WARRINGTON BOROUGH COUNCIL

COUNCIL

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Report of	**Lynton Green, Director of Corporate Services (Section 151 Officer)/Deputy Chief Executive**	
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TITLE OF REPORT: 2019/20 TREASURY MANAGEMENT STRATEGY

1. PURPOSE OF THE REPORT

1.1 This report sets out the Council's proposed Treasury Management Strategy for 2019/20. The report was reported to the Audit and Corporate Governance Committee on 7 February 2019 and was scrutinised by them. It is now presented to Council for approval.

2. BACKGROUND

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

2.2 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 any debt previously drawn may be restructured to meet Council risk or cost objectives.

2.3 The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operation 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 balance, 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.

2.4 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.

2.5 CIPFA defines treasury management as:

> "*The management of the local 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.*"

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

2.7 The Strategy is drawn from the Council's Treasury Policy Statement and covers investments, borrowing, the outlook for interest rates, the management of associated risks, prudential indicators and the policy to be adopted on the Minimum Revenue Provision (MRP).

2.8 The Council's 2019/20 Treasury Management Strategy is attached at Appendix 1. Although, every attempt has been made to reduce the technical content of this report, by its very nature the report is technical in parts and the glossary of terms in Annexe A to the Strategy should aid members understanding of some technical terms used in the report.

3 CONFIDENTIAL OR EXEMPT

Not confidential.

4 FINANCIAL CONSIDERATIONS

N/A

5. RISK ASSESSMENT

5.1 The Council would be putting its financial standing at risk, as well as failing to meet the requirements of the Local Government Act 2003.

5.2 The Treasury Management Strategy and Prudential and Treasury Indicators reflect various assumptions of future interest rate movements and Government support for capital expenditure. These will be continually monitored and any necessary amendments will be made in accordance with the Strategy.

6. EQUALITY AND DIVERSITY/EQUALITY IMPACT ASSESSMENT

6.1 The Finance Service undertakes an Equality Impact Assessment (EIA) in its wider functions. Service changes that emerge from proposals contained in the treasury management strategy are subject to EI Assessments.

7. CONSULTATION

Not applicable.

8. REASONS FOR RECOMMENDATIONS

8.1 To ensure the Council complies with the 2017 revised CIPFA Treasury Management Code of Practice and MHCLG Investment Guidance.

9. RECOMMENDATIONS

9.1 Council considers the Treasury Management Strategy for 2019/20 and approves it as appropriate.

10. BACKGROUND PAPER

10.1 Treasury Management working papers.

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APPENDIX 1

2019/20 COUNCIL'S TREASURY MANAGEMENT STRATEGY

1. INTRODUCTION

1.1 The Local Government Act 2003 (the Act) and supporting regulations requires the Council to 'have regard to' the Chartered Institute of Public Finance and Accountancy's (CIPFA) Prudential Code and the CIPFA Treasury Management Code of Practice to set prudential indicators for the next three years to ensure that its capital investment plans are affordable, prudent and sustainable.

1.2 The Act therefore requires the Council to set out its Treasury Management Strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act). This sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

1.3 The Council's strategy has regard to the Ministry for Housing, Communities and Local Government (MHCLG) Guidance on Local Government Investments ("the Guidance"), which came into effect from 1 April 2010.

1.4 The strategy also includes the Council's 2019/20 Minimum Revenue Provision strategy.

1.5 The CIPFA Code of Practice on Treasury Management (revised November 2009) was adopted by this Council on 1st March 2010. CIPFA issued revisions to the Prudential Code, Treasury Management Code and Treasury Guidance Notes in 2017. The CIPFA Code of Practice has been amended and is detailed in section 9 of this report.

1.6 The primary requirements of the Code are as follows:

(i) Creation and maintenance of a Treasury Management Policy Statement, which set out the policies and objectives of the Council's treasury management activities.

(ii) Creation and maintenance of Treasury Management Practices, which set out the manner in which the Council will seek to achieve those policies and objectives:

- Reporting Requirements – the Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of polices, estimates and actuals.

  - **Prudential and treasury indicators and treasury strategy** – the first, and most important report covers:
    1. The capital plans (including prudential indictors);
    2. A minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
    3. The treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and

4. An investment strategy (the parameters on how investments are to be managed).

- **A mid-year treasury management report** – this will update members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision. In addition, this Council will receive quarterly update reports.

- **An annual treasury report** – this provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

(iii) Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

(iv) Delegation by the Council of the role of scrutiny of the Treasury Management Strategy and policies to a specific named body. For this Council, the delegated body is the Audit and Corporate Governance Committee.

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

1.8 The council has completed a Capital Strategy for 2019/20 is due to be reviewed at the Executive Board on 12th February 2019.

1.9 The suggested strategy for 2019/20 in respect of the following aspects of the treasury management function is based upon treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury advisor (Link). The strategy covers two main areas:

Capital Issues

- The capital expenditure plans and the associated prudential indicators
- The minimum revenue provision (MRP) policy.

Treasury management issues

- The current treasury position
- Treasury indicators which limit the treasury risk and activities of the Council

- prospects for interest rates
- the borrowing strategy
- policy on borrowing in advance of need
- debt rescheduling opportunities
- the investment strategy
- creditworthiness policy
- policy on use of external service providers
- future developments.

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, the MHCLG MRP Guidance, the CIPFA Treasury Management Code and the MHCLG Investment Guidance.

1.10 In particular, Section 32 of that Act requires the Authority to calculate its budget requirement for each financial year to include the revenue costs which flow from capital financing decisions. This means that increases in capital expenditure must be limited to a level where any increases in charges to revenue are from:

- Increases in interest charges caused by increased borrowing to finance additional capital expenditure, or
- Any increases in running costs from new capital projects are limited to a level, which is affordable within the projected income of the Council for the foreseeable future.

1.11 **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 has been undertaken by members in November 2018 and further training will be arranged as required.

2. TREASURY LIMITS FOR 2019/20

2.1 It is a statutory duty, under Section 3 of the Local Government Act 2003 and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the ‘Affordable Borrowing Limit’. In England and Wales the Authorised Limit represents the legislative limit specified in the Act.

2.2 The Council must have regard to the Prudential Code when setting the Authorised Limit. This essentially requires it to ensure that total capital investment remains within sustainable limits and in particular, that the impact upon its future council tax and council rent levels is ‘acceptable’.

2.3 Whilst termed an “Affordable Borrowing Limit”, capital plans to be considered for inclusion in corporate financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set on a rolling basis, for the forthcoming financial year and two successive financial years.

2.4 Prudential and Treasury Indicators identified at Annexe 2 are relevant for the purposes of setting an integrated Treasury Management Strategy.

2.5 The Council is also required to indicate if it has adopted the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management in Local Authorities (the Treasury Management Code). The original Treasury Management Code was adopted in 2004 at a full meeting of the Council, and the 2009 revised Treasury Management Code was adopted at a full meeting of the Council on 1 March 2010. Amendments to the Code have been detailed in section 9 of this report. Subject to any amendments by the Committee it will be forwarded to the Council to approve the code at its meeting of 25th February 2019.

3. CURRENT PORTFOLIO POSITION

3.1 The Council's treasury portfolio position as at 31st December 2018 comprised of:

Current Portfolio Position	Principal £m	Total £m	Average Interest Rate %
Fixed Rate Funding			
- Public Works Loans Board	596.919		2.394
- Money Market	143.512		2.898
- Temporary Borrowing	29.256	769.688	0.830
Variable Rate Funding			
- Public Works Loans Board			
- Money Market	50.000	50.000	0.846
TOTAL BORROWING		**819.688**	2.440
Council Investments			
- Fixed Rate	(29.204)		5.312
- Call Accounts	(54.747)	(83.952)	0.522
TOTAL INVESTMENTS		**(83.952)**	**3.719**
NET		**735.736**	

BORROWING REQUIREMENT

3.2 The capital expenditure plans provide details of the service activity of the Council. 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 this service activity and the Council's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury/prudential indicators, the current and projected debt positions and the annual investment strategy. The Council's capital expenditure plans are the key driver of treasury management activity.

3.3 The output of the capital expenditure plans is reflected in prudential indicators, which are designed to assist member's overview and confirm capital expenditure plans.

3.4 The table below sets out the Council's future borrowing requirement (current and previous year are shown for comparison) based on current commitments and plans.

2017/18 Actual £m	**2018/19 Estimate £m**	**Capital Expenditure**	**2019/20 Estimate £m**	**2020/21 Estimate £m**	**2021/22 Estimate £m**	**TOTAL 3 Years £m**
354.302	343.810	Capital Expenditure	400.319	287.313	43.746	**731.378**
		Financed By:				
23.977	23.587	Capital Grants & Reserves	17.545	6.546	0.537	**24.628**
2.916	6.324	Capital Receipts	3.350	2.000	6.000	**11.350**
0.000	0.726	Council Revenue Funding	0	0	0	**0**
1.327	11.438	External Funding	11.641	4.380	0.075	**16.096**
326.082	**301.735**	**Financing need for year**	**367.783**	**274.387**	**37.134**	**679.304**

4. PROSPECTS FOR INTEREST RATES

4.1 The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates.

4.2 The Bank Base 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 as follows:

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

The overall balance of risks to economic growth in the UK is probably neutral. The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

Link Asset Services' interest rate forecast

The following table gives their central view:

	Bank Rate	**PWLB Borrowing Rates**			
		5 year	**10 year**	**25 year**	**50 year**
Mar-19	0.75%	2.10%	2.50%	2.90%	2.70%
Jun-19	1.00%	2.20%	2.60%	3.00%	2.80%
Sep-19	1.00%	2.20%	2.60%	3.10%	2.90%
Dec-19	1.00%	2.30%	2.70%	3.10%	2.90%
Mar-20	1.25%	2.30%	2.80%	3.20%	3.00%
Jun-20	1.25%	2.40%	2.90%	3.30%	3.10%
Sep-20	1.25%	2.50%	2.90%	3.30%	3.10%
Dec-20	1.50%	2.50%	3.00%	3.40%	3.20%
Mar-21	1.50%	2.60%	3.00%	3.40%	3.20%
Jun-21	1.75%	2.60%	3.10%	3.50%	3.30%
Sep-21	1.75%	2.70%	3.10%	3.50%	3.30%
Dec-21	1.75%	2.80%	3.20%	3.60%	3.40%
Mar-22	2.00%	2.80%	3.20%	3.60%	3.40%

4.3 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 has been healthy since that meeting, but is expected to weaken during the last quarter of 2018. At their November 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. The next increase in Bank Rate is therefore forecast to be in May 2019, followed by increases in February and November 2020, before ending up at 2.0% in February 2022.

4.4 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, there has been 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, was 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 this series of robust responses to combat its perception of rising inflationary pressures by repeatedly increasing the Fed rate to reach 2.00-2.50% 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. US 10 year bond Treasury yields have risen above 3.2% during October 2018 and it has also been seen 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.

4.5 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.

4.6 Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts, (an 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.

4.7 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 incur a revenue cost.

4.8 These assumptions have been used to determine the treasury management budget projections, included as part of the 2019/20 revenue budget and future year projections.

4.9 **Other forecasts** – the data below shows a variety of forecasts published by a number of institutions. The forecast includes Capital Economics (an independent forecasting consultancy). The forecast within this strategy statement has been drawn from these diverse sources.

Capital Economics interest rate forecast

	Bank Rate	**PWLB Borrowing Rates**		
		5 year	**10 year**	**25 year**
Mar-19	0.75%	2.03%	2.43%	2.96%
Jun-19	1.00%	2.15%	2.55%	3.08%
Sep-19	1.25%	2.40%	2.80%	3.33%
Dec-19	1.50%	2.65%	3.05%	3.58%
Mar-20	1.70%	2.70%	3.05%	3.53%
Jun-20	1.75%	2.75%	3.05%	3.48%
Sep-20	2.00%	2.80%	3.05%	3.43%
Dec-20	2.00%	2.85%	3.05%	3.38%

5. ECONOMIC BACKGROUND

5.1 **Global Outlook – World growth** has been doing reasonable well, aided by strong growth in the U.S. However, US growth is likely to fall back in 2019 and, together with weakening economic activity in China and the Eurozone, overall world growth is likely to weaken.

5.2 **Inflation** has been weak during 2018 but 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.

5.3 **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.

5.4 **The key issue now** – is that period of stimulating economic recovery and warding off the threat of deflation, is coming towards a close. A new period is well advanced in the US, and more recently in the UK, of reversing those measures i.e. by raising central rates and, (for the US), reducing central banks' holdings government and other debt. These measures are now required in order to stop the trend of a reduction in space 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 value levels simultaneously. This now means that both asset categories are vulnerable to a sharp downward correction which was seen in a sharp fall in equity values in the last quarter of 2018. It is important 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. Financial markets (January 2019) are very concerned that the Fed is being too aggressive with its policy for raising interest rates and is likely to cause a recession in the US economy.

5.5 The work 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.

5.6 **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.

5.7 At their November quarterly Inflation Report meeting, the MPC repeated 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.

5.8 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 EU). The following increases are then forecast to be in February and November 2020 before ending up at 2.0% in February 2022.

5.9 **Inflation** – the Consumer Price Index (CPI) measure of inflation has been falling from a peak of 3.1% in November 2017 to 2.1% in December 2018. 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.

5.10 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 1.2%, 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.

5.11 In the political arena, The Brexit deal put forward by the Conservative minority government was defeated on 15 January 2019. It is unclear how this situation will move forward. If the Prime Minister May's government is able, despite various setbacks, to reach an orderly Brexit, though the risks are increasing that it may not be possible to get full agreement by the UK and EU before 29 March 2019, in which case this withdrawal date is likely to be pushed back to a new date. 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.

5.12 **USA** – President Trump's massive easing of fiscal policy is fuelling a, (temporary), boost in consumption which has generated an upturn in the rate of strong growth which rose from 2.2%, (annualised rate), in quarter 1 to 4.2% in quarter 2 and 3.5%, (3.0% y/y), in quarter 3, but also an upturn in inflationary pressures. The strong growth in employment numbers and the reduction in the unemployment rate to 3.9%, near to a recent 49 year low, have fed through to an upturn in wage inflation which hit 3.2% in November. However, CPI inflation overall fell to 2.2% in November and looks to be on a falling trend to drop below the Fed's target of 2% during 2019. The Fed has continued on its series of increases in interest rates with another 0.25% increase in December to between 2.25% and 2.50%, this being the fifth increase in 2018 and the ninth in this cycle. However, they did also reduce their forecast for further increases from three to two. This latest increase compounded investor fears that the Fed is over doing the speed and level of increases in rates and that it is going to cause a US recession as a result. There is also much evidence in previous monetary policy cycles of the Fed's series of increases doing exactly that. Consequently, stock markets around the world are falling under the weight of fears around the Fed's actions, the trade war between the US and China and an expectation that world growth will slow.

5.13 The tariff war between the US and China has been generating a lot of heat during 2018, but it is not expected that the current level of actual action would have much in the way of a significant effect on US or world growth. However, there is a risk of escalation if an agreement is not reached soon between the US and China.

5.14 **Eurozone** – growth was 0.4% in quarters 1 and 2 but fell back to 0.2% in quarter 3, though this is probably just a temporary dip. In particular, data from Germany has been mixed and it could be negatively impacted by US tariffs on a significant part of the manufacturing exports e.g. cars. For that reason, although growth is still expected to be in the region of nearly 2% for 2018, the horizon is less clear than it seemed just a short while ago. Having halved its quantitative easing purchases of debt in October 2018 to €15bn per month, the European Central Bank (ECB) ended all further purchases in December 2018. The ECB is forecasting inflation to be a little below its 2% top limit through the next three years so it may find it difficult to warrant a start on raising by the end of 2019 if the growth rate of the EU economy is on a weakening trend.

5.15 **China** – economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems. Progress has been made in reducing the rate of credit creation, particularly from the shadow banking sector, which is feeding through into lower economic growth. There are concerns that official economic statistics are inflating the published rate of growth.

5.16 **Japan** – has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy. It is likely that loose monetary policy will endure for some years yet to try to stimulate growth and modest inflation.

5.17 **Emerging countries** – Argentina and Turkey are currently experiencing major headwinds and are facing challenges in external financing requirements well in excess of their reserves of foreign exchange. However, these countries are small in terms of the overall world economy, (around 1% each), so the fallout from the expected recessions in these countries will be minimal.

5.18 **Interest Rate Forecasts** – the interest rate forecasts provided by Link Asset Services are predicated on an assumption of an agreement being reached on Brexit between the UK and EU. On this basis, while GDP growth is likely to be subdued in 2019 due to all the uncertainties around Brexit depressing consumer and business confidence, an agreement is likely to lead to a boost to the rate of growth in 2020 which could, in turn, increase inflationary pressures in the economy and so cause the Bank of England to resume a series of gentle increases in Bank Rate. Just how fast, and how far, those increases will occur and rise to, will be data dependent. The forecasts in this report assume a modest recovery in the rate and timing of stronger growth and in the corresponding response by the Bank in raising rates.

- In the event of an orderly non-agreement exit, it is likely that the Bank of England would take action to cut Bank Rate from 0.75% in order to help economic growth deal with the adverse effects of this situation. This is also likely to cause short to medium term gilt yields to fall.

- If there was a disorderly Brexit, then any cut in Bank Rate would be likely to last for a longer period and also depress short and medium gilt yields correspondingly. It is also possible that the government could act to protect economic growth by implementing fiscal stimulus.

However, there would appear to be a majority consensus in the Commons against any form of non-agreement exit so the chance of this occurring has now substantially diminished.

5.19 The balance of risks to the UK:

- The overall balance of risks to economic growth in the UK is probably neutral.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are broadly dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

5.20 One risk that is both an upside and downside risk, is that all central banks are now working in very different economic conditions than before the 2008 financial crash as there has been a major increase in consumer and other debt due to the exceptionally low levels of borrowing rates that have prevailed for ten years since 2008. This means that the neutral rate of interest in an economy, (i.e. the rates that is neither expansionary nor deflationary), is difficult to determine definitively in this new environment, although central banks have made statements that they expect it to be much lower than before 2008. Central banks could therefore either over or under do increases in central interest rates.

5.21 **Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:**

- **Brexit** – if it were to cause significant economic disruption and a major downturn in the rate of growth.
- **Bank of England monetary policy** – takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than currently anticipate.
- **Eurozone** – a resurgence of the Eurozone sovereign debt crisis, possibly in Italy, due to its high level of government debt, low rate of economic growth and vulnerable banking system, and due to the election in March of a government which has made a lot of anti-austerity noise. The EU has rejected the proposed Italian budget and has demanded cuts in government spending which the Italian government has refused. However, an alternative was subsequently agreed, but only by delaying the planned increases in expenditure to a later year. The rating agencies have started on downgrading Italian debt to one notch above junk level. If Italian debt were to fall below investment grade, many investors would be unable to hold it. Unsurprisingly, investors are becoming increasingly concerned by the action of the Italian government and consequently, Italian bond yields have risen – at a time when the government faces having to refinance large amounts of debt maturing in 2019.
- **European banks** – weak capitalisation of some European banks, Italian banks are particularly vulnerable; one factor is that they hold a high level of Italian government debt

– debt which is falling in value. This is therefore undermining their capital ratios and raises the question of whether they will need to raise fresh capital to plug the gap.

- **German minority government** – in the German general election of September 2017, Angela Merkel's Christian Democratic Union of Germany (CDU) party was left in a vulnerable minority position dependent on the fractious support of the Social Democratic Party (SPD), as a result of the rise in popularity of the anti-immigration Alternative for Germany (AfD) party. Then in October 2018, the results of the Bavarian and Hesse state elections radically undermined the SPD and showed a sharp fall in support for the CDU. As a result, the SPD is reviewing whether it can continue to support a coalition that is so damaging to its electoral popularity. After the result of the Hesse state election, Angela Merkel announced that she would not stand for re-election as CDU party leader at her party's convention in December 2018. However, this makes little practical difference as she is still expected to aim to continue for now as the Chancellor. However, there are five more state elections coming up in 2019 and EU parliamentary elections in May/June; these could result in a further loss of electoral support for both the CDU and SPD which could also undermine her leadership.
- **Other minority Eurozone governments** – Spain, Portugal, Netherlands and Belgium all have vulnerable minority governments dependent on coalitions which could prove fragile. Sweden is also struggling to form a government due to the anti-immigration party holding the balance of power, and which no other party is willing to form a coalition with. The Belgian coalition collapsed in December 2018 but a minority caretaker government has been appointed until the May EU wide general elections.
- **Austria, the Czech Republic and Hungary** will now form a strongly anti-immigration bloc within the EU while Italy, in 2018, has also elected a strongly anti-immigration government. Elections to the EU parliament are due in May/June 2019.
- Further increases in interest rates in the US could spark a sudden flight of investment funds from more risky assets e.g. shares, into bonds yielding a much improved yield. Throughout the last quarter of 2018, there was a sharp fall in equity markets interspersed with occasional partial rallies. Emerging countries which have borrowed heavily in dollar denominated debt, could be particularly exposed to this risk of an investor flight to safe havens e.g. UK gilts.
- There are concerns around the level of US corporate debt which has swollen massively during the period of low borrowing rates in order to finance mergers and acquisitions. This has resulted in the debt of many large corporations being downgraded to a BBB credit rating, close to junk status. Indeed, 48% of total investment grade corporate debt is now rated at BBB. If such corporations fail to generate profits and cash flow to reduce their debt levels as expected, this could tip their debt into junk ratings which will increase their cost of financing and further negatively impact profits and cash flow.
- **Geopolitical risks** – especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

5.22 **Upside risks to current forecasts for UK gilt yields and PWLB rates**

- **Brexit** – if both sides were to agree by 29 March a compromise that quickly removed all threats of economic and political disruption and so led to an early boost to UK economic growth.
- **The Fed causing a sudden shock in financial markets** through misjudging the pace and strength of increases in its Fed Funds Rate and in the pace and strength of reversal of QE,

which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.

- **The Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than currently expected.
- **UK inflation** – whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

5.23 **Brexit timetable and process**

- March 2017: UK government notified the European Council of its intention to leave under the Treaty on European Union Article 50 on 29 March 2019.
- November 2018: EU27 leaders endorsed the withdrawal agreement
- December 2018: Vote in UK Parliament on the agreement was postponed
- January 2019: Brexit deal defeated in the Commons vote by a large margin
- March 2019: Second vote(?) in UK Parliament
- End March 2019: If the UK Parliament approves a deal, then ratification by EU Parliament requires a simple majority
- End March 2019: if UK and EU parliaments agree the deal, EU Council needs to approve the deal; 20 countries representing 65% of the EU population must agree
- End March 2019: Either the UK leaves the EU or asks the EU for agreement to an extension of the Article 50 period if UK Parliament has been unable to agree on a Brexit deal
- End March 2019: if an agreement is reached with the EU on the terms of Brexit, then this will be followed by a proposed transitional period ending around December 2020
- UK continues as a full EU member until March 2019 with access to the single market and tariff free trade between the EU and UK. Different sectors of the UK economy may leave the single market and tariff free trade at different times during the transitional period.
- The UK and EU would attempt to negotiate, among other agreements, a bi-lateral trade agreement over that period.
- The UK would aim for a negotiated agreed withdrawal from the EU, although the UK could also exit without any such agreements in the event of a breakdown of negotiations.
- If the UK exits without an agreed deal with the EU, World Trade Organisation rules and tariffs could apply to trade between the UK and EU – but this is not certain.
- On full exit from the EU: the UK parliament would repeal the 1972 European Communities Act.

6. BORROWING STRATEGY

6.1 The capital expenditure plans provide details of the service activity of the Council. 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 this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

6.2 In general, the Council will borrow for one of two purposes – to finance cash flow in the short-term or to fund capital investment over the longer term. The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.

6.3 The Council's treasury portfolio position at 31 March 2019, with forward projections is summarised below and detailed in table 3.3. The actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement (CFR)), highlights an underlying need to borrow £301.735m in 2018/19, £367.783m in 2019/20, £274.387m in 2020/21 and £37.134m 2021/22. There is a large requirement in the early years. This is due to the impact of new capital schemes in the programme and the need to replace existing debt as the council has taken some short term loans to take advantage of existing market conditions.

6.4 A key aim of the Treasury Management Strategy is to minimise the cost of the Council's loan portfolio whilst ensuring that the obligation to repay the loan is spread over a period of time. This reduces the impact on the revenue budget of interest payments.

6.5 Currently the average rate of interest on the Council's loan portfolio is 2.44%, which has been one of the lowest rates of the CIPFA group of authorities that we compare ourselves to. The achievement of such low rates ensures the Council benefits from the best value for money in terms of its borrowing. This is the result of a number of years proactively managing the portfolio on loans through restructuring and taking advantage of the best possible interest rates available. The proposed treasury management strategy aims to continue this successful approach.

6.6 The approves sources of long-term and short-term borrowing will be:

- Public Works Loan Board
- UK Local Authorities
- Municipal Bond Agency
- Any institution approved for investments including high quality supranational banks
- European Banks Green Bond Issuance
- UK public and private sector pension funds
- Any other financial institution approved by the Prudential Regulation Authority, which is part of the Bank of England and is responsible for the regulation and supervision of banks, building societies, credit unions, insurers and major investment firms
- Capital market bond investors either over the counter or through electronic trading platforms

6.7 The PWLB rate forecasts are given in the table below. The Council will also evaluate the option of borrowing further from the bond markets during 2018/19. Borrowing from the bond market will take place if it offers greater value for money than borrowing from the PWLB:

	PWLB Borrowing Rates			
	5 year	**10 year**	**25 year**	**50 year**
Mar-19	2.10%	2.50%	2.90%	2.70%
Jun-19	2.20%	2.60%	3.00%	2.80%
Sep-19	2.20%	2.60%	3.10%	2.90%
Dec-19	2.30%	2.70%	3.10%	2.90%
Mar-20	2.40%	2.80%	3.20%	3.00%
Jun-20	2.40%	2.90%	3.30%	3.10%
Sep-20	2.50%	2.90%	3.30%	3.10%
Dec-20	2.50%	3.00%	3.40%	3.20%
Mar-21	2.60%	3.00%	3.40%	3.20%
Jun-21	2.60%	3.10%	3.50%	3.30%
Sep-21	2.70%	3.10%	3.50%	3.30%
Dec-21	2.80%	3.20%	3.60%	3.40%
Mar-22	2.80%	3.20%	3.60%	3.40%

6.8 These forecasts are based around an expectation that there will normally be variations of +/-25bp during each quarter around these average forecasts in the normal economic and political circumstances. However, greater variations can occur should there be any unexpected shocks to financial and/or political systems.

6.9 Borrowing interest rates increased sharply after the result of the general election in June and also after the September MPC meeting when financial markets reacted by accelerating their expectations for the timing of Bank Rate increases. Since then, borrowing rates have eased back. There has been little general trend in rates during the current financial year. 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.

6.10 Against this background and the risks within the economic forecast, caution will be adopted with the 2019/20 treasury operations. The Section 151 Officer will 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. Most likely, fixed rate funding will be drawn whilst interest rates are still lower than they are projected to be in the next few years.

6.11 There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.

6.12 Any decisions will be reported to the Audit and Corporate Governance Committee at the next available opportunity.

6.13 The Council’s policy for 2019/20 will be to balance investments to obtain returns within the council’s risk appetite. However, an assessment of the opportunity for borrowing will be made on the cost of borrowing long-term dependent on the interest rate movements.

7. DEBT RESCHEDULING

7.1 The introduction by the PWLB in 2007 of a spread between the rates applied to new borrowing and repayment of debt (which has now been compounded since 20 October 2010 by a considerable further widening of the difference between new borrowing and repayment rates) has meant that PWLB to PWLB debt restructuring is now much less attractive than before these events. In particular, consideration would have to be given to the large premiums, which would be incurred by prematurely repaying existing PWLB loans and it is very unlikely that these could be justified on value for money grounds if using replacement PWLB refinancing. However, some interest savings may still be achievable through using other local authority loans and market loans in rescheduling exercises rather than using PWLB borrowing as the source of replacement financing.

7.2 As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

7.3 The reasons for any rescheduling to take place will include:

(a) The generation of cash savings and / or discounted cash flow savings;
(b) Help fulfil the borrowing strategy outlined above;
(c) Enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

7.4 Consideration will also be given to identify if there is any residual 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.

7.5 All rescheduling will be reported to the Audit and Corporate Governance Committee at the earliest meeting following this action.

7.6 It is possible that the Municipal Bond Agency will be offering loans to local authorities in the future. The Agency hopes that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). This Authority intends to make use of this new source of borrowing as and when appropriate.

8. TREASURY POLICY STATEMENT

8.1 Treasury management within this Council is undertaken in accordance with the CIPFA Code of Practice for Treasury Management in the Public Services ("the TM Code"). This Code has been reviewed and updated following recent developments in the marketplace and the introduction of the Localism Act 2011 for English local authorities.

8.2 The Council has been compliant with the requirements of the TM Code and has formally adopted the key recommendations as described within Section 4 of the TM Code.

8.3 In accordance with the TM Code, the Council defines treasury management activities as:

"The management of the council'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."

8.4 'Investments' in the definition above covers all the financial assets of the organisation, as well as other non-financial assets which the organisation holds primarily for financial returns, such as investment property portfolios. This may therefore include investments which are not managed as part of normal treasury management or under treasury management delegations. All investments require an appropriate investment management and risk management framework under this Code.

8.5 The 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 organisation, and any financial instruments entered into to manage these risks.

8.6 The 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 measurement techniques, within the context of effective risk management.

8.7 The Council will create and maintain, as the cornerstone for effective treasury management:

- a Treasury policy statement, stating the policies, objectives and approach to risk management of its Treasury Management activities
- suitable Treasury Management Practices (TMPs) setting out the manner in which the Council will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities (reported to the Audit & Corporate Governance Committee annually)
- Treasury management Prudential Indicators as determined by the requirements of the CIPFA Prudential Code; and

- The content of the policy statement and TMPs will follow the recommendations contained in Sections 6 and 7 of the TM Code, subject only to amendment where necessary to reflect the particular circumstances of this organisation. Such amendments will not result in the organisation materially deviating from the TM Code's key principles.
- The Council will receive reports on its treasury management policies, practices and activities, including as a minimum, an annual strategy and plan in advance of the year, an annual report after its close and an half year review report.
- The Council delegates responsibility for the implementation and monitoring of its treasury management policies and practices to the Audit & Corporate Governance Committee, and for the execution and administration of treasury management decisions to the Section 151 Officer, who will act in accordance with the Council's Treasury Management Strategy and the TM Code, who is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.

2019/20 COUNCIL'S ANNUAL INVESTMENT STRATEGY

9. INTRODUCTION

9.1 The aim of our investment strategy is to:

- Maintain capital security;
- Maintain policy flexibility.

9.2 The Council's Section 151 Officer, under delegated powers, will undertake the most appropriate form of investments depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast above.

9.3 The Council invests surplus cash balances only with certain approved organisations, as security of funds is of primary importance. All investments will be made in accordance with the Council's investment policies and prevailing legislation and regulations.

10. INVESTMENT POLICY – Management of Risk

10.1 The MHCLG and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with financial investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy, which is reported to Full Council separately.

10.2 The council will have regard to the MHCLG's Guidance on Local Government Investments ("the Guidance") and the CIPFA Treasury Management in Public Services Code of Practice and cross Sectoral Guidance Notes 2017 ("the CIPFA TM Code"), CIPFA Treasury Management Guidance Notes 2018.

10.3 The Council's investment priorities are:
(a) The security of capital
(b) The liquidity of its investments
(c) Yield
(d) Social Impact

10.4 The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity.

10.5 Council has reviewed its classification with financial institutions under MIFID II requirements. A schedule has been included with the Treasury Management Practices document of those organisations with which it is registered as a professional client and those with which it has an application outstanding to register as a professional client.

10.6 In accordance with guidance from MHCLG and CIPFA, which places a high priority on the management of risk, the Council has stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list, which also enable diversification and thus avoidance of concentration risk.

10.7 Furthermore, the Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that 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 this end the Council will engage with its advisors to maintain and monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings. This is integrated into the credit methodology provided by the advisors, Link Asset Services in producing its colour coding which show the varying degrees of suggested creditworthiness.

10.8 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.

10.9 The aim of the strategy is to generate a list of highly creditworthy counterparties, which will also enable diversification and thus avoidance of concentration risk. The intention of the strategy is to provide security of investment and minimisation of risk.

10.10 Investment instruments identified for use in the financial year are listed below under the 'Specified' and 'Non-Specified' investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices Statement.

11. SPECIFIED INVESTMENTS (MATURITIES UP TO ONE YEAR) AND COUNTERPARTY LIMITS

11.1 All such investments will be sterling denominated, with maturities up to maximum of 1 year, meeting the minimum 'high' rating criteria where applicable. The maximum limit will be applied to each account (i.e. bank, local authority, bond, etc.)

1. Specified Investments (limit per counterparty)	Maximum Group Limit
UK Government	Unlimited
Local Authorities	Unlimited
Money Market Funds CNAV	£50.0m
Money Market Funds LVNAV	£50.0m
Money Market Funds VNAV	£20.0m
Pooled Fund Institution with a min rating of AAA/A1	£50.0m
Institutions with a minimum rating of AAA/A1	£50.0m
Institutions with a minimum rating of AA-/A2	£30.0m
Institutions with a minimum rating of A-/A3	£20.0m
Institutions with a minimum rating of BBB/A3	£15.0m
Building Societies – assets greater than £5,000 million	£5.0m
Building Societies – assets greater than £1,000 million	£2.5m
Building Societies – assets greater than £ 250 million	£1.0m

All investments with maturities up to maximum 1 year, high credit criteria:			
	Minimum 'High' Credit Criteria	**Maximum Limit**	**Maximum Maturity Period**
Debt Management Agency Deposit Facility	UK sovereign rating	£50m	1 year
Term deposits – local authorities and other public institutions	UK sovereign rating	£20m	1 year
Term deposits – banks and building societies*	UK sovereign rating	£20m	1 year

11.2 Term deposits with nationalised banks, banks and building societies

	Minimum 'High' Credit Criteria	Maximum Limit	Maximum Maturity Period
UK part nationalised banks	UK sovereign rating	£20m	1 year
Banks part nationalised by high credit rated (sovereign rating) countries	Sovereign rating A	£20m	1 year

*The countries approved for investing with their banks: UK, Canada, Denmark, Finland, France, Germany, Luxembourg, Netherlands, Norway, Singapore, Sweden, Switzerland, UK, Australia, Belgium, Hong Kong, USA.

11.3 Other instruments

	Minimum 'High' Credit Criteria	Max Individual Investment	Maximum Total Investment	Max Maturity Period
Collateralised deposit	UK sovereign rating	£5m	£5m	1 year
Certificates of deposits issued by banks and building societies	UK sovereign rating	£5m	£20m	1 year
UK Government Gilts	UK sovereign rating	£10m	£50m	1 year
Bonds issued by multilateral development banks	Long term AA	£10m	£20m	1 year
Treasury Bills	UK sovereign rating	£5m	£20m	1 year

Collective Investment Schemes structures as Open Ended Investment Companies (OEICs)			
Government Liquidity Funds	Long term AA	£10m	1 year
Money Market Funds	Variable CNAV Long Term AAA	£50m per fund	1 year
Money Market Funds	Stable LVNAV Long Term AAA	£50m per fund	1 year
Money Market Funds	Stable VNAV Long Term AAA	£20m per fund	1 year
Enhanced Cash Funds	Long Term AA	£5m	1 year
Bonds Funds	Long Term AA	£5m	1 year
Gilt Funds	Long Term AA	£5m	1 year
Bond Funds	B- and unrated debt issuers	£20m	1 year
Managed Account Bond Funds	B- and unrated	£30 per fund	1 year

12. NON-SPECIFIED INVESTMENTS (MATURITIES OVER ONE YEAR)

12.1 These are any investments which do not meet the specified investment criteria. A maximum of 90% may be held in aggregate in non-specified investments. A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the above categories. The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

Term deposits with nationalised banks and building societies:			
	Minimum 'High' Credit Criteria	**Maximum Limit**	**Maximum Maturity Period**
UK part nationalised banks	UK sovereign rating	£20m	5 year
Banks part nationalised by high credit rated (sovereign rating) countries UK and non UK*	Sovereign rating A	£20m	5 year

12.2 Maturities of any period:

	Minimum 'High' Credit Criteria	Maximum Individual Investment	Maximum Group Limit	Maximum Maturity Period
Structured deposits	In accordance with Link's Credit Worthiness Criteria	£5m	£20m	5 years
Banks and Building Societies term deposits with unrated counterparties : any maturity	The top twenty building societies by total assets with a minimum asset size of £1bn and the following credit rating Fitch (or its equivalent):			
	Long term rating AA-, short term rating F2	£1m	£5m	5 years
	Non rated	£0.5m	£1m	1 year
Challenger Banks term deposits with unrated counterparties : any maturity	The non-rated bank must have a minimum asset level of £200m,	£5m	£20m	1 year
Municipal Bonds	UK sovereign rating	£10m	£10m	10 years
Commercial paper	Short-term F2, Long term A	£5m	£5m	5 years
Corporate Bonds Corporate Bond Funds / Gilt Funds	Short-term F2, Long term A	£20m	£20m	10 years
Floating Rate Notes	Long term A	£1m	£5m	5 years
Covered Bonds	Long term AA-	£20m	£50m	10 years
Un-rated bonds	Long term B-	£20m	£50m	10 years
Churches, Charities and Local Authorities (CCLA) Property Fund		£20m	£20m	10 years

12.3 Maturities in excess of 1 year

	Minimum 'High' Credit Criteria	Maximum Individual Limit	Maximum Group Limit	Maximum Maturity Period
Term deposits – local authorities and other public institutions		£5m	£50m	5 years
Term deposits – banks and building societies		£1m	£5m	5 years
Certificates of deposits issued by banks and building societies	UK sovereign rating	£5m	£20m	5 years
UK Government Gilts	UK sovereign rating	£5m	£50m	5 years
Bonds issued by multilateral development banks	AA	£5m	£20m	5 years
Corporate bonds	Short term F2 Long Term A-	£10m	£20m	10 years
Green Energy Bonds	Internal and External Due Diligence	£10m	£20m	5 years
Collateralised Term Deposit	Local Authority	£5m	£20m	5 years
Sovereign bond issues (i.e. other than the UK government)	AA	£5m	£20m	5 years
Property Bonds	External Due Diligence	£20m	£50m	5 years
LiveWire Community Energy	Internal Due Diligence	£1m	£1m	20 years
Funding Circle	Internal and External Due Diligence	£10m	£10m	5 years
Asset Backed Securities	Internal and External Due Diligence	£20m	£100m	10 years
Asset Backed Pooled Funds	Internal and External Due Diligence	£50m	£50m	10 years

Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)				
Bond Funds	AA	£5m	£10m	10 years
Gilt Funds	AA	£5m	£10m	5 years
Forest Financial Instrument	Internal and External Due Diligence	£20m	£50m	30 years
Public Sector Social Impact Fund	Unrated	£50m	£50m	10 years
Bond Funds	B- and unrated debt issuers	£10m	£30m	5 years
Managed Account Bond Funds	B- and unrated	£10m	£30m	5 years

12.4 As a result of the change in accounting standards for 2018/19 under IFRS 9, the Council 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 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)

12.5 OTHER NON-SPECIFIED INVESTMENTS

- Fixed term deposits with variable rate and variable maturities
- Local Authority Partnership Purchase Scheme (LAPP)
- Forest Financial Instruments

13 CREDITWORTHINESS POLICY

13.1 This Council uses the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors. The credit ratings of counterparties are 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.

13.2 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 on some occasions.

13.3 The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions down to a minimum durational band within Link Asset Services weekly credit list of worldwide potential counterparties. The Council will therefore use counterparties within the following durational bands:

Colour	**Suggested Duration**
Yellow	5 years *
Dark Pink	5 years for Ultra-Short Dated Bond Funds with a credit score of 1.25
Light Pink	5 years for Ultra-Short Dated Bond Funds with a credit score of 1.5
Purple	2 years
Blue	1 year (only applies to nationalised or semi nationalised UK Banks)
Orange	1 year
Red	6 months
Green	100 days
No colour	Not to be used

**The yellow colour category is for UK Government debt, or its equivalent, money market funds and collateralised deposits where the collateral is UK Government debt.*

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

13.5 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.

13.6 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 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 (CDS) against the iTraxx (CDS product brand name) benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Councils lending list.

13.7 Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and information, information on any external support for banks and the credit ratings of that government support.

13.8 **UK banks: ring fencing** – the largest UK banks (those with more than £25bn of retail/Small and Medium-sized Enterprise (SME) deposits), are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as "ring-fencing". Whilst smaller banks with less than £25bn in deposits are exempt they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.

13.9 Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank (RFB) will be focused on lower risk, day-to-day core transactions, whilst more complex and "riskier" activities are required to be housed in a separate entity, a non-ring-fenced bank (NRFB). This is intended to ensure that an entity's core activities are not adversely affected by the acts or omissions of other members of its group.

13.10 While the structure of banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered) will be considered for investment purposes.

14. COUNTRY LIMITS

14.1 The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent from other agencies if Fitch does not provide them). The list will be added to, or deducted from by officers should ratings change in accordance with this policy.

15. INVESTMENT STRATEGY

15.1 Prudence will drive the Council's investment strategy in 2019/20 due to the volatility and uncertainty that exists in the world's financial markets. Investments will be of a short term nature. In order to minimise risk, the Council will look to diversify its investment portfolio by investing in other investment vehicles such as money market funds and property funds. The driving force of our strategy will be maintaining the security of capital. The Council will use a combination of credit ratings, sovereign ratings, internal and external due diligence and guarantees to assess the credit quality of financial institutions before placing investments.

16. INTEREST RATE OUTLOOK

16.1 The Bank Rate is forecast to increase steadily but slowly over the next few years to reach 2.00% by quarter on 2022. Bank Rate forecasts for financial year ends (March) are as follows:-

- 2018/19 0.75%
- 2019/20 1.25%
- 2020/21 1.50%
- 2021/22 1.75%

16.2 There are downside risks to these forecasts (i.e. start of increases in Bank Rate occurs sooner) if economic growth weakens. However, should the pace of growth quicken, there could be upside risk.

16.3 The suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year for the next few years are as follows:

- 2018/19 0.75%
- 2019/20 1.00%
- 2020/21 1.50%
- 2021/22 1.75%
- 2022/23 1.75%
- 2023/24 2.00%
- Later years 2.50%

16.4 The overall balance of risks to economic growth in the UK is probably neutral.

16.5 The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

16.6 For 2019/20 the Council will budget for an investment return of 1.00% on investments placed during the financial year.

17. LIQUIDITY OF INVESTMENTS

17.1 The maximum period of investment of treasury balance will be ten years.

17.2 There will be no more than £100m committed for a period over 5 years.

18. POLICY ON THE USE OF EXTERNAL SERVICE PROVIDERS

18.1 The Council uses Link Asset Services (previously named Capita Asset Services) as its external treasury management advisers.

18.2 The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.

18.3 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. The Council tendered for the service in 2015 for a three year period and is currently in the process of preparing a new tender exercise.

19. TREASURY MANAGEMENT SCHEME OF DELEGATION

19.1 The scheme of delegation is in the Council’s Treasury Management Practices statement which will be reported to the Audit and Corporate Governance Committee on an annual basis.

20. MINIMUM REVENUE PROVISION (MRP) STRATEGY

20.1 The Council is required to pay off an element of the accumulated General Fund capital spend (CFR) each year through a revenue charge (MRP). This requirement arises under the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008, which simplifies earlier MRP requirements by placing a duty on the Authority to determine each year an amount of minimum revenue provision, which it considers to be prudent. In order to assist the Council with this determination, guidance for assessing what would represent a prudent provision has been issued under S.21 (1A) of the Local Government Act 2003 (The Guidance). The Council is required to have regard to the Guidance when considering the amount of their annual "prudent" MRP.

20.2 The Council has resolved to have regard to the Guidance when determining the amount of its annual MRP.

20.3 The major proportion of MRP for 2009/10 related to the more historic debt liability that was outstanding at the time the Guidance was adopted. This will be charged over a 50 year period.

20.4 New capital expenditure for each subsequent year will in general be charged in accordance with Option 3 of the Guidance, which recommends that the annual charge should broadly equate to the anticipated life, or period of benefit, which is reflective of the nature of the expenditure. The annual charge will represent an equal annual instalment relative to the assessed life period.

20.5 The determination of which expenditure should be charged under Option 3, and the life periods considered to be applicable to these, will be carried out under delegated powers by the Section 151 Officer.

20.6 The use of this option for certain schemes/expenditures will also result in there being no MRP charge until the year after that in which all expenditures on a scheme, project or other item of capital expenditure have been fully accrued under proper practices, regardless of the extent of such expenditure that has not been accrued at the end of the previous financial year.

20.7 Items of capital expenditure will only be considered to represent separate amounts in cases where two or more major components have substantially different useful economic lives. Assets will not be transferred into the asset register and fixed assets account until complete, in accordance with Accounting Code principles.

20.8 To the extent that expenditure does not create an asset, and is of a type that is subject to estimated life periods that are referred to in the Guidance, these recommended periods will generally be adopted by the Council. However, in the case of long term debtors arising from loans or other types of capital expenditure made by the Council which will be repaid under separate arrangements, there will be no minimum revenue provision made. The Council are satisfied that a prudent provision will be achieved after exclusion of these capital expenditures.

20.9 A similar type of policy will apply in the case of the Golden Square Shopping Centre. However, instead of relying solely upon principal element of repayments to satisfy the MRP liability, the annual MRP charge that will in effect be made will equate to the principal amount that has been assessed by the Council's advisers, Price Waterhouse Coopers, to be included each year within the repayments received by the Authority under the lease. Rather than resulting in a fixed annual MRP charge over the period of the lease, the nominal amount of MRP charge each year will be regarded as met by the element of the lease rental which serves to write down the outstanding long term debtor created as a consequence of the lease having been granted. The deferred capital receipt created under this arrangement will be earmarked on a yearly basis to pay off the debt liability over 200 years and will equate to the MRP charge. This approach mirrors that which is recommended within paragraph 20 of the MRP Guidance with regard to leases where the authority is a lessee.

20.10 Other finance leases and Private Finance Initiative (PFI) assets will have their MRP liability determined according to the life of the financial instrument, which will act as a proxy for asset life. MRP on these instruments will be accounted for with reference to IFRS accounting principles.

20.11 The Council, if it considers it prudent for a particular financial year, will set aside capital receipts to be offset by the matching MRP liability amount.

20.12 For those types of capital expenditure incurred by the Council which are not capable of being related to an individual asset (e.g. capitalising revenue items), 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, and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

20.13 With regard to loans granted by the Council no MRP will be charged on them.
The MRP will be equated to the principal repayment of the individual loans.

20.14 The policy will be reviewed on an annual basis. If it is proposed to vary the terms of the original Policy Statement during any year, a revised statement should be put to members at that time.

20.15 Option 2 & 4 will be used for economic regeneration and investment schemes if thought to be prudent.

20.16 The Council will charge no MRP on its investment in Redwood Bank for a period of 5 years. This is because the Council wants to build up a sustainable profitable bank before taking any dividends per the business case agreed by the Executive Board on 12th January 2017. After year 5 MRP will be charged over 50 years by applying the annuity method. The major reason for forming the bank was for economic regeneration purposes and the

Council sees it as a long term 50+ years investment that all generations of tax payers can benefit from.

20.17 Strategic Asset Investment Programme - The properties in this portfolio are held for investment and economic regeneration purposes and are managed on a fully commercial basis.

20.18 The purchase of these properties will be treated as capital expenditure and will increase the Capital Financing Requirement. The Council is holding these properties solely for investment and economic regeneration purposes and they are leased to business tenants on commercial lease terms. This includes a range from small local growth SME's to global businesses.

20.19 The Council has the ability to sell this asset or a number of varied approaches to an exit strategy that could raise capital – for example joint venture, equity share, partial sale or additional lease. By sale or raising capital through an alternative route, this can be used to repay any outstanding debt liabilities related to the purchase. As such, there is no need to set aside prudent provision to repay the debt liability in the interim period, so there is no MRP application.

20.20 The assets will be reviewed annually and if the asset value significantly decreases, a prudent MRP policy will commence on the amount of the fall in value of the asset.

20.21 The Council's borrowing in the Strategic Asset Investment programme is prudent and within the Council's affordable borrowing limit. The Council's Section 151 Officer is satisfied that the borrowing is prudent and that the risks relating to the repayment of loans or the value of the investment are deemed to be low thus there are no resource implications in following this approach.

ANNEXE A

GLOSSARY OF TERMS

Basis Point (BP)	1/100th of 1%, i.e. 0.01% (or 0.0001 decimal form)
Base Rate	Minimum lending rate of a bank or financial institution in the UK
Benchmark	A measure against which the investment policy or performance of a fund manager can be compared.
Bill of Exchange	A financial instrument financing trade.
Callable Deposit	A deposit placed with a bank or building society at a set rate for a set amount of time. However, the borrower has the right to repay the funds on pre agreed dates, before maturity. This decision is based on how market rates have moved since the deal was agreed. If rates have fallen the likelihood of the deposit being repaid rises, as cheaper money can be found by the borrower.
Cash Fund Management	Fund management is the management of an investment portfolio of cash on behalf of a private client or an institution, the receipts and distribution of dividends and interest, and all other administrative work in connection with the portfolio.
Certificate of Deposit	Evidence of a deposit with a specified bank or building society repayable on a fixed date. They are negotiable instruments and have a secondary market; therefore the holder of a CD is able to sell it to a third party before the maturity of the CD.
Commercial Paper	Short-term obligations with maturities ranging from 2 to 270 days issued by banks, corporations and other borrowers. Such instruments are unsecured and usually discounted, although some may be interest bearing.
Corporate Bond	Strictly speaking, corporate bonds are those issued by companies. However, the term is used to cover all bonds other than those issued by governments in their own currencies and includes issues by companies, supranational organisations and government agencies.
Counterparty	Another (or the other) party to an agreement or other market contract (e.g. lender/borrower/writer of a swap/etc.)
CDS	Credit Default Swap – a swap designed to transfer the credit exposure of fixed income products between parties. The buyer of a credit swap receives credit protection, whereas the seller of the swap guarantees the credit worthiness of the product. By doing this, the risk of default is transferred from the holder of the fixed income security to the seller of the swap.
CFR	Capital Financing Requirement
CIPFA	Chartered Institute of Public Finance and Accountancy
CLG	Department for Communities and Local Government
CPI	Consumer Price Index – calculated by collecting and comparing prices of a set basket of goods and services as bought by a typical consumer, at regular intervals over time. The CPI covers some items that are not in the RPI, such as unit trust and stockbrokers fees, university accommodation fees and foreign students' university tuition fees.
Derivative	A contract whose value is based on the performance of an underlying financial asset, index or other investment, e.g. an option is a derivative

	because its value changes in relation to the performance of an underlying stock.
DMADF	Deposit Account offered by the Debt Management Office, guaranteed by the UK government.
ECB	European Central Bank – sets the central interest rates in the EMU area. The ECB determines the targets itself for its interest rate setting policy; this is to keep inflation within a band of 0 to 2%. It does not accept that monetary policy is to be used to manage fluctuations in unemployment and growth caused by the business cycle.
EMU	European Monetary Union
Equity	A share in a company with limited liability. It generally enables the holder to share in the profitability of the company through dividend payments and capital gain.
EU	European Union
Fed.	Federal Reserve Bank of America – sets the central rates in the USA
Floating Rate Notes	Bonds on which the rate of interest is established periodically with reference to short-term interest rates
Forward Deal	The act of agreeing today to deposit funds with an institution for an agreed time limit, on an agreed future date, at an agreed rate.
Forward Deposits	Same as forward dealing (above).
FSA	Financial Services Authority – body responsible for overseeing financial services.
Fiscal Policy	The Government policy on taxation and welfare payments.
GDP	Gross Domestic Product
GF	General Fund
Gilt	Registered British government securities giving the investor an absolute commitment from the government to honour the debt that those securities represent.
Gilt Funds	Pooled fund investing in bonds guaranteed by the UK government.
Government MMF	MMFs that invest solely in government securities, or reverse repurchase agreements backed by Government Securities.
HM Treasury	Her Majesty's Treasury
HRA	Housing Revenue Account
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
iTraxx	The brand name for the group of credit default swaps index products.
LOBO's	Lenders Option Borrowers Option loans
MHCLG	Ministry of Housing, Communities and Local Government
Money Market Fund	A well rated, highly diversified pooled investment vehicle whose assets mainly comprise of short term instruments. It is very similar to a unit trust, however in a MMF.
Monetary Policy committee (MPC)	Government body that sets the bank rate (commonly referred to as being base rate). Their primary target is to keep inflation within plus or minus 1% of a central target of 2.5% in two year's time from the date of the monthly meeting of the Committee. Their secondary target is to support the Government in maintaining high and stable levels of growth and

	employment.
MRP	Minimum Revenue Provision
MTFP	Medium Term Financial Plan
Open Ended Investment Companies	A diversified pooled investment vehicle, with a single purchase price, rather than a bid/offer spread.
Other Bond Funds	Pooled funds investing in a wide range of bonds.
PFI	Private Finance Initiative
PWLB	Public Works Loan Board
QE	Quantitative Easing
Reverse Gilt Repo	This is a transaction as seen from the point of view of the party which is buying the gilts. In this case, one party buys gilts from the other and, at the same time and as part of the same transaction, commits to resell equivalent gilts on a specified future date, or at call, at a specified price.
Retail Price Index (RPI)	Measurement of the monthly change in the average level of prices at the retail level weighted by the average expenditure pattern of the average person.
RPIX	As RPI but excluding mortgage interest rate movements.
RPIY	As RPI but excluding mortgage interest rate movements and changes in prices caused by changes in taxation.
Sovereign Issues (Ex UK Gilts)	Bonds issued or guaranteed by nation states, but excluding UK government bonds.
Supranational Bonds	Bonds issued by supranational bodies, e.g. European investment bank. These bonds – also known as Multilateral Development Bank bonds – are generally AAA rated and behave similarly to gilts, but pay a higher yield (“spread”) given their relative illiquidity when compared with gilts.
SORP	Statement of Recommended Practice
S151	Section 151 Officer
Term Deposit	A deposit held in a financial institution for a fixed term at a fixed rate.
Treasury Bill	Treasury bills are short term debt instruments issued by the UK or other governments. They provide a return to the investor by virtue of being issued at a discount to their final redemption value.
UBS	Union Bank of Switzerland
US	United States
WARoR	Weighted Average Rate of Return is the average annualised rate of return weighted by the principal amount in each rate.
WAM	Weighted Average Time to Maturity is the average time, in days, till the portfolio matures, weighted by principal amount.
WATT	Weighted Average Total Time is the average time, in days, that deposits are lent out for, weighted by principal amount.
WA Risk	Weighted Average Credit Risk Number. Each institution is assigned a colour corresponding to a suggested duration using Sector’s Suggested Credit Methodology.
Model WARoR	Model Weighted Average Rate of Return is the WARoR that the model produces by taking into account the risks inherent in the portfolio.

PRUDENTIAL INDICATORS

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within defined limits.

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

A Capital Expenditure

The Council has to make a reasonable estimate of the capital expenditure that it plans to incur in the following three years and after the year-end must record the actual capital expenditure incurred in that year.

The Council's capital programme informs the requirements of these indicators. The actual capital expenditure that was incurred by the authority in 2017/18, the revised estimate for the current year and estimates for the future years are as follows:

2017/18 Actual £m	2018/19 Forecast £m	Capital Expenditure	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
8.708	10.662	Families & Wellbeing	14.893	3.954	0.537
3.331	5.991	Corporate Services	5.395	2.120	6.000
43.770	55.398	Economic Regeneration Growth & Environment	51.725	30.890	2.148
298.493	271.759	Invest to Save Programme	328.306	250.349	35.061
354.302	**343.810**	**Total Capital Expenditure**	**400.319**	**287.313**	**43.746**

Other long-term liabilities – The above financing need excludes other long-term liabilities, such as PFI and leasing arrangements that already include borrowing instruments.

The table below summarises the above capital expenditure plans and how these plans are being finance by capital or revenue resources. Any shortfall of resources results in a funding borrowing need:

2017/18 Actual £m	2018/19 Forecast £m	Capital Financing	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
326.082	301.735	Unsupported Borrowing	367.783	274.387	37.134
23.977	23.587	Capital Grants and Reserves	17.545	6.546	0.537
2.916	6.324	Capital Receipts	3.350	2.000	6.000
0	0.726	Revenue Funding	0	0	0
1.327	11.438	External Funding	11.641	4.380	0.075
354.302	**343.810**	**Total Capital Financing**	**400.319**	**287.313**	**43.746**

B Capital financing cost indicators

One of the indicators of affordability is the estimated ratio of the Council's general fund capital financing costs to its net revenue stream in percentage terms. This indicator shows the proportion of the revenue budget spent on capital financing costs; if the ratio is increasing rapidly over time then a larger proportion of revenue resources is being taken up by capital financing costs, which could be used for other elements of the authority's budget.

For 2018/19, net revenue streams are based on the MTFP draft general fund (GF). For future years, the GF net revenue stream is projected in the Council's MTFP.

2017/18 Actual %	2018/19 Forecast %	Ratio of financing costs to net revenue stream	2019/20 Estimate %	2020/21 Estimate %	2021/22 Estimate %
4.3	6.43	Services (i.e. Non-HRA)	17.62	23.96	31.09

C Capital Financing Requirement – the Council's borrowing need

Another prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and so the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life, and so charges the economic consumption of capital assets as they are used.

The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility by the PFI, PPP lease provider and so the Council is not required to separately borrow for these schemes.

2017/18 Actual £m	**2018/19 Forecast £m**	**Capital Financing Requirement (CFR)**	**2019/20 Estimate £m**	**2020/21 Estimate £m**	**2021/22 Estimate £m**
708.945	**999.198**	CFR	**1356.598**	**1621.325**	**1645.929**
Movement in CFR represented by:					
326.082	301.735	Net financing need for the year	367.783	274.387	37.134
(5.024)	(11.483)	Less MRP, other financing movements	(10.381)	(9.660)	(12.530)
321.058	**290.252**	**Movement in CFR**	**357.402**	**264.727**	**24.604**

D Gross Borrowing Requirement

There is a clear linkage between the authority's capital financing requirement indicators and its gross external borrowing. Within the code there is a key indicator of prudence that ensures that, over the medium term, gross borrowing is only for a capital purpose. This can be demonstrated by comparing gross external borrowing shown in the table below to the total CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years. Gross external borrowing should not exceed this limit except in the short term. There is some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Council's treasury portfolio position at 31 March 2018, with forward projections are summarised below. The table shows the actual external debt (the treasury management operation), against the underlying capital borrowing need (the Capital Financing Requirement (CFR)), highlighting any over or under borrowing:

2017/18 Actual £m	**2018/19 Forecast £m**	**Current Portfolio Position**	**2019/20 Estimate £m**	**2020/21 Estimate £m**	**2021/22 Estimate £m**
		External Debt			
400.878	721.042	Debt at 1 April	976.090	1329.617	1559.938
320.164	255.048	Expected change in Debt	353.527	230.321	36.449
721.042	976.090	External Debt at 31 March	1329.617	1559.938	1596.387
4.018	3.900	Other LT Liabilities (OLTL)	3.774	3.639	3.494
0	0	Expected change in OLTL	0	0	0
725.060	979.990	Actual Gross Debt at 31 March	1333.391	1563.577	1599.881
708.945	999.198	Capital Financing Requirement	1356.598	1621.325	1645.929
(16.115)	**19.208**	**Under / (over) borrowing**	**23.207**	**57.748**	**46.048**

The Section 151 Officer reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

E Impact of Capital Investment Decisions on Council Tax

The other indicator of affordability is the estimate of the incremental impact on Council Tax, over and above capital investment decisions that have previously been taken by the Council. This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in this budget report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period. The indicator is intended to show the effect on Council Tax of approving new capital expenditure in the capital programme.

2017/18 Actual £	2018/19 Forecast £	Impact of capital investment decisions for band D Council Tax	2019/20 Estimate £	2020/21 Estimate £	2021/22 Estimate £
8.86	9.20	Unsupported Borrowing	11.63	7.08	0.61

F Authorised Limit for External Debt

A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

The authority has to set an Authorised Limit, which is the statutory maximum borrowing permitted, and an Operational Boundary, which is the normal level of borrowing expected, for external debt. This is a statutory limit determined under section 3(1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.

The Authorised Limits set out below are consistent with the authority's current commitments, existing plans and the proposals set out in this report for the capital expenditure and financing, and with its approved treasury policy statement and practices. They are based on the most likely, prudent, but not worse case scenario, with sufficient headroom over and above this to allow for operational management recognising that during the year it may be necessary to exceed the operational boundary in order to take advantage of interest rate movements or to accommodate unusual cash flow movements.

2017/18 Actual £m	2018/19 Forecast £m	Authorised Limit for External Debt	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
793.146	1073.699	Borrowing	1729.617	1959.938	1996.387
4.018	3.900	Other Long Term Liabilities	3.774	3.639	3.494
797.164	**1077.599**	**Total Authorised Limit**	**1733.391**	**1963.577**	**1999.881**

In agreeing these limits, it should be noted that the Authorised Limit for 2018/19 will be the statutory limit determined under Section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised. This indicator being the maximum limit the Council may borrow at any point in time in the year. If borrowing above this level were needed a report would go to Executive Board for authorisation to increase the limit.

G Operational Boundary for External Debt

The operational boundary is a key management tool for in-year monitoring. Temporary breach of the operational boundary will not in itself be a cause for concern, although a sustained breach might indicate an underlying issue that would need investigation and action.

The Operational Boundaries below are based on the Authorised Limit, estimating the authority's most likely level of borrowing and leasing each year. It includes long term borrowing to fund capital and short term borrowing to meet day to day variations in cash flow but without the additional headroom.

This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

2017/18 Actual £m	2018/19 Forecast £m	Operational Boundary	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
731.042	986.090	Debt	1629.617	1859.938	1896.387
4.018	3.900	Other long term liabilities	3.774	3.639	3.494
735.060	**989.990**	**Total**	**1633.391**	**1863.577**	**1899.881**

Treasury management indicators for debt

There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:

H Maturity structure of debt

It is recommended that the Council sets upper and lower limits for the maturity structure of its debt for the forthcoming year as follows:

Maturity Structure	Lower Limit		Upper Limit	
	Fixed	Variable	Fixed	Variable
Under 12 months	0%	0%	30%	40%
12 months to 2 years	0%	0%	30%	0%
2 years to 5 years	0%	0%	35%	0%
5 years to 10 years	0%	0%	30%	0%
10 years to 20 years	40%	0%	100%	0%
20 years to 30 years	40%	0%	100%	0%
30 years to 40 years	40%	0%	100%	0%
40 years and above	40%	0%	100%	0%

The above percentages are the ranges for the projected borrowing maturing in each year out of the total projected borrowing. The indicator is designed to be a control over the Council having large concentrations of fixed interest rate debt needing to be replaced at any one time and thus being at risk of having to borrow large amounts when interest rates may be unfavourable.

Please note that the maturity structure guidance for lobo loans deems the maturity date to be the next call date which would account for £68.5m and 10.5% of the current loan portfolio. The loans have remained as the expected maturity date, however, these loans could potentially be called by the lender within the next six month period but they are unlikely to do so due to the current low interest rate environment.

I Fixed interest rate exposure

The table below shows the Council's upper limit for fixed interest rate exposure for the next three years. This indicator shows the percentage of borrowing that can be undertaken at fixed interest rates. Up to 100% of borrowing can be at fixed interest rates. Again, this indicator is set at levels to reduce the risk from interest rate movements.

Upper Limit – Fixed Interest Rate Exposure	2019/20 %	2020/21 %	2021/22 %
Fixed Interest Rates	100	100	100

J Variable interest rate exposure

The following indicator shows the percentage of borrowing that can be undertaken at variable interest rates. The purpose of the indicator is to restrict variable rate borrowing in order to reduce the risk from sudden movements in interest rates. The Council sets its upper limit for borrowing, reflecting variable interest rates less investments that are variable rate investments at 40%.

Upper Limit – Variable Interest Rate Exposure	**2019/20 %**	**2020/21 %**	**2021/22 %**
Variable Interest Rates	40	40	40

K Investment periods

It is recommended that the Council sets a limit on the amount invested for periods longer than one year of **£100m** in total for 2019/20, with the maximum period for any one investment being ten years. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment and are based on the availability of funds after each year-end.

Upper Limit for Total Principal Sums Invested for over 365 days	**2019/20 Estimate £m**	**2020/21 Estimate £m**	**2021/22 Estimate £m**
Investment	100.000	100.000	100.000