Report to:	**Cabinet**
Date:	**22 January 2019**
By:	**Chief Operating Officer**
Title of report:	**Treasury Management Policy and Strategy 2019/20**
Purpose of report:	**This report proposes the Treasury Management Policy and Strategy for 2019/20. The Council is also required to set Prudential Indicators as set out in the Prudential Code which are included in this strategy for approval.**

RECOMMENDATIONS

Cabinet is recommended to recommend Council to:

1) **approve the Treasury Management Policy and Strategy Statement for 2019/20;**
2) **approve the Annual Investment Strategy for 2019/20;**
3) **approve the Prudential and Treasury Indicators 2019/20 to 2021/22;**
4) **approve the revised Minimum Revenue Provision (MRP) Policy Statement 2019/20 at Appendix A (Section 3).**

1. Background

1.1 A requirement under the Chartered Institute for Public Finance and Accountancy (CIPFA) Code of Practice for Treasury Management in the Public Services is to prepare a Treasury Management Policy and Strategy setting out the Council's policies for managing investments and borrowing.

1.2 The Local Government Act 2003 and supporting regulations requires the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

1.3 The Treasury Management Policy and Strategy Statement (TMSS) for 2019/20 is presented in Appendix 'A' to this report. The strategy includes the Treasury Management Policy Statement, the Treasury Management Strategy Statement, the Annual Investment Strategy, Prudential and Treasury Indicators for the next three years and the annual Minimum Revenue Provision Policy Statement.

1.4 The 2019/20 TMSS has been prepared within the context the financial challenge being faced by the County Council over the Medium Term Financial Plan, and the resulting Core Offer that the Council is exploring through the Reconciling Policy, Performance and Resources process for 2019/20. The 2019/20 TMSS seeks to complement the Council's Core Offer by:

- utilising long term cash balances as effectively as possible by investing in longer term instruments and/or using to fund borrowing to reduce borrowing costs;
- ensuring the investment portfolio is working hard to maximise income by exploring alternative appropriate investment opportunities during 2019/20;
- ensuring effective management of the borrowing portfolio by exploring rescheduling opportunities and identifying and exploiting the most cost effective ways of funding the Council's borrowing requirement.

1.5 The 2018/19 Annual Investment Strategy was revised considerably to include a broader group of investment instruments including pooled property funds, short dated bond funds, and pooled mixed asset funds. The inclusion of these instruments provides options for the Council to invest its longer term cash, which assists in both diversifying the investment portfolio whilst providing an improvement to the overall yield. The council's first step in using these wider instruments was with a £5m investment in the CCLA Pooled Property fund in July 2018 following a fund selection process. In its first 3 months, this investment achieved an annualised yield of 3% over and above what the council could achieve for one year deposits with banks at the time. It was always intended that a total of £10m would be invested in the CCLA Property Fund. A further investment of £5m will be reviewed in April/May 2019, once the impact of the UK withdrawal from the EU on the UK property market can be assessed.

1.6 The 2019/20 Investment Strategy continues with officers seeking new opportunities to invest long-term cash in suitable longer term instruments in order to assist in delivering treasury savings by increasing investment income. An investment options appraisal will be undertaken during 2019/20 to identify which assets are most appropriate for the Council's need. The 2019/20 strategy continues to prioritise security of the Council's cash and as such, caution will be taken to ensure that any risks associated with prevailing market and economic climates, including any perceived impact of a disorderly withdrawal from the European Union, are considered, understood and mitigated as part of the options appraisal process.

1.7 The Borrowing Strategy and the Capital Programme identifies a borrowing need of £74m over the next 4 years. No external borrowing is planned in 2019/20. The council currently has large cash balances, therefore officers will seek to use cash from the Council's own reserves to initially fund borrowing where it may be required. This will decrease the council's cash balances, reducing counterparty risk, and reducing borrowing costs. This strategy will be kept under constant review by officers, and borrowing will be undertaken where it is felt there is a significant risk of steep increases in borrowing rates.

1.8 The Medium Term Financial Plan includes a total of £1.5m savings in the Treasury Management budget over the next three years, with the first £0.5m to be delivered in 2019/20.

2. Supporting Information

Treasury Management Reporting

2.1 As well as this annual strategy, the CIPFA Code requires the Council reports as a minimum:

- A mid-year review;
- An annual report at the close of the year.

2.2 This Council meets this requirement with the Treasury Management Annual Report 2017/18 and mid-year report 2018/19 presented to Cabinet on 11 December 2018. Additionally, a treasury management monitoring position is reported to Cabinet four times a year.

Economic Background

2.3 The Council takes advice from Link Asset Services on its treasury management activities. A detailed view of the current economic situation and forecasts, as prepared by Link Asset Services is included in Appendix A (Annex B) to this report.

Minimum Revenue Provision (MRP)

2.4 A paper was discussed at Audit Committee on 20 September 2018 recommending a revision to the MRP methodology, which was supported by the committee. The current methodology is based on using an equal instalment method. The alternative proposed was an annuity method. Under this revised methodology, MRP will be lower in the early years and increases over time. This is considered a prudent approach as it reflects the time value of money (i.e. the impact of inflation) as well as providing a charge which is better matched to how the benefits of the asset financed by borrowing are consumed over its useful life. That is, a method that reflects the fact that asset deterioration is slower in the early years of an asset and accelerates towards the latter years. The revised MRP Policy Statement (Appendix A, Section 3) therefore reflects this change in policy which, if approved, will be introduced during 2018/19.

2.5 Officers are in conversation with the Council's auditors, Grant Thornton, regarding this change in policy and the impact on the council's accounts.

Revision of CIPFA Codes and MHCLG Guidance

2.6 The framework in which treasury management operates was revised by the Ministry for Housing, Communities and Local Government (MHCLG) and CIPFA during 2017/18, with full implementation expected by 2019/20. The changes were largely in response to a growing number of authorities increasing their use of non-financial investments (such as commercial property portfolios) to generate income in response to reducing resources to deliver their core services. The revised codes and guidance sought to increase transparency and to provide a single place to assess the proportionality of this activity in comparison to an authority's core services. This report is fully compliant with the revised requirements, and a new, separate, report (The Capital Strategy) will be part of Reconciling Policy, Performance and Resources as reported to Cabinet on 22 January 2019. The purpose of the Capital Strategy is to drive the authority's capital investment ambition, whilst also ensuring appropriate capital expenditure, capital financing and treasury management in the context of the sustainable, long term delivery of services.

3 Conclusion and recommendations

3.1 This policy sets out the acceptable limits on ratings, investment periods, amounts to be invested and the borrowing strategy. Cabinet will be aware that the financial position is kept under constant review and if at any time it is felt that any of these limits represent an unacceptable risk appropriate and immediate action will be taken accordingly.

3.2 Cabinet recommends the 2019/20 Treasury Management Policy and Strategy Statement for approval by Council.

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<u>BACKGROUND DOCUMENTS</u>

CIPFA Prudential Code and CIPFA Treasury Management Code
Local Government Act 2003 – Capital Finance
MHCLG Statutory Guidance on Local Authority Investments and the Minimum Revenue Provision.

Appendix A

TREASURY MANAGEMENT POLICY AND STRATEGY 2019/20

CONTENTS

1. INTRODUCTION

1.1 Background

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 counterparties or instruments commensurate with the Council's risk appetite, providing adequate liquidity initially before considering investment return.

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, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.

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.

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.

CIPFA defines treasury management 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."

Revised reporting is required for the 2019/20 reporting cycle due to revisions of the Ministry for Housing Communities and Local Government (MHCLG) Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the CIPFA Prudential Code and the 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 capital strategy is being reported separately.

1.2 Reporting Requirements

1.2.1 Capital Strategy

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

The aim of the capital strategy is to ensure that all elected members on the full council fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

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. The capital strategy will show:

- The corporate governance arrangements for these types of activities;
- Any service objectives relating to the investments;
- The expected income, costs and resulting contribution;
- 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.

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.

Where the Council has borrowed to fund any non-treasury investment, there should also be an explanation of why borrowing was required and why the MHCLG Investment Guidance and CIPFA Prudential Code have not been adhered to.

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.

1.2.2 Treasury Management reporting

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.

This Council delegates responsibility for implementation and monitoring treasury management to Cabinet and responsibility for the execution and administration of treasury management decisions to the Section 151 Officer. Cabinet therefore receives the Mid Year and Annual treasury reports in December each year.

The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Audit Committee.

1.3 Treasury Management Strategy for 2019/20

The strategy for 2019/20 covers two main areas:

Capital issues

- the capital expenditure plans (section 2) and the associated prudential indicators (Annex C);
- the minimum revenue provision (MRP) policy (Section 3).

Treasury management issues

- the current treasury position (section 1.5);
- treasury indicators which limit the treasury risk and activities of the Council (Annex C);
- prospects for interest rates (Annex B);
- the borrowing strategy (section 2);
- policy on borrowing in advance of need (section 2.2);
- debt rescheduling (section 2.3);
- the investment strategy (section 4);
- creditworthiness policy (section 4.4); and
- the policy on use of external service provider (section 5.3).

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.

1.4 Treasury Management Policy Statement

The policies and objectives of the Council's treasury management activities are as follows:

i) This Council defines its treasury management activities as

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

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

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

1.5 Current Treasury Position

A summary of the council's borrowing & investment portfolios as at 30th November 2018 and forecast at the end of the financial year is shown in **Table 1** below:

Table 1	**Actual at 30 November 2018**			**Forecast to 31 March 2019**		
	£'000	**% of portfolio**	**Average Rate**	**£'000**	**% of portfolio**	**Average Rate**
Investments						
Banks	182,000	74%	0.99%	190,000	81%	0.99%
Local Authorities	22,500	9%	1.09%	27,500	12%	1.09%
Money Market Funds	38,000	15%	0.74%	11,500	5%	0.75%
CCLA Pooled Property Fund	5,000	2%	4.00%	5,000	2%	4.00%
Total Investments	**247,500**	**100%**	**1.02%**	**234,000**	**100%**	**1.05%**
Borrowing						
PWLB loans	233,570	95%	4.83%	230,275	95%	4.78%
Market loans	12,900	5%	4.00%	12,900	5%	4.00%
Total external Borrowing	**246,470**	**100%**	**4.79%**	**243,175**	**100%**	**4.74%**

2. BORROWING STRATEGY

The capital expenditure plans of the council are set out in the Capital Strategy Report being considered by full Council on 5 February 2019. 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 the capital expenditure plans.

Any capital investment that is not funded from these new and/or existing resources (e.g. capital grants, receipts from asset sales, revenue contributions or earmarked reserves) increases the council's need to borrow. However, external borrowing does not have to take place immediately to finance it's related capital expenditure: the council can utilise cash being held for other purposes (such as earmarked reserves and working capital balances) to temporarily defer the need for external borrowing. This is known as 'internal borrowing'.

The council's primary objective is to strike an appropriate balance between securing cost certainty and securing low interest rates.

The council's cumulative need to borrow is known as the Capital Financing Requirement (CFR). The CFR and the actual level of external borrowing will differ according to decisions made to react to expected changes in interest rates and the prevailing economic environment. Where a decision to defer borrowing (or internally borrow) is made, the council will be underborrowed. Where a decision to borrow in advance of need to secure cost certainty, the council will be overborrowed.

The Council borrowed £25m in advance of need during 2016/17 at an average rate of 2.74% This move was to secure low cost borrowing to fund the capital programme. In order to secure historically low interest rates. As a result, cash balances remain high, and at a time where investment returns are low and counterparty risk continues to be relatively high, no further external borrowing has been entered into. A restructuring opportunity arose in October 2018, with one of the council's market lenders (RBS) offering to allow the council to repay the £23m loans on attractive terms. The Council funded the repayment through using cash within the investment portfolio, thereby reducing the overborrowed position of the Council's CFR.

There is also £11m is expected to be funded via borrowing in the 2018/19 Capital Programme. No new borrowing is expected to be undertaken to fund this, and this will be funded through cash balances. The combination of the repayment of loans and the £11m of borrowing to be funded from cash is expected to shift the Council's borrowing position compared to it's CFR from £25m overborrowed at 31 March 2018 to £8m underborrowed by 31 March 2019.

2.1 Borrowing Strategy for 2019/20

The council's Capital Programme 2019/20 to 2022/23 forecasts £271m of capital investment over the next four years with £197m met from existing or new resources. The increase in the council's borrowing need over this period is therefore £74m as shown in **Table 2** below.

2018/19 Projected £m	Table 2	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	Total £m
92	Capital Expenditure	103	80	45	43	271
(81)	**Financed by:** New & existing resources	(89)	(46)	(25)	(37)	(197)
11	**Borrowing Need**	**14**	**34**	**20**	**6**	**74**

Table 3 below shows the actual expected external borrowing against the capital financing requirement, identifying any under or over borrowing.

2018/19 Estimate £m	Table 3	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m
271	External Debt at 1 April	243	239	257	269
(28)	Expected change in Debt	(4)	18	12	(2)
243	**External Debt at 31 March**	**239**	**257**	**269**	**267**
247	CFR* at 1 April	252	260	286	299
11	Borrowing need (Table 2)	14	34	20	6
(6)	MRP	(6)	(7)	(8)	(8)
252	**CFR* at 31 March**	**260**	**287**	**299**	**296**
9	**Under / (Over) borrowing**	**21**	**30**	**30**	**29**

**CFR in Table 3 is the underlying need to borrow and excludes PFI and lease arrangements, which are included in the CFR figure in the Prudential Indicators in Annex C*

Table 2 demonstrates that the Council has a borrowing need of £74m over the next four years. The strategy will initially focus on meeting this borrowing need from internal borrowing; avoiding external borrowing by utilising the council's own surplus funds. This will reduce the net revenue cost of borrowing and reduce counterparty risk within the council's investment portfolio by reducing the portfolio size. However, borrowing rates have been volatile so far in 2018/19 and have increased modestly over the summer. Therefore the internal borrowing position needs to be carefully and continually reviewed to avoid incurring higher borrowing costs in the future at a time when the authority may not be able to avoid new borrowing to finance capital expenditure or refinance maturing debt.

There will remain a cost of carry (the difference between borrowing costs and investment rates) to any new long term borrowing that causes a temporary increase in cash balances which will, most likely, lead to a cost to revenue.

2.2 Policy on Borrowing in Advance of Need

The Council will not borrow purely in order to profit from investment of extra sums borrowed. Any decision to borrow in advance will be within approved Capital Financing Requirement 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. Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting.

2.3 Debt Rescheduling

Officers continue to regularly review opportunities for debt rescheduling, but there has been a considerable widening of the difference between new borrowing and repayment rates, which has resulted in much fewer opportunities to realise any savings or benefits from rescheduling PWLB debt.

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;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

The strategy is to continue to seek opportunity to reduce the overall level of Council's debt where prudent to do so, thus providing in future years cost reduction in terms of lower debt repayments costs, and potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt. All rescheduling will be agreed by the S151 Officer.

2.4 Interest Rate Risk & Continual Review

The total borrowing need in **Table 2,** as well as the debt at risk of maturity shown in **Table 4** is the extent to which the council is subject to interest rate risk.

Table 4	**2019/20**	**2020/21**	**2021/22**	**2022/23**
	£m	**£m**	**£m**	**£m**
Maturing Debt	4	3	4	6
Debt Subject to early repayments options	6	6	6	6
Total debt at risk of maturity	**10**	**9**	**10**	**12**

Officers continue to review the need to borrow taking into consideration the potential increases in borrrowing costs, the need to finance new capital expenditure, refinancing maturing debt, and the cost of carry that might incur a revenue loss between borrowing costs and investment returns.

Against this background and the risks within the economic forecast, caution will be adopted with the 2019/20 treasury operations. The Chief Finance Officer will continue to monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- if it was felt 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 borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.
- if it was felt 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 with the likely action that fixed rate funding will be drawn whilst interest rates are still lower than they will be in the next few years.

3. MINIMUM REVENUE PROVISION POLICY STATEMENT

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the Capital Financing Requirement - CFR) through a revenue charge (the minimum revenue provision - MRP). Ministry of Housing, Communities and Local Government (MHCLG) regulations require the full Council to approve an MRP Statement in advance of each year. A variety of options are available to councils, so long as the principle of any option selected ensures a prudent provision to redeem its debt liability over a period which is commensurate with that over which the capital expenditure is estimated to provide benefits (i.e. estimated useful life of the asset being financed).

The below MRP Policy Statement reflects a change in policy for borrowing incurred both before and after 2008. The current policy is to make a provision on a straight line basis over a maximum period of 50 years for land and 40 years for other assets. Paragraph 2.4 of the main report details the rationale for making changes to the policy.

The Council is recommended to approve the following MRP Statement for 2018/19 onwards:

For borrowing incurred before 1 April 2008, the MRP policy will be:

- Annuity basis over a maximum of 40 years.

From borrowing incurred after 1 April 2008, the MRP policy will be:

- Asset Life Method (annuity method) – MRP will be based on the estimated life of the assets, in accordance with the proposed regulations. A maximum useful economic life of 50 years for land and 40 years for other assets. This option will also be applied for any expenditure capitalised under a capitalisation directive.

For PFI schemes, finance leases and closed landfill sites that come onto the Balance Sheet, the MRP policy will be:

- Asset Life Method (annuity method) - The MRP will be calculated according to the flow of benefits from the asset, and where the principal repayments increase over the life of the asset. Any related MRP will be equivalent to the “capital repayment element” of the annual charge payable.

There is the option to charge more than the prudent provision of MRP each year through a Voluntary Revenue Provision (VRP).

For loans to third parties that are being used to fund expenditure that is classed as capital in nature, the policy will be to set aside the repayments of principal as capital receipts to finance the initial capital advance in lieu of making an MRP.

In view of the variety of different types of capital expenditure incurred by the Council, which is not in all cases 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. Also whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure. This approach also allows the Council to defer the introduction of an MRP charge for new capital projects/land purchases until the year after the new asset becomes operational rather than in the year borrowing is required to finance the capital spending.

4. ANNUAL INVESTMENT STRATEGY

The MHCLG and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals with financial investments. Non-financial investments 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

The Council's investment priorities will be the security of capital first, portfolio liquidity second and then yield (return).

4.1 Annual Investment Strategy for 2019/20

Investments will be made with reference to the core balance and cash flow requirements and the outlook for interest rates. Bank Rate is forecast to increase steadily but slowly over the next few years to reach 2.00% by Quarter 1 2022. Bank Rate forecasts for financial year ends (March) are:

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

Link Asset Service's (LAS) view on the prospect for interest rates, including their forecast for short term investment rates is appended at Annex B.

Following consultation, changes to the strategy were made from 2018/19 to broaden the risk profile by reducing liquidity and to include some suitable, alternative investment products that are held for the medium (2-5 years) to longer term (5 years+). These products can generate better overall returns but there is a higher risk of volatility of performance so a longer term commitment is required.

During 2018/19, £5m was invested in the CCLA Pooled Property Fund which was the first step into utilising the new instruments within the revised strategy. It is expected that further investments into the fund will take place during 2019/20, but the due diligence and subsequent decision to increase the Council's exposure to the Property fund will be undertaken during April/May 2019 once the impact of the withdrawal from the EU and the resultant prevailing economic environment has been appraised.

An options appraisal process will also be undertaken during 2019/20 to ascertain which of the other instruments are most appropriate to expand and diversify the Council's investment portfolio. This will include a thorough due diligence process which will consider the risks & returns of each investment type, the cash flow requirements over the investment time horizon and the diversification of risks across the whole investment portfolio. Risks will be assessed in the context of prevailing economic and market conditions. The result of this process will be reported as part of the 2019/20 Mid-Year report to Cabinet in December 2019.

Table 5 below summarises the changes to the 2018/19 & 2019/20 strategies from those approved in 2017/18. Each of the new investment products included are described in more detail in the paragraphs below. The inclusion of an investment product category in the strategy does not automatically result in investments being placed – investments will only be placed following a due diligence procedure as described above.

Table 5 - Investment options	2017/18	2018/19	2019/20
Money Market Funds (Including LVNAV)	✓	✓	✓
Bank Notice Accounts	✓	✓	✓
Fixed Term Bank Deposits	✓	✓	✓
UK Local Authorities	✓	✓	✓
Enhanced Money Market Funds (VNAV)	✓	✓	✓
Building Societies	✗	✓	✓
Pooled Property Funds	✗	✓	✓
Corporate Bond Funds	✗	✓	✓
Multi Asset Funds	✗	✓	✓
Equity Funds	✗	✗	✓

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

- It maintains a policy covering both the categories of investment types it will invest in and the criteria for choosing investment counterparties with adequate security, and monitoring their security;
- It has sufficient liquidity in its investments.

4.2 Investment Policy – Management of risk

Treasury management risks and how risks are managed and mitigated are identified in the Council's Treasury Management Practices and related procedures, details of which are held within the Council's Treasury Management Team. The main risks to the Council's treasury activities are:

- liquidity risk (inadequate cash resources);
- market or interest rate risk (fluctuations in interest rate levels and thereby in the value of investments);
- inflation risks (exposure to inflation);
- credit and counterparty risk (security of investments);
- refinancing risks (impact of debt maturing in future years); and
- legal and regulatory risk (i.e. non-compliance with statutory and regulatory requirements, risk of fraud).

The 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: -

i) 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.

ii) 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.

iii) 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.

iv) This authority has defined the list of types of investment instruments that the treasury management team are authorised to use.

    a. **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year. The limits and permitted instruments for specified investments are listed within Table 7.

    b. **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. The limits and permitted instruments for non-specified investments are listed within Table 8.

v) Lending limits (amounts and maturity) for each counterparty will be set through applying the credit criteria matrix (within Table 7).

vi) This authority will set a limit for the amount of its investments which are invested for longer than 365 days, detailed in the Treasury Indicators in Annex C.

vii) Investments will only be placed with counterparties from countries with a specified minimum sovereign rating of AA+ (see paragraph 4.3).

viii) This authority has engaged external consultants, (see paragraph 5.3), 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.

ix) All investments will be denominated in sterling.

x) As a result of the change in accounting standards for 2018/19 under IFRS 9, this authority will consider 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, the Ministry of Housing, Communities and Local Government, [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 1.4.18.).

4.3 Sovereign Credit Ratings

For 2019/20 it is recommended to maintain the policy of lending to sovereign nations and their banks which hold either a AAA or AA+ rating, with the exception of the UK which is currently rated AA by two of the three rating agencies (Aa2 Moody's). Maximum investment limits and duration periods will remain the same as in the previous strategy at £60 million and one year respectively. The list of countries that qualify using this credit criteria (as at the date of this report) are shown below:

AAA Australia, Canada, Denmark, Germany, Netherlands, Singapore, Sweden and Switzerland
AA+ (No Country currently)
AA UK

4.4 Creditworthiness Policy

The Council as part of its due diligence in managing creditworthiness, uses amongst other information, a tool provided by LAS. This tool employs a sophisticated modelling approach utilising credit ratings from the three credit rating agencies which is then 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.

This weighted scoring system then produces an end product of a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments.

The Council (in addition to other due diligence consideration) will use counterparties within the following durational bands provided they have a minimum AA+ soverign rating from three rating agencies:

- Yellow *5 years*
- *Purple* *2 years*
- *Blue* *1 year (semi nationalised UK Bank – NatWest/RBS)*
- *Orange* *1 year*
- *Red* *6 months*
- *Green* *3 months*
- *No Colour* *Not to be used*

Y	***P***	***B***	***O***	***R***	***G***	***N/C***
Up to 5yrs	*Up to 2yrs*	*Up to 1yr*	*Up to 1yrs*	*Up to 6 months*	*Up to 100 days*	*Not to be used*

Typically the minimum credit ratings criteria the Council use 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 these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

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

- It maintains a policy covering both the categories of investment types it will invest in and the criteria for choosing investment counterparties with adequate security, and monitoring their security;

- It has sufficient liquidity in its investments.

All credit ratings are monitored daily. The Council is alerted to changes to ratings of all three agencies through its use of the LAS credit worthiness service. If a downgrade results in the counterparty or investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.

In addition to the use of credit ratings, the Council will be advised of information re movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list. The counterparties in which the Council will invest its cash surpluses is based on officers assessment of investment security, risk factors, market intelligence, a diverse but manageable portfolio and their participation in the local authority market.

Table 7 below summarises the types of specified investment counterparties available to the Council, and the maximum amount and maturity periods placed on each of these. A full list of the Council's counterparties and the current limits for 2019/20 are appended at Annex A.

Criteria for Specified Investments

Table 7	Country/ Domicile	Instrument	Min. Credit Criteria/LAS colour band	Max. Amount	Max. maturity period
Debt Management and Deposit Facilities (DMADF)	UK	Term Deposits (TDs)	N/A	unlimited	12 Months
Government Treasury bills	UK	TDs	UK Sovereign Rating	unlimited	12 Months
UK Local Authorities	UK	TDs	UK Sovereign Rating	£60m	12 Months
Banks – part nationalised	UK	▪ TDs ▪ Deposits on Notice ▪ Certificates of Deposit (CDs)	N/A	£60m	12 Months
Banks	UK	▪ TDs ▪ Deposits on Notice ▪ CDs	Blue	£60m	12 Months
			Orange	£60m	12 Months
			Red	£60m	6 Months
			Green	£60m	100 Days
Building Societies	UK	▪ TDs ▪ Deposits on Notice ▪ CDs	Blue	£60m	12 Months
			Orange	£60m	12 Months
			Red	£60m	6 Months
			Green	£60m	100 Days
Individual Money Market Funds (MMF) CNAV and LVNAV	UK/Ireland/ EU domiciled	AAA Rated Money Market Fund Rating	N/A	£60m	Liqiuid

<table>
<tr><th>Table 7</th><th>Country/ Domicile</th><th>Instrument</th><th>Min. Credit Criteria/LAS colour band</th><th>Max. Amount</th><th>Max. maturity period</th></tr>
<tr><td>VNAV MMF’s and Ultra Short Dated Bond Funds</td><td>UK/Ireland/EU domiciled</td><td>AAA Rated Bond Fund Fund Rating</td><td>N/A</td><td>£60m</td><td>Liquid</td></tr>
<tr><td rowspan="4">Banks – Non-UK</td><td rowspan="4">Those with sovereign rating of at least AA+*</td><td rowspan="4">▪ TDs
▪ Deposits on Notice
▪ CDs</td><td>Blue</td><td>£60m</td><td>12 Months</td></tr>
<tr><td>Orange</td><td>£60m</td><td>12 Months</td></tr>
<tr><td>Red</td><td>£60m</td><td>6 Months</td></tr>
<tr><td>Green</td><td>£60m</td><td>100 Days</td></tr>
</table>

*See Paragraph 4.3 for full list of countries that meet these criteria

Non-Specified investments are any other types of investment that are not defined as specified. The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out in **Table 8** below:

Table 8	Minimum credit criteria	Maximum investments	Period
UK Local Authorities	Government Backed	£60m	2 years
Corporate Bond Fund(s)	Investment Grade	£30m	2 - 5 years
Pooled Property Fund(s)	N/A	£30m	5+ years
Mixed Asset Fund(s)	Appropriate rating	£30m	2 - 5 years

The maximum amount that can be invested will be monitored in relation to the Council surplus monies and the level of reserves. The approved counterparty list will be maintained by referring to an up-to-date credit rating agency reports, and the Council will liaise regularly with brokers for updates. Counterparties may be added to or removed from the list only with the approval of the Chief Finance Officer. A full list of the Council’s counterparties and the current limits for 2019/20 are appended at Annex A.

Equity Fund(s)

The 2018/19 Annual Investment Strategy, as agreed at full Council 6 February 2018, included Equity funds into the list of authorised instruments from 2019/20 onwards.

Equity funds are pooled investment vehicles which invest in a range of sectors and stocks, providing the benefit of diversification whilst providing inflation beating returns long term. Equity funds are highly liquid, but it is recommended that they are used only as a long term investment tool (typically 5+ years) as a result of potential considerable volatility in prices in line with that of global equity markets.

5. OTHER TREASURY ISSUES

5.1 Banking Services

NatWest, which is part Government owned, currently provides banking services for the Council.

5.2 Training

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 last provided to Audit Committee members on 22 November 2018 and further training will be arranged as required.

The training needs of treasury management officers are periodically reviewed and training arranged as required.

5.3 Policy on the use of External Service Providers

The Council uses Link Asset Services as its external treasury management advisors.

The Council recognises that responsibility for treasury management decisions remains with the Council at all times and will ensure that undue reliance is not placed upon our external service providers. It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The 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.

5.4 Lending to Third Parties

The Council has the power to lend monies to third parties subject to a number of criteria. These are not treasury type investments rather they are policy investments. Any activity will only take place after relevant due diligence has been undertaken.

5.5 Updates to Accounting Requirements

- **IFRS 9 – Financial Instruments**

  The accounting treatment for all financial instruments will be in the scope IFRS9 from 2018/19. This is not expected to have significant impact on the Council's investment portfolio, but the key considerations are as follows:

  - A provision will be required for expected loss on the Council's investment portfolio as at the 31 March 2019 using the "expected loss" model, taking into account historical losses for instruments that carry a similar credit quality. To provide an estimate of the impact of this, a provision based on the investment portfolio as at 30th November 2018 would result in a provision being required of £0.032m.
  - The valuation of investments previously classified as Available for Sale (AfS) will now be classified as Fair Value through Profit & Loss (FVPL). Under this change, any gains or losses on the valuation to the council's pooled property fund holding at 31 March in each year would have to be charged to the general fund revenue account. Following the consultation undertaken by the Ministry of Housing, Communities and Local Government, [MHCLG], on IFRS9 the Government has introduced a mandatory statutory override for local authorities to reverse out all unrealised fair value movements resulting from pooled investment funds. This will be effective from this financial year, 1 April 2018. The statutory override applies for five years from this date. Local authorities are required to disclose the net impact of the unrealised fair value movements in a separate unusable reserve throughout the duration of the override in order for

the Government to keep the override under review and to maintain a form of transparency.

- **IFRS 16 – Leasing**

  CIPFA issued a consultation to local authorities regarding the accounting impact of operating leases being bought onto the balance sheet. The Council's Prudential Indicators and Capital Financing Requirement will need to be amended to allow for leases which were previously off balance sheet being bought onto balance sheet from 1 April 2020. The authorised limit and operational boundary for 2020/21 onwards will be increased to reflect the effect of this change once assessed.

Counterparty List 2019/20 **ANNEX A**

Bank with duration colour	Country	Fitch Ratings				Moody's Ratings		S & P Ratings		CDS Price	ESCC Duration	Link Duration Limit	Money Limit
Specified Investments:		L Term	S Term	Viab.	Supp.	L Term	S Term	L Term	S Term		(Months)	(Months)	(£m)
Lloyds Banking Group:													
Lloyds Bank	UK	A+	F1	a	5	Aa3	P-1	A+	A-1	67.64	12	12	60
Bank of Scotland	UK	A+	F1	a	5	Aa3	P-1	A+	A-1	60.16	12	12	
RBS/NatWest Group:													
NatWest Bank	UK	A-	F2	bbb+	5	A1	P-1	A-	A-2	-	12	12	60
Royal Bank of Scotland	UK	A-	F2	bbb+	5	A1	P-1	A-	A-2	-	12	12	
HSBC Bank	UK	AA-	F1+	a	1	Aa3	P-1	AA-	A-1+	44.23	12	12	60
Barclays Bank	UK	A	F1	a	5	A2	P-1	A	A-1	91.04	6	6	60
Santander (UK)	UK	A	F1	a	2	Aa3	P-1	A	A-1	-	6	6	60
Goldman Sachs IB	UK	A	F1	-	1	A1	P-1	A+	A-1	90.14	6	6	60
Standard Chartered Bank	UK	A+	F1	a	5	A1	P-1	A	A-1	58.72	6	6	60
Nationwide Building Society	UK	A	F1	a	5	Aa3	P-1	A	A-1	-	6	6	60
Coventry Building Society	UK	A	F1	a	5	A2	P-1	-	-	-	6	6	60
Non UK Counterparties:													
Australia & New Zealand Banking Group	Australia	AA-	F1+	aa-	1	Aa3	P-1	AA-	A-1+	68.33	12	12	60
Commonwealth Bank of Australia	Australia	AA-	F1+	aa-	1	Aa3	P-1	AA-	A-1+	70.32	12	12	60
National Australia Bank	Australia	AA-	F1+	aa-	1	Aa3	P-1	AA-	A-1+	69.36	12	12	60
Westpac Banking Corporation	Australia	AA-	F1+	aa-	1	Aa3	P-1	AA-	A-1+	70.36	12	12	60
Royal Bank of Canada	Canada	AA	F1+	aa	2	A1	P-1	AA-	A-1+	-	12	12	60
Toronto Dominion	Canada	AA-	F1+	aa-	2	Aa1	P-1	AA-	A-1+	-	12	12	60
Dev. Bank of Singapore	Singapore	AA-	F1+	aa-	1	Aa1	P-1	AA-	A-1+	-	12	12	60
Oversea Chinese Banking Corp	Singapore	AA-	F1+	aa-	1	Aa1	P-1	AA-	A-1+	-	12	12	60
United Overseas Bank	Singapore	AA-	F1+	aa-	1	Aa1	P-1	AA-	A-1+	-	12	12	60

Continued Counterparty list Bank with duration colour	Country	Fitch Ratings				Moody's Ratings		S & P Ratings		CDS Price	ESCC Duration	Link Duration Limit	Money Limit
		L Term	S Term	Viab.	Supp.	L Term	S Term	L Term	S Term		(Months)	(Months)	(£m)
Svenska H	Sweden	AA	F1+	aa	5	Aa2	P-1	AA-	A-1+	-	12	12	60
Nordea Bank AB	Sweden	AA-	F1+	aa-	5	Aa3	P-1	AA-	A-1+	-	12	12	60
ABN AMRO Bank	Netherlands	A+	F1	a	5	A1	P-1	A	A-1	-	6	6	60
Rabobank	Netherlands	AA-	F1+	a+	5	Aa3	P-1	A+	A-1	36.00	12	12	60
ING Bank NV	Netherlands	A+	F1	a+	5	Aa3	P-1	A+	A-1	39.27	12	12	60
UBS	Switzerland	AA-	F1+	a+	5	Aa2	P-1	A+	A-1	43.65	12	12	60
Credit Suisse	Switzerland	A	F1	a-	5	A1	P-1	A	A-1	97.27	6	6	60
DZ Bank	Germany	AA-	F1+		WD	Aa1	P-1	AA-	A-1+	-	12	12	60
Danske Bank	Denmark	A	F1	a	5	Aa2	P-1	A	A-1	60.20	6	6	60

Yellow	***Purple***	***Blue***	***Orange***	***Red***	***Green***	***No Colour***
Up to 5yrs	*Up to 2yrs*	*Up to 1yr (semi nationalised UK bank NatWest/RBS)*	*Up to 1yr*	*Up to 6 months*	*Up to 100 days*	*Not to be used*

Non-Specified Investments:			
	Minimum credit Criteria	**Maximum Investments**	**Period**
UK Local Authorities	Government Backed	£60m	2 years
Corporate Bond Fund(s)	Investment Grade	£30m	2 – 5 years
Pooled Property Fund(s)	N/A	£30m	5+ years
Mixed Asset Fund(s)	Appropriate rating	£30m	2 - 5 years

ANNEX B

ECONOMIC OVERVIEW

Provided by Link Asset Services 8 January 2018

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. The US Fed has therefore increased rates nine times and the Bank of England twice. However, the ECB is unlikely to start raising rates until late in 2019 at the earliest.

KEY RISKS - central bank monetary policy measures

Looking back on nearly 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 is well advanced in the US, and started 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 meant that both asset categories were exposed to the risk of a sharp downward correction and we have indeed, seen a sharp fall in equity values in the last quarter of 2018. 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, or, 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. At the time of writing, (early January 2019), financial markets are very concerned that the Fed is being too aggressive with its policy for raising interest rates and was likely to cause a recession in the US economy.

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, (currently about $50bn per month). In addition, the European Central Bank ended its QE purchases in December 2018.

UK. The flow of positive economic statistics since the end of the first quarter of 2018 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 and by a strong performance in quarter 3 of +0.6%. However, growth in quarter 4 is expected to weaken significantly.

At their November quarterly Inflation Report meeting, the MPC repeated their well-worn phrase that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary of 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 could potentially provide fiscal stimulus to support economic growth, though at the cost of increasing the budget deficit above currently projected levels.

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 well into spring 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, (on the assumption that a Brexit deal is agreed by both the UK and the EU). 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 2.3% in November. 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 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 October**,** 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 3.3%, (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 1.0%, 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, 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.

Prospect for Interest Rates

The Council has appointed Link Asset Services (LAS) as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives LAS's central view.

Link Asset Services Interest Rate View	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	1.75%	2.00%
3 Month LIBID	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%
6 Month LIBID	1.00%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%
12 Month LIBID	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%
5yr PWLB Rate	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.80%
10yr PWLB Rate	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%
25yr PWLB Rate	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%

The flow of generally positive economic statistics after the quarter ended 30 June meant that it came as no surprise that the 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%. Growth became increasingly strong during 2018 until slowing significantly during the last quarter. At their November quarterly Inflation Report 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. However, it is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. On a major assumption that Parliament and the EU agree a Brexit deal in the first quarter of 2019, then the next increase in Bank Rate is forecast to be in May 2019, followed by increases in February and November 2020, before ending up at 2.0% in February 2022.

The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. However, over about the last 25 years, we have been through 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. Quantitative easing, conversely, also caused a rise in equity values as investors searched for higher returns and purchased riskier assets. In 2016, we saw 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. 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 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 2.25 – 2.50% in December 2018. 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. We therefore saw US 10 year bond Treasury yields rise above 3.2% during October 2018 and also investors causing a sharp fall in equity prices as they sold out of holding riskier assets. However, by early January 2019, US 10 year bond yields had fallen back considerably on fears that the Fed was being too aggressive in raising interest rates and was going to cause a recession. Equity prices have been very volatile on alternating good and bad news during this period.

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.

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. 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

- Investment returns are likely to remain low during 2019/20 but to be on a gently rising trend over the next few years.

- Borrowing interest rates have been volatile so far in 2018-19 and while they were on a rising trend during the first half of the year, they have backtracked since then until early January. 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;

- 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.

ANNEX C

PRUDENTIAL AND TREASURY INDICATORS 2019/20 to 2021/22

The Council's capital expenditure plans are a key driver of treasury management activities. The output of the capital expenditure plans are reflected in prudential indicators. Local Authorities are required to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable. The Code sets out the indicators that must be used but does not suggest limits or ratios as these are for the authority to set itself.

The Prudential Indicators for 2019/20 to 2021/22 are set out in **Table A** below:

Table A	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Capital Expenditure £m (gross) Council's capital expenditure plans	£103m	£80m	£45m
Capital Financing Requirement £m Measures the underlying need to borrow for capital purposes (including PFI & Leases)	£343m	£371m	£380m
Ratio of financing costs to net revenue stream** Identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against net revenue stream	5.77%	4.70%	4.68%

** the ratio of financing costs to net revenue stream illustrates the percentage of the Council's net revenue budget being used to finance the council's borrowing. This includes interest costs relating to the council's borrowing portfolio and MRP, net of the investment income from the council's investment portfolio.

The Treasury Management Code requires that Local Authorities set a number of indicators for treasury performance in addition to the Prudential Indicators which fall under the Prudential Code. The Treasury Indicators for 2019/20 to 2021/22 are set out in **Tables B & C** below:

Table B	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Authorised Limit for External Debt £m* The Council is expected to set a maximum authorised limit for external debt. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by Full Council.	£373m	£401m	£410m
Operational boundary for external debt £m* The Council is required to set an operational boundary for external debt. This is the limit which external debt is not normally expected to exceed. This indicator may be breached temporarily for operational reasons.	£353m	£381m	£390m
Principal Sums invested for longer than 365 days	£60m	£60m	£60m

Control on interest rate exposure: **Upper limit for fixed interest rate exposure*** Identifies a maximum limit for fixed interest rates for borrowing and investments.	100%	100%	100%
Control on interest rate exposure: **Upper limit for variable interest rate exposure*** Identifies a maximum limit for variable interest rates for borrowing and investments.	15%	15%	15%

Table C **Maturity Structure of fixed interest rate borrowing*** The Council needs to set upper and lower limits with respect to the maturity structure of its borrowing.		
	Lower	Upper
Under 12 months	0%	25%
12 months to 2 years	0%	40%
2 years to 5 years	0%	60%
5 years to 10 years	0%	70%
Over 10 years	0%	90%

Note-
**the Treasury Indicators above have been calculated and determined by Officers in compliance with the Treasury Management Code of Practice.*

ANNEX D

SCHEME OF DELEGATION

1. Full Council

In line with best practice, Full Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of polices, estimates and actuals. These reports are:

i. Treasury Management Policy and Strategy Report

The report covers:

- the capital plans (including prudential indicators);
- the Capital Strategy
- a Minimum Revenue Provision 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).

ii. A Mid-Year Review Report and a Year End Stewardship Report

These will update members with the progress of the capital position, amending prudential indicators as necessary, and indicating whether the treasury strategy is meeting the strategy or whether any policies require revision. The report also provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

2. Cabinet

- Approval of the Treasury Management quarterly update reports;
- Approval of the Treasury Management outturn report.

3. Audit Committee

- Scrutiny of performance against the strategy.

4. Role of the Section 151 Officer

The Section 151 (responsible) Officer:

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.

There are further responsibilities for the S151 Officer identified within the 2017 Code in respect of non-financial investments. They are identified and listed in the Capital Strategy where relevant.

ANNEX E

INVESTMENT PRODUCT GLOSSARY

Bank / Building Society: 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.

Bank / Building Society Secured (Covered Bonds): These investments are secured on the bank's assets, which limit the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in.

Money Market Funds: An open ended fund that invests in short term debt securities, offers same-day liquidity and very low volatility.

Government: Loans, bonds and bills issued or guaranteed by UK government, local authorities and supranational banks. These investments are not subject to bail-in, and there is a minimal risk of insolvency.

Corporate Bonds: Bonds 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.

Enhanced Cash / Bond Funds: Fund designed to produce an enhanced return over and above a Money Market Fund. The manager may use a wider range of alternative options to try and generate excess performance. These could include different counterparties, instruments as well as longer dated investments.

Pooled Property Funds: Shares in diversified property investment vehicles. Property funds offer enhanced returns over the longer term, but are more volatile in the short term. The funds have no defined maturity date, but are available for withdrawal after a notice period.

Mixed Asset Fund: Rather than focus on a particular asset class, these funds will look to invest across a broader range of classes in an effort to provide investors with a smoother performance on a year-to-year basis. Primarily, the asset classes will be equities and fixed income, but the latter will include both corporate and government-level investments.

Equity Fund: Equity funds are pooled investment vehicles that will focus investments primarily in UK equities.