

Treasury Management Strategy Statement 2019/20

Introduction

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

Treasury risk management at the Authority is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition* (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year. In addition, the Department of the Environment (DoE) issued Guidance on Local Authority Investments in October 2011 that requires the Authority to approve an investment strategy before the start of each financial year. This report fulfils the Authority's legal obligation under the *Local Government Finance Act (Northern Ireland) 2011* to have regard to both the CIPFA Code and the DoE Guidance.

Revised strategy: In accordance with the DoE Guidance, the Authority will be asked to approve a revised Treasury Management Strategy Statement should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates, in the Authority's capital programme or in the level of its investment balance.

External Context

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

Following a weak reading in the first quarter of 2018 attributed to weather-related factors, UK GDP growth rebounded in the second quarter to 0.4%, but at an annual rate of only 1.2% this remains below trend. As economic growth had evolved broadly in line with its May Inflation Report forecast, the Bank of England's Monetary Policy Committee (MPC) voted unanimously for a rate rise of 0.25% in August, taking Bank Rate to 0.75%. In November 2018 the MPC maintained Bank Rate at 0.75% while the Inflation Report showed that compared to the August report further interest rate increases may be required to bring inflation down to the 2% target over the forecast horizon.

The headline rate of UK Consumer Price Inflation fell back to 2.4% year-on-year in September 2018 from 2.7% in August, as higher import and energy prices continued to hold inflation above the BoE target. Labour market data is positive. The ILO unemployment rate fell to 4%, its lowest level since 1975. The 3-month average annual growth rate for pay excluding bonuses rose to

3.1% in August providing some evidence that a shortage of labour is supporting wages. However, adjusting for inflation this means real wages were only up by 0.7% and only likely to have a moderate impact on household spending.

While external inflationary pressures from energy costs and import prices are expected to subside, domestic pressures are projected to build over the forecast horizon with the balance of these effects likely to keep inflation above the Bank of England's target throughout most of their forecast horizon, meaning that strong real income growth is unlikely to materialise any time soon.

As the US economy has continued to perform well, the Federal Reserve maintained its monetary tightening stance and pushed up its target range for the Fed Funds Rate in September 2018 by 0.25% to 2% - 2.25%. One further rise is expected in 2018 and two more in 2019.

The fallout from the US-China trade war continues which, combined with tighter monetary policy, risks contributing to a slowdown in global economic activity in 2019. Despite slower growth in the region, the European Central Bank has started conditioning markets for the end of quantitative easing as well as the timing of the first interest rate hike, currently expected in 2019, and the timing and magnitude of increases thereafter.

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

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

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

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

Gilt yields and hence long-term borrowing rates have remained at low levels but some upward movement from current levels is expected based on Arlingclose's interest rate projections, due to the strength of the US economy and the ECB's forward guidance on higher rates. 10-year and 20-year gilt yields are forecast to remain around 1.5% and 2% respectively over the interest rate forecast horizon, however volatility arising from both economic and political events are likely to continue to offer borrowing opportunities.

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

Local Context

On 1st February 2019, the Authority held £40.7m of borrowing and £4m of investments. 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 £m | 31.3.19 Estimate £m | 31.3.20 Forecast £m | 31.3.21 Forecast £m | 31.3.22 Forecast £m |
|---------------------------------------|----------------------------------|------------------------------------|------------------------------------|------------------------------------|------------------------------------|
| Capital financing requirement | 67.9 | 87.3 | 114.0 | 129.3 | 124.0 |
| Less: External borrowing * | (42.8) | (40.7) | (38.3) | (36.1) | (34.0) |
| Internal (over) borrowing | 25.1 | 46.6 | 75.7 | 93.2 | 90.0 |
| Less: Usable reserves | (28.5) | (28.5) | (28.5) | (28.5) | (28.5) |
| Less: Working capital | (3.4) | (3.4) | (3.4) | (3.4) | (3.4) |
| Investments (or New borrowing) | 6.8 | (14.7) | (43.8) | (61.3) | (58.1) |

* shows only loans to which the Authority is committed and excludes optional refinancing

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

The Authority has an increasing CFR due to the capital programme, but minimal investments and will therefore be required to borrow up to £61.3m over the forecast period.

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

Liability benchmark: To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as table 1 above, but that cash and investment balances are kept to a minimum level.

Table 2: Liability benchmark

| | 31.3.18 Actual £m | 31.3.19 Estimate £m | 31.3.20 Forecast £m | 31.3.21 Forecast £m | 31.3.22 Forecast £m |
|----------------------------|-------------------------|---------------------------|---------------------------|---------------------------|---------------------------|
| CFR | 67.9 | 87.3 | 114.0 | 129.3 | 124.0 |
| Less: Usable reserves | (28.5) | (28.5) | (28.5) | (28.5) | (28.5) |
| Less: Working capital | (3.4) | (3.4) | (3.4) | (3.4) | (3.4) |
| Plus: Minimum investments | 0 | 0 | 0 | 0 | 0 |
| Liability Benchmark | 36.0 | 55.4 | 82.1 | 97.4 | 92.1 |

Borrowing Strategy

The Authority currently holds £40.7 million of loans, a decrease of £2.1 million on the previous year, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 1 shows that the Authority expects to borrow up to £43.8m in 2019/20

Objectives: The Authority'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. The flexibility to renegotiate loans should the Authority's long-term plans change is a secondary objective.

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

By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal and 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. Arlingclose will assist the Authority with this 'cost of carry' and breakeven analysis. Its output may determine whether the Authority borrows additional sums at long-term fixed rates in 2019/20 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

Alternatively, the Authority may arrange forward starting loans during 2019/20, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

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

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

- Government Loans Fund (via the Department of Finance, DoF)
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- any other UK public sector body

- UK public and private sector pension funds (except NILGOSC Pension Fund)
- capital market bond investors
- Special purpose companies created to enable local authority bond issues
- Other Local Authorities

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

- leasing
- hire purchase
- Private Finance Initiative
- sale and leaseback

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

LOBOs: The Authority holds £5m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. £5m of these LOBOs have options during 2019/20, and although the Authority understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The Authority will take the option to repay LOBO loans at no cost if it has the opportunity to do so. Total borrowing via LOBO loans will be limited to £5m.

Short-term and variable rate loans: These loans leave the Authority 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.

Debt rescheduling: The DoF allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Authority may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk. Recent experience however, has shown penalties in respect of early redemption of loans outweigh the benefits of re-financing the loans at lower interest rates.

Investment Strategy

The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Authority's investment balance has ranged between £1million and £7 million, and similar levels are expected to be maintained in the forthcoming year.

Objectives: Both the CIPFA Code and the DoE Guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an

appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Authority will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

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

Strategy: Given the increasing risk and very low returns from short-term unsecured bank investments, the Authority aims to diversify into more secure and/or higher yielding asset classes during 2019/20. All of the Authority’s surplus cash is currently invested in money market funds. This diversification will represent a continuation of the strategy adopted in 2018/19.

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

Table 3: Approved investment counterparties and limits

| Credit rating | Banks unsecured | Banks secured | Government | Corporates | Registered Providers |
|---|-----------------|-----------------------|-------------------------|------------------|----------------------|
| UK Govt | n/a | n/a | £ Unlimited 50 years | n/a | n/a |
| AAA to A- | £2m 6 months | £2m 13 months | £2m 5 years | £2m 13 months | £2m 13 months |
| None | £0m | n/a | £2m 5 years | £100k 5 years | £2m 5 years |
| Pooled funds and real estate investment trusts | | £2m per fund or trust | | | |

This table must be read in conjunction with the notes below

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

Banks unsecured: Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

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

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

Corporates: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made either following an external credit assessment or to a maximum of £100,000 per company as part of a diversified pool in order to spread the risk widely.

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

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

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

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

Operational bank accounts: The Authority may incur operational exposures, for example through 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 £3m per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Authority maintaining operational continuity.

Risk assessment and credit ratings: Credit ratings are obtained and monitored by the Authority's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

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

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

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

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

Investment limits: The Authority's revenue reserves available to cover investment losses are forecast to be £28.5 million on 31st March 2019. In order that no more than 8% 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 £2million. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do

not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table 4: Investment limits

| | Cash limit |
|---|-------------------|
| Any single organisation, except the UK Central Government | £2m each |
| UK Central Government | unlimited |
| Any group of organisations under the same ownership | £2m per group |
| Any group of pooled funds under the same management | £8m per manager |
| Negotiable instruments held in a broker's nominee account | £8m per broker |
| Foreign countries | £2m per country |
| Registered providers and registered social landlords | £2m in total |
| Unsecured investments with building societies | £2m in total |
| Loans to unrated corporates | £2m in total |
| Money market funds | £8m in total |
| Real estate investment trusts | £2m in total |

Liquidity management: The Authority uses cash flow forecasting spread sheets 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 Authority being forced to borrow on unfavourable terms to meet its financial commitments

Treasury Management Indicators

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

Security: The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. T Unrated investments are assigned a score based on their perceived risk.

| Credit risk indicator | Target |
|---------------------------------|---------------|
| Portfolio average credit rating | A- |

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

| Liquidity risk indicator | Target |
|--------------------------------------|---------------|
| Total cash available within 1 months | £3m |

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

| Interest rate risk indicator | Limit |
|--|---------|
| Upper limit on one-year revenue impact of a 1% <u>rise</u> in interest rates | £30,000 |
| Upper limit on one-year revenue impact of a 1% <u>fall</u> in interest rates | £30,000 |

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

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

| Refinancing rate risk indicator | Upper limit | Lower limit |
|---------------------------------|-------------|-------------|
| Under 12 months | 15% | 0% |
| 12 months and within 24 months | 20% | 0% |
| 24 months and within 5 years | 30% | 10% |
| 5 years and within 10 years | 40% | 15% |
| 10 years and above | 90% | 40% |

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

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

| Price risk indicator | 2019/20 | 2020/21 | 2021/22 |
|---|---------|---------|---------|
| Limit on principal invested beyond year end | £1m | £1m | £1m |

Related Matters

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

Financial Derivatives: Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 79 of the *Local Government Act (Northern Ireland) 2014* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

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

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

Markets in Financial Instruments Directive: The Authority has retained retail client status with its providers of financial services, including advisers, brokers and fund managers, allowing it access to a smaller range of services but with the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Authority's treasury management activities, the Chief Financial Officer believes this to be the most appropriate status.

Government Guidance: Further matters required by the DoE Guidance are included in Appendix B

Appendix A – Arlingclose Economic & Interest Rate Forecast October 2018

Underlying assumptions:

- The MPC left Bank Rate unchanged at the September meeting, after voting unanimously to increase Bank Rate to 0.75% in August.
- Our projected outlook for the UK economy means we maintain the significant downside risks to our interest rate forecast. The UK economic environment is relatively soft, despite seemingly strong labour market data. GDP growth recovered somewhat in Q2 2018, but the annual growth rate of 1.2% remains well below the long term average. Our view is that the UK economy still faces a challenging outlook as the country exits the European Union and Eurozone economic growth softens.
- Cost pressures were projected to ease but have risen more recently and are forecast to remain above the Bank's 2% target through most of the forecast period. The rising price of oil and tight labour market means inflation may remain above target for longer than expected. This means that strong real income growth is unlikely in the near future.
- The MPC has a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. We believe that MPC members consider both that: 1) ultra-low interest rates result in other economic problems, and 2) higher Bank Rate will be a more effective policy weapon should downside Brexit risks crystallise and cuts are required.
- The global economy appears to be slowing, particularly the Eurozone and China, where the effects of the trade war has been keenly felt. Despite slower growth, the European Central Bank is adopting a more strident tone in conditioning markets for the end of QE, the timing of the first rate hike (2019) and their path thereafter. Meanwhile, European political issues, mostly lately with Italy, continue.
- The US economy is expanding more rapidly. The Federal Reserve has tightened monetary policy by raising interest rates to the current 2%-2.25% range; further rate hikes are likely, which will start to slow economic growth. Central bank actions and geopolitical risks have and will continue to produce significant volatility in financial markets, including bond markets.

Forecast:

- The MPC has maintained expectations of a slow rise in interest rates over the forecast horizon. Our central case is for Bank Rate is to rise twice in 2019. The risks are weighted to the downside.
- Gilt yields have remained at low levels. We expect some upward movement from current levels based on our interest rate projections, the strength of the US economy and the ECB's forward guidance on higher rates. However, volatility arising from both economic and political events will continue to offer borrowing opportunities.

| | Dec-18 | Mar-19 | Jun-19 | Sep-19 | Dec-19 | Mar-20 | Jun-20 | Sep-20 | Dec-20 | Mar-21 | Jun-21 | Sep-21 | Dec-21 | Average |
|--------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------|
| Official Bank Rate | | | | | | | | | | | | | | |
| Upside risk | 0.00 | 0.00 | 0.00 | 0.00 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.17 |
| Arlingclose Central Case | 0.75 | 1.00 | 1.00 | 1.25 | 1.25 | 1.25 | 1.25 | 1.25 | 1.25 | 1.25 | 1.25 | 1.25 | 1.25 | 1.17 |
| Downside risk | 0.00 | 0.50 | 0.50 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.65 |
| 3-mth money market rate | | | | | | | | | | | | | | |
| Upside risk | 0.10 | 0.10 | 0.10 | 0.10 | 0.15 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.17 |
| Arlingclose Central Case | 0.80 | 1.00 | 1.10 | 1.20 | 1.30 | 1.30 | 1.25 | 1.20 | 1.20 | 1.20 | 1.20 | 1.20 | 1.20 | 1.17 |
| Downside risk | 0.20 | 0.50 | 0.60 | 0.70 | 0.80 | 0.80 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.68 |
| 1-yr money market rate | | | | | | | | | | | | | | |
| Upside risk | 0.20 | 0.30 | 0.30 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.33 |
| Arlingclose Central Case | 1.05 | 1.25 | 1.35 | 1.40 | 1.50 | 1.45 | 1.40 | 1.40 | 1.40 | 1.40 | 1.40 | 1.40 | 1.40 | 1.37 |
| Downside risk | 0.35 | 0.50 | 0.60 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.69 |
| 5-yr gilt yield | | | | | | | | | | | | | | |
| Upside risk | 0.15 | 0.20 | 0.25 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.32 |
| Arlingclose Central Case | 1.15 | 1.20 | 1.25 | 1.35 | 1.40 | 1.40 | 1.35 | 1.35 | 1.30 | 1.30 | 1.30 | 1.30 | 1.30 | 1.30 |
| Downside risk | 0.30 | 0.35 | 0.45 | 0.50 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | 0.54 |
| 10-yr gilt yield | | | | | | | | | | | | | | |
| Upside risk | 0.20 | 0.25 | 0.25 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.32 |
| Arlingclose Central Case | 1.60 | 1.65 | 1.65 | 1.70 | 1.75 | 1.75 | 1.75 | 1.70 | 1.70 | 1.70 | 1.70 | 1.70 | 1.70 | 1.70 |
| Downside risk | 0.30 | 0.45 | 0.50 | 0.55 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | 0.55 |
| 20-yr gilt yield | | | | | | | | | | | | | | |
| Upside risk | 0.20 | 0.25 | 0.25 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.32 |
| Arlingclose Central Case | 1.90 | 1.95 | 1.95 | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 | 2.00 | 1.98 |
| Downside risk | 0.30 | 0.40 | 0.45 | 0.45 | 0.45 | 0.45 | 0.45 | 0.45 | 0.45 | 0.45 | 0.45 | 0.45 | 0.45 | 0.43 |
| 50-yr gilt yield | | | | | | | | | | | | | | |
| Upside risk | 0.20 | 0.25 | 0.25 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.32 |
| Arlingclose Central Case | 1.80 | 1.85 | 1.85 | 1.90 | 1.90 | 1.90 | 1.90 | 1.90 | 1.90 | 1.90 | 1.90 | 1.90 | 1.90 | 1.88 |
| Downside risk | 0.30 | 0.40 | 0.45 | 0.45 | 0.45 | 0.45 | 0.45 | 0.45 | 0.45 | 0.45 | 0.45 | 0.45 | 0.45 | 0.43 |

Government loans are available at 1.00% above the gilt yield

Appendix B – Additional requirements of the Government Investment Guidance

Specified investments: The DoE Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
 - the UK Government,
 - a UK local authority, parish council or community council, or
 - a body or investment scheme of “high credit rating”, and
- where the principal sum to be repaid at maturity is the same as the initial sum invested, other than investments in the UK Government.

The Authority defines “high credit rating” organisations and securities as those having a credit rating of [A-] or higher that are domiciled in the UK or a foreign country with a sovereign rating of [AA+] or higher. For money market funds and other pooled funds “high credit rating” is defined as those having a credit rating of [A-] or higher.

Non-specified Investments: Any investment not meeting the definition of a specified investment is classed as non-specified. The Authority does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as unlisted bonds and shares. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement; investments with bodies and schemes without high credit ratings; and investments where the principal sum to be repaid at maturity is not the same as the initial sum invested, for example corporate bonds. Limits on non-specified investments are shown in table C1 below.

Table C1: Non-specified investment limits

| | Cash limit |
|--|-------------------|
| Total long-term investments | £1m |
| Total investments without credit ratings or rated below [A-] (except UK Government and local authorities) | £2m |
| Total investments (except pooled funds) with institutions domiciled in foreign countries rated below [AA+] | £1m |
| Total investments where the principal amount varies (other than those with the UK Government) | £1m |
| Total non-specified investments | £5m |

Investment training: The needs of the Authority’s treasury management staff for training in investment management are assessed as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.

Staff regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA, the Association of Corporate Treasurers and other appropriate organisations.

Investment advisers: The Authority has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues.

Investment of money borrowed in advance of need: The Authority may, from time to time, borrow in advance of need, where this is expected to provide the best long-term value for money. Since amounts borrowed will be invested until spent, the Authority is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Authority's overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit of £173 million. The maximum period between borrowing and expenditure is expected to be two years, although the Authority is not required to link particular loans with particular items of expenditure.