TREASURY MANAGEMENT STRATEGY STATEMENT 2019/2020

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1. Introduction

1.1 Treasury management is the management of the Council's cash flows, borrowing and investments, and the associated risks. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Council's prudent financial management.

1.2 Treasury risk management at the Council 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 Council to approve a treasury management strategy before the start of each financial year. This report fulfils the Council's legal obligation under the *Local Government Act 2003* to have regard to the CIPFA Code.

1.3 Investments held for service purposes or for commercial profit are considered in a different report, the Investment Strategy – see appendix D (iv).

2. External Context

2.1 ***Economic background:*** The UK's progress in 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.

2.2 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.

2.3 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 Bank of England, 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.

2.4 Following the Bank of England's decision to increase Bank Rate to 0.75% in August 2018, no changes to monetary policy have 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.

2.5 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 2.5% in December. Expectations are fading that the further hikes previously expected in 2019 will materialise as concerns over trade wars drag on economic activity.

2.6 ***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.

2.7 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 Bank of England did not require any bank to raise additional capital.

2.8 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.

2.9 ***Interest rate forecast***: Following the increase in Bank Rate to 0.75% in August 2018, the Council'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 a higher Bank Rate will enable an effective policy weapon should rate cuts will be required.

2.10 The UK economic environment remains relatively soft, despite a 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. Whilst 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 early January). As such, the risks to the interest rate forecast are considered firmly to the downside.

2.11 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 European Central Bank'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.

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

3. Local Context

On 31st December 2018 the Council held £58.07m of borrowing and £119.35m of investments. This is set out in further detail at Appendix A. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance Sheet Summary and Forecast

	31.03.18 Actual £m	**31.03.19 Estimate £m**	**31.03.20 Forecast £m**	**31.03.21 Forecast £m**	**31.03.22 Forecast £m**
General Fund CFR	3.83	0.00	0.00	0.00	0.00
HRA CFR	57.61	55.85	51.41	46.97	37.52
Total CFR	**61.44**	**55.85**	**51.41**	**46.97**	**37.52**
Less: Existing External Borrowing	60.53	55.85	51.41	46.97	37.52
Internal (over) Borrowing	**0.91**	**0.00**	**0.00**	**0.00**	**0.00**
Less: General Reserve HRA balances Earmarked/capital reserves	3.00 13.08 42.54	3.00 11.69 46.33	3.00 8.43 41.38	3.00 7.01 40.38	3.00 2.83 39.75

Less: Working capital	39.67	43.35	40.00	40.00	40.00
Investments net of internal borrowing	**97.38**	**104.37**	**92.81**	**90.39**	**85.58**

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 Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Council expects to comply with this recommendation during 2019/20.

Liability Benchmark: To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecast as table 1 above, but that cash and investment balances are kept to a minimum level of £10m each year-end to maintain sufficient liquidity but minimise credit risk.

Table 2: Liability benchmark

	31.03.18 Actual £m	31.03.19 Estimate £m	31.03.20 Forecast £m	31.03.21 Forecast £m	31.03.22 Forecast £m
CFR	61.44	55.85	51.41	46.97	37.52
Less: General Reserve	3.00	3.00	3.00	3.00	3.00
HRA Balances	13.08	11.69	8.43	7.01	2.83
Earmarked/capital reserves	42.54	46.33	41.38	40.38	39.75
Less: Working capital	39.67	43.35	40.00	40.00	40.00
Plus: Minimum investments	10.00	10.00	10.00	10.00	10.00
Liability benchmark	-26.85	-38.52	-31.40	-33.42	-38.06

The table above shows that the Council does not have a need to borrow at this time as the liability benchmark is negative.

4 The Borrowing Strategy

The Council currently has £58.07m of loans outstanding which were borrowed in March 2012 to fund the Housing Self Financing settlement. The amount outstanding will fall to £56.07m by March 2019.

The Council is not expecting to borrow to fund the capital programme during 2019/20; should there be a requirement to do so, total borrowing will not exceed the Authorised Limit of £120m. The Council will, in consultation with its treasury management adviser, adopt a flexible approach to borrowing should it be required. The Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which the funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

Borrowing 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
- 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 Kent Pension Fund)
- Capital market bond investors
- UK Municipal Bonds Agency plc 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
- Private Finance Initiative
- sale and leaseback

Currently all of the Council's debt is with the Public Works Loan Board (PWLB) but it continues to monitor other sources of finance, such as local authority loans and bank loans, which may be available at more favourable rates.

The Council applied to be, and was successful in becoming, a qualifying authority, giving it access to reduced interest rates from the PWLB – the 'Certainty Rate'. This eligibility is reviewed annually by HM Treasury/PWLB.

As an alternative to the PWLB, the UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association. Any decision to borrow from the Municipal Bonds Agency will be the subject of a separate report to Cabinet, prior to borrowing.

Prior to undertaking further borrowing, the Council will undertake a full analysis of the various sources open to it at that time. This will be in consultation with its treasury management advisers.

Debt Rescheduling: 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 Authority 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.

Borrowing, rescheduling and repayment of debt will be reported to Cabinet and to the Treasury Management Panel.

5 Investment Strategy

The Council holds significant invested funds, representing income received in advance of expenditure, plus balances and reserves. In the current financial year to 31 December 2018, the Council's investment balances have ranged between £103.5m and £130.7m and roughly similar levels are expected to be maintained in the forthcoming year. However, these may rise should land sales at Stone Lodge materialise. The peaks in investments generally relate to the timing of the receipt of business rates and council tax, which are then held until the pre-set payment dates of precepts.

Objectives: The CIPFA Code requires the Council 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 Council's objective when investing money is to strike a balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving very low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal to or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

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.

Strategy: The Council's investment strategy during 2018/19, given the increasing risk and very low returns from short-term unsecured bank investments, was to maintain a large proportion of investments which offer diversification and potentially higher yields. The Council now has £93.67m (78.47%) of its investments in externally managed pooled funds which are considered to be longer term investments, i.e. defined as those invested for periods longer than a year. Each fund has different characteristics, asset classes and risk – details of the externally managed pooled fund balances as at 31 December 2018, by fund type, are included in Appendix A. The balance of the Council's funds (£25.70m) is currently invested in money market funds. The Council intends to continue this strategy over the coming year.

Business models: Under the new IFRS 9 standard, the accounting for certain investments depends on the Council's "business model" for managing them. The Council 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.

Approved counterparties: The Council may invest its funds with any of the counterparty types in table 3 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 3: 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	£7.5m 5 years	£7.5m 20 years	£10m 50 years	£3m 20 years	£3m 20 years
AA+	£5m 5 years	£7.5m 10 years	£7.5m 25 years	£3m 10 years	£3m 10 years
AA	£5m 4 years	£7.5m 5 years	£7.5m 15 years	£3m 5 years	£3m 10 years
AA-	£5m 3 years	£7.5m 4 years	£7.5m 10 years	£3m 4 years	£3m 10 years
A+	£5m 2 years	£7.5m 3 years	£5m 5 years	£3m 3 years	£3m 5 years
A	£5m 13 months	£7.5m 2 years	£3m 5 years	£3m 2 years	£3m 5 years
A-	£5m 6 months	£7.5m 13 months	£3m 5 years	£3m 13 months	£3m 5 years
None	£1m 6 months	n/a	£7.5m 5 years	n/a	£3m 5 years
Pooled funds and	No single investment in a pooled fund will exceed £15m. Limits for each individual fund are set following consultation with the Council's treasury advisers				

real estate investment trusts	

This table must be read in conjunction with the notes below.

Credit rating: Investment limits are set 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.

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. See below for arrangements relating to operational bank accounts.

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 higher 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.

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 low 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.

Corporates: Companies other than banks and registered providers issue loans, bonds and commercial paper. These investments are not subject to bail-in, but are exposed to the risk of the company becoming insolvent. Loans to unrated companies will only be made as part of a diversified pool in order to spread the risk widely.

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.

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 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.

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Council 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 Council's investment objectives will be monitored regularly.

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.

Operational Bank accounts: The Council may incur operational exposures, for example through 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 £1m 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 Council maintaining operational continuity.

Investment Instruments:
Of the above investment instruments within the scope of the strategy the following are currently being used:

- Pooled Funds with variable net asset value ('cash plus', bond, equity income, multi-asset, absolute return funds and a property fund)
- Money Market Funds (MMF)
- Operational bank accounts

However, as stated above, the Council recognises the importance of diversification and will continue to diversify its investments and consider all types of investment and asset classes, for use during the life of this Strategy.

Risk assessment and credit ratings: Credit ratings are obtained and monitored by the Council's treasury advisers, who 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.

Other information on the security of investments: The Council 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 organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press and analysis and advice from the Council's treasury 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 Council 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 Council'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. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

Investment Limits: The Council's General Fund and HRA reserves available to cover investment losses are forecast to be £61.02m on 31 March 2019. In order that no more than 15% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £7.5m. Individual limits for unsecured investments with financial institutions are determined on a variety of credit criteria and in most instances will be lower than the £7.5m maximum limit. The Council has never suffered an investment loss requiring the use of reserves.

A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on investments in brokers' nominee accounts, foreign countries and industry sectors as below. 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.

Table 4: Investment Limits

	Cash limit
Any single organisation, (except the UK Central Government and externally managed pooled funds)	£7.5m each
UK Central Government	unlimited
Any group of organisations under the same ownership (excluding externally managed pooled funds)	£7.5m per group
Any group of pooled funds under the same management	£25m per manager
Negotiable instruments held in a broker's nominee account	£25m per broker
Foreign countries	£10m per country
Registered Providers and registered social landlords	£5m in total
Unsecured investments with Building Societies	£5m in total
Loans to unrated corporates	£5m in total

Money Market Funds	£65m in total, £7m per individual money market fund
Real estate investment trusts	£25m in total

Tables 3 and 4 set the parameters and boundaries for the Council's investments, the operational use of counterparties will be determined by the credit criteria outlined in Table 2. A counterparty list along with individual exposure and maturity limits for in-house use is always maintained and updated on a regular basis in line with evolving credit conditions.

Liquidity management

The Council uses purpose-built cash flow forecasting software (Logotech) to assist with determining 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 Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's Medium Term Financial Plan and cash flow forecast.

6 Treasury Management Indicators

The Council measures and manages its exposures to treasury management risks using the following indicators:

Security

The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average 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.

	Target
Portfolio average credit score	A

Liquidity

The Council 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 one month period, without additional borrowing.

	Target
Total cash available within 1 month	£5m

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

Interest rate risk indicator	Target
One-year revenue impact of a 1% rise in interest rates	£400,000
Upper limit on a one-year revenue impact of a 1% fall in interest rates	(£1,000,000)

The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates. The Council's debt is at fixed rates of interest, maturing debt is not being replaced with new borrowing and will not be impacted by an increase in interest rates. The Council will benefit from any increase in interest rates on its investments.

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

	Maturity % as at 31/03/2019	**Upper Limit for 2019/2020**	**Lower Limit for 2019/2020**
Under 12 months	7.96%	25%	0%
12 months and within 24 months	7.96%	25%	0%
24 months and within 5 years	29.60%	50%	0%
5 years and within 10 years	28.27%	50%	0%
10 years and within 20 years	26.22%	50%	0%
20 years and above	0.00%	20%	0%

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.

Principal sums invested for longer than a year
The purpose of this indicator is to control the Council'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 period end will be:

Limit on principal invested beyond year end	**2018/19**	**2019/20**	**2020/21**
Internally Managed Funds	£20m	£15m	£10m

Externally Managed Funds	£125m	£125m	£125m

7 Related Matters

The CIPFA code requires the Council to include the following in its treasury management strategy:

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 Council will only use the 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 Council 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 transactions, 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.

Policy on Apportioning Interest to the Housing Revenue Account (HRA)
As all the Council's borrowing relates solely to the HRA, a 'one pool' approach was adopted, meaning that all interest paid on the loans is charged direct to the Housing Revenue Account. Interest on the average notional cash balances within the HRA are calculated annually and credited/debited to the HRA.

8 Financial Implications

The budget for investment income in 2019/20 is £0.65m. This is based on the current level of investment and current interest rates. If actual levels of investment or actual interest rates differ, performance against budget will be correspondingly different. The budget for debt interest paid in 2019/20 is £1.34m.

9 Other options considered

The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Council 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 may 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 may be smaller
Reduce level of borrowing	Cost of premature redemption is extremely high. 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 may be less certain

Appendix A – Existing Investment & Debt Portfolio Position as at 31 December 2018

External Borrowing						
Loan Type	**Maturity Date**	**Years to Maturity**	**Principal Borrowed (28/03/12) £m**	**Semi-annual repayment**	**Interest Rate %**	**Principal Outstanding (31/12/18) £m**
Maturity	01/02/2022	3.09	5.00		2.40%	5.00
EIP	01/02/2039	20.10	18.00	0.33	2.90%	13.67
EIP	01/02/2026	7.09	9.00	0.32	1.82%	4.82
EIP	01/02/2022	3.09	9.00	0.45	1.31%	3.15
EIP	01/02/2032	13.10	26.95	0.67	2.44%	18.19
EIP	01/02/2037	18.10	9.00	0.18	2.79%	6.66
EIP	01/02/2031	12.10	10.00	0.26	2.35%	6.58
			86.95	2.22	2.41%	58.07
Total Gross External Debt						**58.07**

Investments	
Managed in-house	
Short-term investments	25.70
Long-term investments	0.00
Pooled Funds by type:	
Cash Plus Funds	18.96
Short Dated Bond Funds	14.96
Long Dated Bond Funds	11.89
Multi-asset Income Funds	22.69
Equity Income Funds	18.78
Absolute Return Bond Funds	4.41
Property Funds	1.98
Total Investments	**119.37**
Net Investments	**61.30**

Appendix B – Economic & Interest Rate Forecast – provided by Arlingclose

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.

	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.17**
Arlingclose Central Case	**0.75**	**0.75**	**1.00**	**1.00**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.13**
Downside risk	0.00	-0.50	-0.75	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	**-0.85**
3-mth money market rate														
Upside risk	0.10	0.10	0.10	0.10	0.15	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	**0.17**
Arlingclose Central Case	**0.90**	**0.95**	**1.10**	**1.30**	**1.40**	**1.40**	**1.40**	**1.35**	**1.35**	**1.35**	**1.35**	**1.35**	**1.35**	**1.27**
Downside risk	-0.20	-0.45	-0.60	-0.80	-0.90	-0.90	-0.90	-0.85	-0.85	-0.85	-0.85	-0.85	-0.85	**-0.76**
1-yr money market rate														
Upside risk	0.20	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	**0.33**
Arlingclose Central Case	**1.15**	**1.25**	**1.35**	**1.50**	**1.70**	**1.60**	**1.50**	**1.40**	**1.35**	**1.35**	**1.35**	**1.35**	**1.35**	**1.40**
Downside risk	-0.35	-0.50	-0.60	-0.80	-0.90	-0.90	-0.90	-0.85	-0.85	-0.85	-0.85	-0.85	-0.85	**-0.77**
5-yr gilt yield														
Upside risk	0.25	0.30	0.30	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.37**
Arlingclose Central Case	**1.15**	**1.25**	**1.35**	**1.50**	**1.50**	**1.40**	**1.35**	**1.35**	**1.30**	**1.30**	**1.30**	**1.30**	**1.30**	**1.33**
Downside risk	-0.50	-0.60	-0.65	-0.80	-0.80	-0.70	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	**-0.66**
10-yr gilt yield														
Upside risk	0.25	0.30	0.30	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.37**
Arlingclose Central Case	**1.50**	**1.65**	**1.70**	**1.80**	**1.80**	**1.75**	**1.75**	**1.70**	**1.70**	**1.70**	**1.70**	**1.70**	**1.70**	**1.70**
Downside risk	-0.55	-0.70	-0.70	-0.80	-0.80	-0.75	-0.75	-0.70	-0.70	-0.70	-0.70	-0.70	-0.70	**-0.71**
20-yr gilt yield														
Upside risk	0.25	0.30	0.30	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.37**
Arlingclose Central Case	**2.00**	**2.10**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.18**
Downside risk	-0.60	-0.70	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	**-0.73**
50-yr gilt yield														
Upside risk	0.25	0.30	0.30	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.37**
Arlingclose Central Case	**1.90**	**1.95**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**1.99**
Downside risk	-0.60	-0.70	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	**-0.73**

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%
PWLB Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%