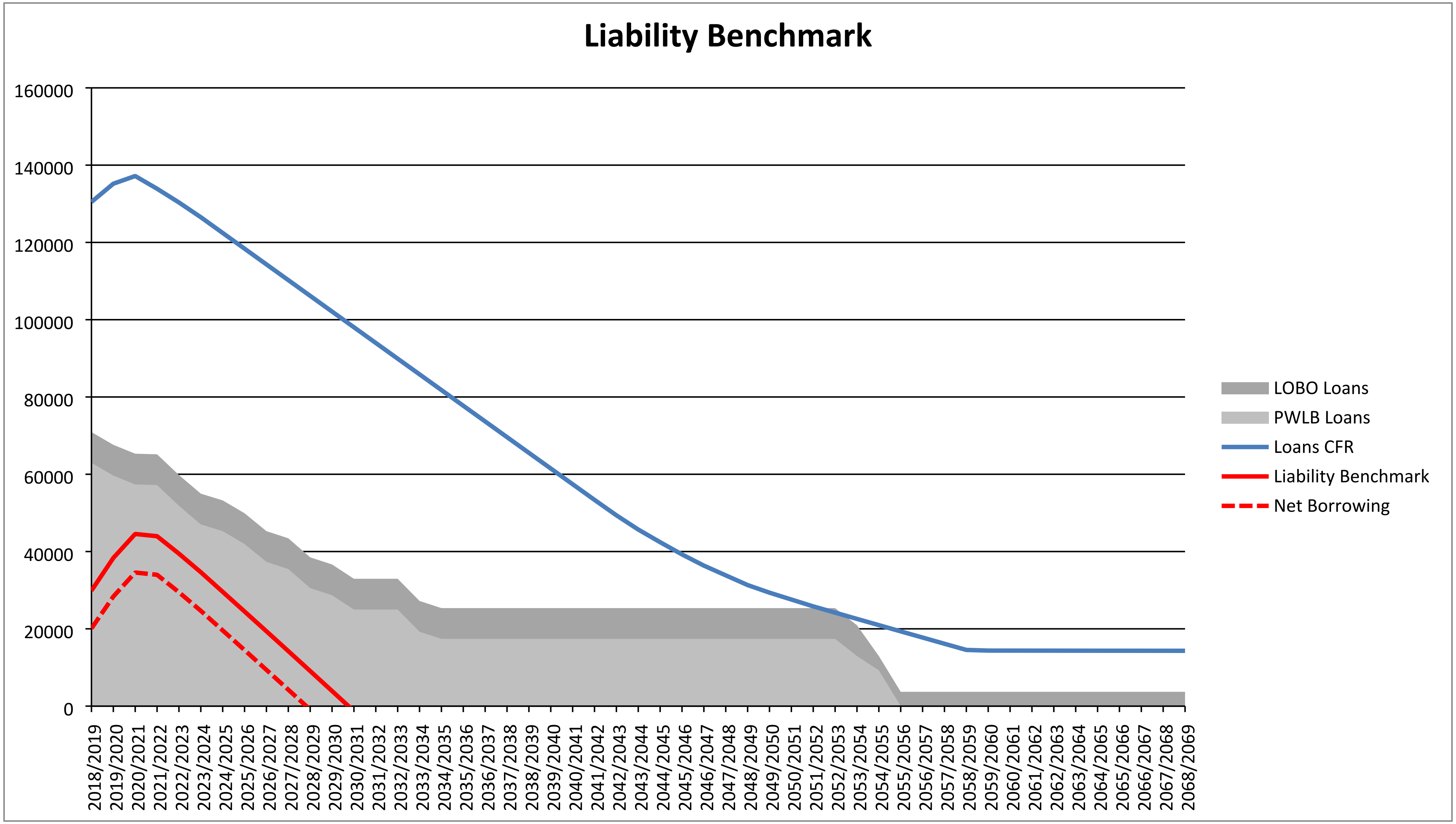
	31.3.2018 Actual £m	31.3.2019 Estimate £m	31.3.2020 Forecast £m	31.3.2021 Forecast £m	31.3.2022 Forecast £m
General Fund CFR	129,533	130,672	135,209	137,200	133,904
Less: Other debt liabilities	-516	-206	-19	-18	-17
Loans CFR	**129,017**	**130,465**	**135,190**	**137,182**	**133,886**
Less: External Borrowing	-74,321	-70,976	-67,738	-66,646	-66,069
Internal (over) borrowing	**54,696**	**59,490**	**67,452**	**70,535**	**67,817**
Less: Usable Reserves	-73,395	-63,861	-55,339	-51,039	-48,241
Less: Working Capital	-42,478	-46,716	-51,514	-51,596	-51,679
Investments	**-61,177**	**-51,088**	**-39,401**	**-32,100**	**-32,103**

Projections are based on the Capital Programme approved by Full Council on 10th October 2018.

Appendix D

	31.3.2018 Actual £m	31.3.2019 Estimate £m	31.3.2020 Forecast £m	31.3.2021 Forecast £m	31.3.2022 Forecast £m
Loans CFR	129,017	130,465	135,190	137,182	133,886
Less: Usable reserves	-73,395	-63,861	-55,339	-51,039	-48,241
Less: Working Capital	-42,478	-46,716	-51,514	-51,596	-51,679
Plus: Minimum investments	10,000	10,000	10,000	10,000	10,000
Liability Benchmark	**23,144**	**29,888**	**38,337**	**44,546**	**43,967**

Appendix E


Liability Benchmark
160000
140000
120000
100000
80000
60000
40000
20000
0
LOBO Loans
PWLB Loans
Loans CFR
Liability Benchmark
Net Borrowing
2018/2019
2068/2069

Appendix F

Approved Investment Counterparties and Limits

Credit Rating	Banks unsecured	Banks secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 Years	n/a	n/a
AAA	£3 Million 5 Years	£5 Million 20 Years	£5 Million 50 Years	£3 Million 20 Years	£3 Million 20 Years
AA+	£3 Million 5 Years	£5 Million 10 Years	£5 Million 25 Years	£3 Million 5 Years	£3 Million 10 Years
AA	£3 Million 4 Years	£5 Million 5 Years	£5 Million 15 Years	£3 Million 5 Years	£3 Million 10 Years
AA-	£3 Million 3 Years	£5 Million 4 Years	£5 Million 10 Years	£3 Million 5 Years	£3 Million 5 Years
A+	£3 Million 2 Years	£5 Million 3 Years	£5 Million 5 Years	£3 Million 5 Years	£3 Million 5 Years
A	£3 Million 13 Months	£5 Million 2 Years	£5 Million 5 Years	£3 Million 5 Years	£3 Million 5 Years
A-	£3 Million 6 Months	£5 Million 13 Months	£5 Million 5 Years	£3 Million 5 Years	£3 Million 5 Years
None	£1 Million 6 Months	n/a	£5 Million 25 Years	£3 Million 5 Years	£3 Million 5 Years
Pooled funds and real estate investment trusts		£15million per fund or trust (Total Exposure £60million)			

Appendix G

Counterparty	Arlingclose Maximum Duration as at 30.11.2018	Credit Rating 30.11.2018	Domicile
Barclays Bank plc	100 Days		United Kingdom
Barclays Bank UK plc	100 Days		United Kingdom
Goldman Sachs International Bank	100 Days		United Kingdom
National Westminster Bank plc	100 Days		United Kingdom
Royal Bank of Scotland plc	100 Days		United Kingdom
Ulster Bank Limited	100 Days		United Kingdom
Close Brothers Limited	6 Months		United Kingdom
HSBC Bank plc	6 Months		United Kingdom
HSBC UK Bank plc	6 Months		United Kingdom
Lloyds Bank plc	6 Months		United Kingdom
Bank of Scotland plc	6 Months		United Kingdom
Santander UK Plc	6 Months		United Kingdom
Abbey National Treasury Services plc	6 Months		United Kingdom
Standard Chartered Bank	6 Months		United Kingdom
Coventry Building Society	100 Days		United Kingdom
Nationwide Building Society	100 Days		United Kingdom
Leeds Building Society	100 Days		United Kingdom
Darlington Building Society	100 Days		United Kingdom
Furness Building Society	100 Days		United Kingdom
Harpenden Building Society	100 Days		United Kingdom
Hinckley & Rugby Building Society	100 Days		United Kingdom
Leek United Building Society	100 Days		United Kingdom
Mansfield Building Society	100 Days		United Kingdom
Marsden Building Society	100 Days		United Kingdom
Melton Mowbray Building Society	100 Days		United Kingdom

National Counties Building Society	100 Days		United Kingdom
Newbury Building Society	100 Days		United Kingdom
Scottish Building Society	100 Days		United Kingdom
Tipton & Coseley Building Society	100 Days		United Kingdom
Australia & New Zealand Banking Group	6 Months		Australia
Commonwealth Bank of Australia	6 Months		Australia
National Australia Bank	6 Months		Australia
Westpac Banking Group	6 Months		Australia
Bank of Montreal	6 Months		Canada
Bank of Nova Scotia	6 Months		Canada
Canadian Impreial Bank of Commerce	6 Months		Canada
Royal Bank of Canada	6 Months		Canada
Toronto Dominion Bank	6 Months		Canada
Danske Bank	100 Days		Denmark
OP Corporate Bank	6 Months		Finland
Bayerische Landesbank	6 Months		Germany
DZ Bank AG Deutsche Zentral	6 Months		Germany
Landesbank Baden-Wuerrtemberg	6 Months		Germany
Landesbank Hesen Thuringen(Heleba)	6 Months		Germany
Cooperatieve Rabobank	13 Months		Netherlands
ING Bank	100 Days		Netherlands
DBS Bank Ltd	13 Months		Singapore
Oversea - Chinese Bankling Corporation	13 Months		Singapore
United Overseas Bank	13 Months		Singapore
Nordea Bank AB	13 Months		Sweden
Svenska Handelsbanken	13 Months		Sweden
Credit Suisse	100 Days		Switzerland

	Cash limit
Any single organisation, except the UK Central Government	£5million each
UK Central Government	Unlimited
Any group of organisations under the same ownership	£5million per group
Any group of pooled funds under the same management	£15million per manager
Negotiable instruments held in a brokers' nominee account	£20million per broker
Foreign countries	£5million per country
Registered providers and registered social landlords	£15million in total
Unsecured investments with building societies	£5million in total
Loans to unrated corporates	£5million in total
Money market funds	£30million in total
Real estate investment trusts	£5million in total