APPENDIX C

Treasury Management Strategy Statement 2019/20

1. Introduction

1.1. Put simply, treasury management is the management of the Council's cash flows, borrowing and investments and the associated risks. The pursuit of optimum performance will be consistent with the management of the associated risks.

1.2. Treasury management includes the funding of the Council's capital plans and as the Council is required to operate a balanced budget, to ensure that cash flow is adequately planned and that cash is available when it is needed. The successful identification, monitoring and control of financial risk are therefore central to the Council's prudent financial management.

1.3. 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.

1.4. The Council has recently borrowed loans from the Public Works Loans Board and is likely to undertake further borrowing over the next few years. The Council also has investments and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates.

1.5. The Council holds treasury investments as Investments held for service purposes or to earn investment income (known as commercial investments). These are considered in a different report, the Investment Strategy (Appendix B).

2. **External Context** *(please note that in this section, the economic background, the credit outlook and the interest rate forecast are those of Arlingclose (treasury management advisors), who have assisted the Council in preparing this Treasury Management Strategy)*

2.1. Economic background

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

2.1.2. The UK economic environment appears relatively soft, despite seemingly strong labour market data. Uncertainty surrounding Brexit and global growth is damaging consumer and business sentiment. GDP growth slowed markedly in Q4 2018 and has not recovered in Q1 2019. Our view is that the UK economy faces a challenging outlook as the country exits the European Union and Eurozone/global economic growth softens, notwithstanding a possible short term bounce in activity should a Brexit deal be agreed.

2.1.3. Cost pressures have eased due to a fall in oil prices. The apparent tight labour market risks longer term domestically-driven inflationary pressure whatever the external inflation effects. Wage growth has picked up in recent months.

2.1.4. Following the Bank of England's decision to increase Bank Rate to 0.75% in August, no change to monetary policy has been made since. The Bank's Monetary Policy Committee's bias towards tighter monetary policy remains, but appears to have eased a little on the back of slower global and UK growth/inflation expectations. Policymakers are unlikely to raise Bank Rate unless there is a withdrawal arrangement and the prospect of a transitionary period.

2.2. Credit outlook

2.2.1. 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.

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

2.2.3. European banks have considered their approach to Brexit and some have created 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.

2.3. Interest rate forecast

2.3.1. The MPC has maintained expectations of a slow rise in interest rates over the forecast horizon. Our central case incorporates the likelihood of the MPC raising rates in the last quarter of 2019 after an extended period of uncertainty or a delay to Brexit.

2.3.2. Whilst assumptions are that a Brexit deal might be struck in March 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. As such, the risks to the interest rate forecast are considered firmly to the downside.

2.3.3. Gilt yields and hence long-term borrowing rates have remained at low levels but some upward movement from current levels is expected. Volatility arising from both economic and political events may continue to offer borrowing opportunities.

2.3.4. A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix 1.

For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 0.56%, and that new long-term loans will be borrowed at an average rate of between 2.5% and 3%.

3. Local Context

3.1. As at 28th February 2019, the Council held £5.49m of borrowing and £35m of investments. This is set out in further detail at Appendix 2 of this report. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance sheet summary and forecast

	31.3.18 Actual £'000s	**31.3.19 Estimate £'000s**	**31.3.20 Forecast £'000s**	**31.3.21 Forecast £'000s**	**31.3.22 Forecast £'000s**
General Fund CFR	646	6,168	23,336	36,367	29,353
Less: External borrowing	0	5,490	22,912	36,276	29,891
Internal/(over) borrowing**	**646**	**678**	**424**	**91**	**-538**
Less: Usable reserves	-4,909	-14,640	-15,107	-15,067	-14,917
Less: Working capital	-23,732	-16,550	-16,550	-16,550	-16,550
Investments (predicted investments at the year end)	**27,995**	**30,512**	**31,233**	**31,526**	**32,005**

** In 2021/22 the debt is slightly higher than the CFR by £0.538m but this is only a short term position as the gross debt will reduce in 2022/23.

3.2. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. Up to now the Council's Capital Programme has been funded by receipts, grants and contributions. Up until 2017/18, the strategy was to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

3.3. The Council has approved at Full Council on 27th September 2018 a Commercial Property Strategy of up to £60m. This will mean the Council will have an increasing CFR due to the Capital Programme and existing investments will not be sufficient. It is therefore envisaged that the Council may require to borrow up to £60m in total over the forecast period. Of this £60m, borrowing before 30th April 2019 is capped at £30m.

3.4. 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. In 2021/22, the debt is slightly higher than the CFR by £0.538m but this is only a short term position as the gross debt will reduce in 2022/23.

4. **Borrowing Strategy**

4.1. In 2016 the Council agreed to fund £6.3m for the new leisure contract through prudential borrowing. The leisure investment in 2017/18 was just under £1m and on 31st March 2018 the Council had no external borrowing, as the Council had funded the required amount through 'internal borrowing'. With further capital expenditure incurred in 2018/19, the Council borrowed a series of maturity loans totaling £5.49m from the Public Works Loans Board in 2018 (Council 29/3/18 – Minute 74/17).

4.2. In 2018 the Council approved an ambitious commercial property strategy. Alongside the use of its own resources and in addition to the £5.49m already borrowed in 2018, the Council expects to borrow up to approximately £10m in 2019/20 primarily to fund this property strategy, along with £7m for community housing (although the total capital expenditure is in the region of £8.5m, it is anticipated that Homes England capital grant and S106 contributions will fund some of this expenditure). The Council has taken a decision that no more than £30m may be borrowed by 30th April 2019.

4.3. Objectives

4.3.1. 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 funds are required. (At the current time short-term debt is cheap whilst longer-term debt is expensive.) The flexibility to renegotiate loans should the Council's long-term plans change, whilst important, is a secondary objective.

4.4. Strategy

4.4.1. The Council's commercial property strategy will significantly change the Council's debt dynamics and its Balance Sheet position. The Council will only borrow as required when there is certainty to the specific acquisitions or development. The borrowing strategy will address the key issue of affordability without compromising the longer-term stability of the debt portfolio.

4.4.2. Matters to be considered before borrowing include, but not limited to, are affordability, maturity profile of existing debt, interest rate and refinancing risk and the borrowing source.

4.4.3. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to use some internal resources, and in some instances borrowing short-term loans instead may be appropriate. Short-term loans are currently available at around 0.75% to 1% and long-term fixed rate loans where the future cost is known are higher (currently 2.0% to 3.0% from the PWLB). By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) in the near term and reduce overall treasury risk.

4.4.4. The benefits of internal / short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. The business case for each commercial property acquisition or development and the structure of the borrowing will be assessed on a case by case basis as well as considering the Council's overall debt portfolio.

4.4.5. The "cost of carry**":** Borrowing rates are higher than investment rates, and are expected to remain so, partly due to positive yield curve, also due to the increased PWLB margin. Borrowing money and re-investing it therefore leads to a cost of carry, at least in the early years. There is therefore a balance to be struck between borrowing now and borrowing later. The cost of carry will be weighed up against the interest rate risk on projects, particularly those where the asset has a 50 year asset life.

4.5. <u>Short-term and variable rate loans</u>

4.5.1. These loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below. The Council currently has no short-term loans of less than 5 years or any variable loans.

4.6. <u>Sources of borrowing</u>

4.6.1. The approved sources of long-term and short-term borrowing are:

i. Public Works Loan Board (PWLB) and any successor body
ii. any institution approved for investments (see below)
iii. any other bank or building society authorised to operate in the UK
iv. UK public and private sector pension funds (except the Devon County Pension Fund)
v. UK local authorities any other UK public sector body
vi. capital market bond investors
vii. UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

4.7. Other sources of debt finance

4.7.1. In addition, capital finance may be raised by leasing which is not borrowing, but may be classed as other debt liabilities.

4.8. The PWLB remains an attractive source of borrowing, given the transparency and control that its facilities continue to provide. The types of PWLB loans are:

- Fixed rate Maturity loans borrowed on a Maturity ('bullet') or Equal Instalments of Principal (EIP) or Annuity basis – these are available for maturities ranging from 1 year to 50 years
- Variable rate loans on a Maturity or EIP basis - for periods up to 10 years (the Council has not entered into any variable loans to date and it is unlikely that variable rate loans will be used in the future).

4.9. Municipal Bonds Agency

4.9.1. The UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a joint and several guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to Full Council and the appropriate due diligence, particularly regarding the joint and several guarantee.

5. Investment Strategy

5.1. As at 28th February 2019, the Council had £35m of invested funds, representing income received in advance of expenditure plus balances and reserves held. Of this, £0.5m was invested in the CCLA Local Authorities Property Fund and £1m in the CCLA Diversified Income Fund. In the past 12 months, the Council's investment balance has ranged between £25m and £45m, and broadly similar levels are expected in the forthcoming year.

The Council's investments mid way through the year are always higher than that at the end of the year due to the cashflow advantage that the Council benefits from part way through the year. This is, in part, due to the timing differences between the Council collecting council tax income and paying this over to the major precepting authorities such as Devon County Council, the Police and the Fire Authority.

5.2. Objectives

5.2.1. 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 an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably 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 or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

5.3. Negative interest rates

5.3.1. There is significant uncertainty over Brexit. 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.

5.4. Strategy

5.4.1. Given the increasing risk and very low returns from short-term unsecured bank investments, the Council aims to diversify into more secure and/or higher yielding asset classes during 2019/20. This is especially the case for the estimated £3.5m that will be invested in the CCLA Diversified Income Fund and Local Authorities Property Fund, for longer-term investment. The majority of the Council's surplus cash remains invested in short-term unsecured money market instruments and money market funds. This diversification will represent a partial change in strategy over the coming year.

5.5. Business models

5.5.1. 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.

5.6. Approved counterparties

5.6.1. The Council may invest its surplus funds with any of the counterparty types below, subject to the cash limits (per counterparty) and the time limits shown.

Table 3: Approved investment counterparties and limits

	Minimum credit criteria/colour band	Limit per institution Max % of total investments	Maximum maturity
DMADF	n/a	100%	6 months
Money Market Funds	AAA	£6m	Daily liquidity
Cash Plus Funds/ Ultra short bond funds	AAA, AA	£6m	T+1 to T+4
CCLA Local Authorities Property Fund	Not credit rated	£1.5m	Fund has a monthly dealing date. The council's intended investment period is around 5 years, but will depend on the statutory override provided by MHCLG
Multi asset funds (e.g. CCLA Diversified Income Fund)	Not credit rated	£2m	Funds have a daily dealing date, however the intended investment period would likely be around 5 years, but will depend on the statutory override
Local Authorities	n/a	£6m	5 years
Unsecured investments with banks and building societies	Yellow Purple Blue Orange Red Green No Colour	£6m (£7m for Lloyds plc)	Up to 5 years Up to 2 years Up to 1 years Up to 1 years Up to 6 months Up to 100 days Not for use

5.7. Credit rating

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

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

This modelling approach combines credit ratings, credit Watches and credit Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments.

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

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.

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

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

Investment decisions are never made solely based on credit ratings and all other relevant factors including external advice will be taken into account.

5.8. Types of counterparty / investment instruments

5.8.1. **Banks unsecured:** call/notice accounts, deposits 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.

5.8.2. **Pooled funds:** 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.

5.8.2.1. Pooled funds whose value changes with market prices (i.e. variable net asset value) 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. The Council has an £0.5m investment in the CCLA's Local Authorities' Property Fund and a £1m investment in CCLA's Diversified Income Fund which is a multi-asset income fund.

5.9. Operational bank accounts

5.9.1. The Council banks with Lloyds Bank and will incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services. 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.

5.10. Risk assessment and credit ratings

5.10.1. Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. At the time of writing this report, this information is provided by Link Asset Services.

Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

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

5.10.2. 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.

5.11. Other information on the security of investments

5.11.1. 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 (if any), reports in the quality financial press and analysis and advice from the Council's treasury management adviser**.** No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

5.11.2 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 with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

5.12. Investment limits

5.12.1. The Council's revenue reserves available to cover investment losses are forecast to be £14.6 million on 31st March 2019. In order that no more than 41% 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 £6 million (£7 million for Lloyds plc).

Table 4: Investment limits –

	Cash limit
Any single organisation, except the UK Central Government	£6m each (£7m for Lloyds plc)
UK Central Government	unlimited
Any group of organisations under the same ownership	£6m per group
Any group of pooled funds under the same management	£3.5m per manager (CCLA current limit)
Money market funds	£30m in total (£6m per MMF)

5.13. Liquidity management

5.13.1. The Council uses cash flow forecasting to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis 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 strategy and cash flow forecast.

6. Treasury Management Indicators

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

6.2. Interest rate exposures

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

Interest rate risk indicator	**Limit**
One-year revenue impact of a 1% rise in interest rates	£365,000
One-year revenue impact of a 1% fall in interest rates	£365,000

6.2.2. The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.

6.3. Maturity structure of all borrowing

6.3.1. 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:

Refinancing rate risk indicator	Upper limit	Lower limit
Under 12 months	10%	0%
12 months and within 24 months	30%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	75%	0%
10 years and within 20 years	100%	0%
20 years and above	100%	0%

6.3.2. As the Council currently has a very small loans portfolio (currently £5.49m) but may borrow up to a total of £75m over the coming years, the limits in the table above will permit loans to be borrowed in the appropriate maturity band.

6.3.3. 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.

6.4. Principal sums invested for periods longer than a year

6.4.1. 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:

Price risk indicator	2019/20	2020/21	2021/22
Limit on principal invested beyond year end*	£3.5m	£3.5m	£3.5m
Limit on principal invested in bank and building societies beyond one year	£12m	£12m	£12m

**Monies already invested in the CCLA Property Fund (£0.5m) and the CCLA Diversified Income Fund (£1m) plus further investments of £2m.*

7. **Related Matters**

7.1. The CIPFA Code requires the Council to include the following in its treasury management strategy.

7.2. Financial Derivatives

7.2.1. 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).

7.2.2. The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the 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.

7.2.3. 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.

7.3. Markets in Financial Instruments Directive

7.3.1. The Council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the Strategic Finance Lead (S151 Officer) believes this to be the most appropriate status.

8. Financial Implications

8.1. The budget for investment income in 2019/20 is £183,000 based on an average investment portfolio of £30 million at an interest rate of 0.6%.

8.2. The budget for debt interest paid in 2019/20 is £647,000 based on an average debt portfolio of £22.9 million at an average interest rate of 2.8%.

8.3. If actual levels of investments and borrowing, or actual interest rates, differ from those forecast, performance against budget will be correspondingly different.

9. Other Options Considered

9.1. The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Strategic Finance Lead (S151 Officer), having consulted the Executive Member for Finance, 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
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

Appendix 1 – Economic & Interest Rate Forecast

(Please note that this is Arlingclose's_interest rate forecast)

Underlying assumptions:

- The uncertain political situation surrounding Brexit has produced the prospect of divergent paths for UK monetary policy.

- Recent political manoeuvrings appear aimed at avoiding the worst-case Brexit scenarios, which may suggest reduced downside risks to the economic outlook and the interest rate forecast, although it is too soon to reflect this in the Arlingclose forecast.

- The MPC bias towards tighter monetary policy remains, but appears to have eased a little on the back of slower global and UK growth/inflation expectations. Policymakers are unlikely to raise Bank Rate unless there is a withdrawal arrangement and the prospect of a transitionary period.

- 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 stronger growth following an extension to Article 50 or a withdrawal agreement as business investment/general confidence recovers. The potential for severe economic outcomes in the short term is uncomfortably higher than it should be. We expect the Bank of England to hold at or reduce interest rates from current levels if Brexit risks materialise.

- The UK economic environment appears relatively soft, despite seemingly strong labour market data. Uncertainty surrounding Brexit and global growth is damaging consumer and business sentiment. GDP growth slowed markedly in Q4 2018 and has not recovered in Q1 2019. Our view is that the UK economy faces a challenging outlook as the country exits the European Union and Eurozone/global economic growth softens, notwithstanding a possible short term bounce in activity should a Brexit deal be agreed.

- Cost pressures have eased due to a fall in oil prices. The apparent tight labour market risks longer term domestically-driven inflationary pressure whatever the external inflation effects. Wage growth has picked up in recent months.

- Global economic growth has eased and the economic/political outlook has prompted central banks to reduce expectations for on-going monetary tightening. Central bank actions and geopolitical risks 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. Our central case incorporates the likelihood of the MPC raising rates in the last quarter of 2019 after an extended period of uncertainty or a delay to Brexit.
- The forecast range encompasses the interest rate responses for various Brexit outcomes, from an immediate no-deal Brexit to remaining in the EU.
- Gilt yields have remained at low levels. We expect some upward movement from current levels based on a Brexit transitionary period. However, our projected weak economic outlook and volatility arising from both economic and political events will continue to offer borrowing opportunities**.**

	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	Average
Official Bank Rate														
Upside risk	0.00	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.37
Arlingclose Central	0.75	0.75	0.75	1.00	1.00	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.10
Downside risk	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	0.85
3-mth money mark														
Upside risk	0.10	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.37
Arlingclose Central	0.90	0.90	0.95	1.20	1.25	1.35	1.40	1.40	1.40	1.40	1.40	1.40	1.40	1.26
Downside risk	0.50	0.55	0.60	0.85	0.90	0.95	1.00	1.00	1.00	1.00	1.00	1.00	1.00	0.87
1-yr money market														
Upside risk	0.10	0.30	0.35	0.35	0.35	0.35	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.41
Arlingclose Central	1.20	1.20	1.25	1.50	1.60	1.75	1.75	1.70	1.70	1.70	1.70	1.70	1.70	1.57
Downside risk	0.50	0.60	0.60	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	0.88
5-yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.40	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.43
Arlingclose Central	0.95	0.95	1.00	1.25	1.30	1.45	1.45	1.40	1.40	1.40	1.40	1.40	1.40	1.29
Downside risk	0.45	0.45	0.50	0.75	0.80	0.95	0.95	0.90	0.90	0.90	0.90	0.90	0.90	0.79
10-yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.40	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.43
Arlingclose Central	1.30	1.35	1.40	1.65	1.75	1.90	1.85	1.85	1.85	1.85	1.85	1.85	1.85	1.72
Downside risk	0.60	0.65	0.70	0.95	1.00	1.10	1.00	1.00	1.00	1.00	1.00	1.00	1.00	0.92
20-yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.40	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.43
Arlingclose Central	1.70	1.75	1.80	2.00	2.05	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.07
Downside risk	0.60	0.65	0.70	0.95	1.00	1.10	1.00	1.00	1.00	1.00	1.00	1.00	1.00	0.92
50-yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.40	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.43
Arlingclose Central	1.65	1.70	1.75	1.95	2.00	2.15	2.15	2.15	2.15	2.15	2.15	2.15	2.15	2.02
Downside risk	0.60	0.65	0.70	0.95	1.00	1.10	1.00	1.00	1.00	1.00	1.00	1.00	1.00	0.92

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

Appendix 2 – Existing Investment and Debt Portfolio Position

	28th February 2019 Actual Portfolio £'000	28th February 2019 Average Rate %
External borrowing:		
Public Works Loan Board	5,490	2.4
Local authorities	-	-
Other loans	-	-
Total external borrowing	**5,490**	**2.4**
Other long-term liabilities:		
Private Finance Initiative	-	-
Finance Leases	-	-
Total other long-term liabilities		
Total gross external debt	**5,490**	**-**
Treasury investments:		
Banks and building societies (unsecured)	18,000	0.73
Government (incl. local authorities)	-	-
Money Market Funds	15,800	0.60
Other pooled funds (CCLA)		
Property Fund	500	4.22
Diversified Income Fund	1,000	3.26
Total treasury investments	**35,300**	-
Net debt	**(29,810)**	-