

TREASURY MANAGEMENT STRATEGY STATEMENT 2018/19

1. Introduction

In January 2010 the Council adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes 2011 Edition* (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year.

During December 2017, CIPFA released a refreshed version of their publication *Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes 2017 Edition*. This Treasury Management Strategy Statement complies with this new guidance.

In addition, the Department for Communities and Local Government (CLG) issued revised *Guidance on Local Council Investments* in March 2010 that requires the Council to approve an investment strategy before the start of each financial year.

This report fulfils the Council's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the CLG Guidance.

The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Council's treasury management strategy.

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

**Reporting requirements:** The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

**Prudential and treasury indicators and treasury strategy** (this report) - The first, and most important report covers:

- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

**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.

**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.

**Investment 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. The following training has been undertaken by members: A Senior Advisor from Arlingclose, the Councils Treasury Advisors, attended the Audit and Accounts Committee in November 2017, and further training will be arranged as required.

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

**Investment advisers:** The Council has appointed Arlingclose Limited as treasury management advisers who provide specific advice on investment, debt and capital finance issues.

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 advisers.

The Council 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.

## 2. External Context

**Economic background:** The major external influence on the Council's treasury management strategy for 2018/19 will be the UK's progress in negotiating its exit from the European Union and agreeing future trading arrangements. The domestic economy has remained relatively robust since the surprise outcome of the 2016 referendum, but there are indications that uncertainty over the future is now weighing on growth. Transitional arrangements may prevent a cliff-edge, but will also extend the period of uncertainty for several years. Economic growth is therefore forecast to remain sluggish throughout 2018/19.

Consumer price inflation reached 3.0% in September 2017 as the post-referendum devaluation of sterling continued to feed through to imports. However, this effect is expected to fall out of year-on-year inflation measures during 2018, removing pressure on the Bank of England to raise interest rates.

In contrast, the US economy is performing well and the Federal Reserve is raising interest rates in regular steps to remove some of the emergency monetary stimulus it has provided for the past decade. The European Central Bank is yet to raise rates, but has started to taper its quantitative easing programme, signalling some confidence in the Eurozone economy.

**Credit outlook:** High profile bank failures in Italy and Portugal have reinforced concerns over the health of the European banking sector. Sluggish economies and fines for pre-crisis behaviour continue to weigh on bank profits, and any future economic slowdown will exacerbate concerns in this regard.

Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the European Union, Switzerland and USA, while Australia and Canada are progressing with their own plans. In addition, the largest UK banks will ringfence their retail banking functions into separate legal entities during 2018. There remains some uncertainty over how these changes will impact upon the credit strength of the residual legal entities.

The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Council; returns from cash deposits however remain very low.

**Interest rate forecast:** The Council's treasury adviser Arlingclose's central case is for UK Bank Rate to remain at 0.25% during 2018/19. Two of the nine-member Monetary Policy Committee voted for an increase to 0.50% in September, and the decision was said to be finely balanced for others, although all agreed that any increases would be limited and gradual. But stilted progress in the EU exit negotiations, softening consumer spending and a tightening of consumer credit are expected to stay the Committee's hands. The risk of a cut to zero or negative rates has diminished and there is now a chance that rates will rise despite the economic fundamentals.

Longer-term interest rates have risen in the past year, reflecting the possibility of increasing short-term rates. Arlingclose forecasts these to remain broadly constant during 2018/19, but with some volatility as interest rate expectations wax and wane with press reports on the progress of EU exit negotiations.

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

For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 1.5%, and that new long-term loans will be borrowed at an average rate of 3.5%.

### 3. Local Context

On 31st December 2017, the Council held £87m of borrowing (Housing Revenue Account) and £36m of investments. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance sheet summary and forecast

|                                       | <b>31.3.17<br/>Actual<br/>£'000</b> | <b>31.3.18<br/>Estimate<br/>£'000</b> | <b>31.3.19<br/>Forecast<br/>£'000</b> | <b>31.3.20<br/>Forecast<br/>£'000</b> | <b>31.3.21<br/>Forecast<br/>£'000</b> |
|---------------------------------------|-------------------------------------|---------------------------------------|---------------------------------------|---------------------------------------|---------------------------------------|
| General Fund CFR                      | 21,057                              | 23,458                                | 24,545                                | 25,101                                | 25,616                                |
| HRA CFR                               | 93,432                              | 104,012                               | 104,010                               | 105,022                               | 102,745                               |
| <b>Total CFR</b>                      | <b>114,489</b>                      | <b>127,470</b>                        | <b>128,555</b>                        | <b>130,123</b>                        | <b>128,361</b>                        |
| Less: Other debt liabilities          | -224                                | -224                                  | -224                                  | -224                                  | -224                                  |
| <b>Borrowing CFR</b>                  | <b>114,265</b>                      | <b>127,246</b>                        | <b>128,331</b>                        | <b>129,899</b>                        | <b>128,137</b>                        |
| Less: External borrowing              | -87,123                             | -97,113                               | -96,091                               | -94,068                               | -94,043                               |
| <b>Internal (over) borrowing</b>      | <b>27,142</b>                       | <b>30,133</b>                         | <b>32,240</b>                         | <b>35,831</b>                         | <b>34,094</b>                         |
| Less: Usable reserves                 | -43,337                             | -34,760                               | -31,316                               | -28,000                               | -28,000                               |
| Less: Working capital                 | -5,709                              | -3,000                                | -3,000                                | -3,000                                | -3,000                                |
| <b>Investments (or New borrowing)</b> | <b>21,904</b>                       | <b>7,627</b>                          | <b>2,076</b>                          | <b>-4,831</b>                         | <b>-3,094</b>                         |

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

The Council has an increasing CFR due to the capital programme, but a relatively small level of investments and will assess the capital financing need to borrow, taking into account the ability for internal borrowing.

CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Council expects to comply with this recommendation during 2018/19.

#### 4. Borrowing Strategy

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.

**Objectives:** The Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

#### **Current Borrowing portfolio position**

The Council's treasury portfolio position at 31 March 2017, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

|                                          | <b>2016/17<br/>Actual<br/>£'000</b> | <b>2017/18<br/>Estimate<br/>£'000</b> | <b>2018/19<br/>Estimate<br/>£'000</b> | <b>2019/20<br/>Estimate<br/>£'000</b> | <b>2020/21<br/>Estimate<br/>£'000</b> |
|------------------------------------------|-------------------------------------|---------------------------------------|---------------------------------------|---------------------------------------|---------------------------------------|
| <b>External Debt</b>                     |                                     |                                       |                                       |                                       |                                       |
| Debt at 1 April                          | 87,917                              | 87,123                                | 97,113                                | 96,091                                | 94,068                                |
| Expected change in Debt                  | -1,018                              | 9,766                                 | -1,246                                | -2,247                                | -249                                  |
| Other long-term liabilities (OLTL)       | 224                                 | 224                                   | 224                                   | 224                                   | 224                                   |
| Expected change in OLTL                  | 0                                   | 0                                     | 0                                     | 0                                     | 0                                     |
| <b>Actual gross debt at 31 March</b>     | <b>87,123</b>                       | <b>97,113</b>                         | <b>96,091</b>                         | <b>94,068</b>                         | <b>94,043</b>                         |
| <b>The Capital Financing Requirement</b> | <b>114,265</b>                      | <b>127,246</b>                        | <b>128,331</b>                        | <b>129,899</b>                        | <b>128,137</b>                        |
| <b>Under / (over) borrowing</b>          | <b>27,142</b>                       | <b>30,133</b>                         | <b>32,240</b>                         | <b>35,831</b>                         | <b>34,094</b>                         |

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2018/19 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

## Treasury Indicators: limits to borrowing activity

**Operational Boundary for External Debt:** The operational boundary is based on the Authority's estimate of most likely (i.e. prudent but not worst case) scenario for external debt. It links directly to the Authority's estimates of capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring. Other long-term liabilities comprise finance lease, Private Finance Initiative and other liabilities that are not borrowing but form part of the Authority's debt.

| <b>Operational Boundary</b> | <b>2017/18<br/>Revised<br/>£'000</b> | <b>2018/19<br/>Estimate<br/>£'000</b> | <b>2019/20<br/>Estimate<br/>£'000</b> | <b>2020/21<br/>Estimate<br/>£'000</b> |
|-----------------------------|--------------------------------------|---------------------------------------|---------------------------------------|---------------------------------------|
| Borrowing                   | 127,251                              | 128,336                               | 129,904                               | 128,142                               |
| Other long-term liabilities | 400                                  | 400                                   | 400                                   | 400                                   |
| <b>Total Debt</b>           | <b>127,651</b>                       | <b>128,736</b>                        | <b>130,304</b>                        | <b>128,542</b>                        |

**Authorised Limit for External Debt:** The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Authority can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

| <b>Authorised Limit</b>     | <b>2017/18<br/>Limit<br/>£'000</b> | <b>2018/19<br/>Limit<br/>£'000</b> | <b>2019/20<br/>Limit<br/>£'000</b> | <b>2020/21<br/>Limit<br/>£'000</b> |
|-----------------------------|------------------------------------|------------------------------------|------------------------------------|------------------------------------|
| Borrowing                   | 127,256                            | 128,341                            | 129,909                            | 128,147                            |
| Other long-term liabilities | 600                                | 600                                | 600                                | 600                                |
| <b>Total Debt</b>           | <b>127,856</b>                     | <b>128,941</b>                     | <b>130,509</b>                     | <b>128,747</b>                     |

Separately, the Council is also limited to a maximum HRA CFR through the HRA self-financing regime. This limit is currently:

| <b>HRA Debt Limit</b> | <b>2017/18<br/>Estimate<br/>£'000</b> | <b>2018/19<br/>Estimate<br/>£'000</b> | <b>2019/20<br/>Estimate<br/>£'000</b> | <b>2020/21<br/>Estimate<br/>£'000</b> |
|-----------------------|---------------------------------------|---------------------------------------|---------------------------------------|---------------------------------------|
| HRA Debt Cap          | 112,475                               | 112,475                               | 112,475                               | 112,475                               |
| HRA CFR               | 104,012                               | 104,010                               | 105,022                               | 102,745                               |
| <b>HRA Headroom</b>   | <b>8,463</b>                          | <b>8,465</b>                          | <b>7,453</b>                          | <b>9,730</b>                          |

**Maturity structure of borrowing:** This indicator is set to control the Council’s exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed and variable rate borrowing will be:

|                                | <b>Upper</b> | <b>Lower</b> |
|--------------------------------|--------------|--------------|
| Under 12 months                | 15%          | 0%           |
| 12 months and within 24 months | 15%          | 0%           |
| 24 months and within 5 years   | 30%          | 0%           |
| 5 years and within 10 years    | 100%         | 0%           |
| 10 years and above             | 100%         | 0%           |

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

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

By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal or short term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Council with this ‘cost of carry’ and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2018/19 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

Alternatively, the Council may arrange forward starting loans during 2018/19, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

In addition, the Council may borrow (normally for up to one month) short-term loans to cover unplanned cash flow shortages.

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

- Public Works Loan Board (PWLB) and any successor body
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds
- Capital market bond investors

- UK Municipal Bonds Agency plc and other special purpose companies created to enable local Council bond issues
- Local Authorities

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

- operating and finance leases
- hire purchase
- Private Finance Initiative
- sale and leaseback

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

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

**LOBOs:** The Council holds £3.5m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. None of these LOBOS have options during 2018/19.

**Short-term and variable rate loans:** These loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators below.

**Debt rescheduling:** The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

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

The total amount borrowed will not exceed the authorised borrowing limit of £124 million. The maximum period between borrowing and expenditure is expected to be two years, although the Council is not required to link particular loans with particular items of expenditure.

**Policy on internal borrowing interest to the HRA:** On 1st April 2012, the Council notionally split each of its existing long-term loans into General Fund and HRA pools. In the future, new long-term loans borrowed will be assigned in their entirety to one pool or the other.

Interest payable and other costs/income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged/ credited to the respective revenue account. Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (capital financing requirement) will result in an internal borrowing situation. The internal borrowing on the HRA will be charged on the CPI inflation rate for February for the relevant financial year with the credit going to the General Fund balance.

## 5. Investment Strategy

The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council's investment balance has ranged between £11 million and £36 million. Levels available for investment are affected by capital expenditure and use of reserves, both will continue to be monitored throughout the financial year.

**Objectives:** Both the CIPFA Code and the CLG Guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

**Negative interest rates:** If the UK enters into a recession in 2018/19, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

**Strategy:** Given the increasing risk and very low returns from short-term unsecured bank investments, the Council will consider diversifying into more secure and/or higher yielding asset classes during 2018/19. This is especially the case for the estimated £20m that is available for longer-term investment. The majority of the Council's surplus cash remains invested in short-term unsecured bank deposits and money market funds. This diversification will represent a substantial change in strategy over the coming year, in line with the Council's approved Investment Plan and Commercialisation Strategy.

**Approved counterparties:** The Council may invest its surplus funds with any of the counterparty types in table 2 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 2: Approved investment counterparties and limits

| Credit rating | Banks unsecured | Banks secured    | Government              | Corporates      | Registered Providers |
|---------------|-----------------|------------------|-------------------------|-----------------|----------------------|
| UK Govt       | n/a             | n/a              | £ Unlimited<br>20 years | n/a             | n/a                  |
| AAA           | £5m<br>3 years  | £10m<br>10 years | £10m<br>20 years        | £5m<br>10 years | £5m<br>10 years      |
| AA+           | £5m<br>2 years  | £10m<br>4 years  | £10m<br>5 years         | £5m<br>4 years  | £5m<br>4 years       |
| AA            | £5m<br>1 year   | £10m<br>2 years  | £10m<br>3 years         | £5m<br>2 years  | £5m<br>4 years       |
| AA-           | £5m<br>1 year   | £10m<br>2 years  |                         |                 | £5m<br>4 years       |
| A+            | £5m<br>6 months | £10m<br>1 year   |                         |                 | £5m<br>2 years       |

|              |                 |                  |  |  |                |
|--------------|-----------------|------------------|--|--|----------------|
| A            | £5m<br>6 months | £10m<br>1 year   |  |  | £5m<br>2 years |
| A-           | £5m<br>3 months | £10m<br>6 months |  |  | £5m<br>2 years |
| None         |                 | n/a              |  |  | £5m<br>2 years |
| Pooled funds | £10m per fund   |                  |  |  |                |

This table must be read in conjunction with the notes below

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

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

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

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

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

**Registered providers:** Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing, formerly known as housing associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services, they retain the likelihood of receiving government support if needed.

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

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

**Operational bank accounts:** The Council will incur operational exposures through their current accounts, with Lloyds Bank. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £500,000 net in the bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.

**Country and sector limits:** Due care will be taken to consider the country, group and sector exposure of the Council's investments.

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA (excluding UK) from Fitch (or equivalent). This list will be added to, or deducted from by officers should ratings change in accordance with this policy.

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

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

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

**Other information on the security of investments:** The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality

financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

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

**Specified investments:** The CLG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
  - the UK Government,
  - a UK local Council, parish council or community council, or
  - a body or investment scheme of "high credit quality".

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

**Non-specified investments:** Any investment not meeting the definition of a specified investment is classed as non-specified. The Council does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement, and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown in table 3 below.

Table 3: Non-specified investment limits

|                                 | <b>Cash limit</b> |
|---------------------------------|-------------------|
| Total non-specified investments | £20m              |

**Liquidity management:** The Council maintains a daily cash flow forecast to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium term financial plan and cash flow forecast.

**Policy on internal investment interest to the HRA:** On 1st April 2012, the Council notionally split each of its existing long-term loans into General Fund and HRA pools. Interest receivable for HRA balance sheet resources available for investment will result in a notional cash balance. This balance will be measured at the end of the financial year and interest transferred from the General Fund to the HRA at the average investment rate for a DMO investment for the financial year due to the General Fund carrying all the credit risk per investment.

### **Non-Treasury Investments**

Although not classed as treasury management activities and therefore not covered by the CIPFA Code or the CLG Guidance, the Council may also purchase property for investment purposes and may also make loans and investments for service purposes, for example in shared ownership housing, as loans to local businesses and landlords, or as equity investments and loans to the Council's subsidiaries.

Such loans and investments will be subject to the Council's normal approval processes for revenue and capital expenditure and need not comply with this treasury management strategy.

### **Treasury Indicators: limits to investing activity**

**Interest rate exposures:** This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the amount of net principal borrowed will be:

|                                                  | <b>2018/19</b> | <b>2019/20</b> | <b>2020/21</b> |
|--------------------------------------------------|----------------|----------------|----------------|
|                                                  | <b>£m</b>      | <b>£m</b>      | <b>£m</b>      |
| <b><u>Fixed Rate</u></b>                         |                |                |                |
| Borrowing                                        | 124.2          | 124.2          | 124.2          |
| Investments                                      | -5             | -5             | -5             |
| <b>Net Upper limit on fixed rate exposure</b>    | <b>119.2</b>   | <b>119.2</b>   | <b>119.2</b>   |
| <b><u>Variable Rate</u></b>                      |                |                |                |
| Borrowing                                        | 31             | 31             | 31             |
| Investments                                      | -37.3          | -37.3          | -37.3          |
| <b>Net Upper limit on variable rate exposure</b> | <b>-6.3</b>    | <b>-6.3</b>    | <b>-6.3</b>    |

Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate.

**Principal sums invested for periods longer than 365 days:** The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

|                                             | <b>2018/19</b> | <b>2019/20</b> | <b>2020/21</b> |
|---------------------------------------------|----------------|----------------|----------------|
| Limit on principal invested beyond year end | £20m           | £20m           | £20m           |

## 6. Arlingclose Economic & Interest Rate Forecast January 2018

### Underlying assumptions:

- The MPC increased Bank Rate in November 2017 to 0.5%. The rise was questionable based on the available economic data. Market rate expectations are broadly unchanged since the rise and policy makers continue to emphasise that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.
- Further potential movement in Bank Rate is reliant on economic data and the likely outcome of the EU negotiations. Policymakers have revised lower the supply capacity of the UK economy, suggesting inflationary growth is more likely. However, the MPC will be wary of raising rates much further amid low business and household confidence.
- The UK economy faces a challenging outlook as the minority government continues to negotiate the country's exit from the European Union. While recent economic data has improved, it has done so from a low base: UK Q3 2017 GDP growth was 0.4%, after a 0.3% expansion in Q2. Forecasts for future GDP growth have generally been revised downwards.
- Household consumption growth, the driver of recent UK GDP growth, has softened following a contraction in real wages, despite both saving rates and consumer credit volumes indicating that some households continue to spend in the absence of wage growth. Policymakers have expressed concern about the continued expansion of consumer credit; any action taken will further dampen household spending.
- More recent labour market data suggested that employment has plateaued, although house prices (outside London) appear to be relatively resilient. However, both of these factors can also be seen in a negative light, displaying the structural lack of investment in the UK economy post financial crisis.
- The depreciation in sterling may assist the economy to rebalance away from spending. Export volumes will increase, helped by a stronger global and Eurozone economic expansions.
- Near-term global growth prospects have continued to improve and broaden, and expectations of inflation are subdued. Central banks are moving to reduce the level of monetary stimulus.

### Forecast:

- The MPC increased Bank Rate largely to meet expectations they themselves created. Expectations for higher short term interest rates are relatively subdued. On-going decisions remain data dependant and negotiations on exiting the EU cast a shadow over monetary policy decisions.
- Our central case for Bank Rate is 0.5% over the medium term. The risks to the forecast are broadly balanced on both sides.
- The Arling close central case is for gilt yields to remain broadly stable across the medium term. Upward movement will be limited, although the UK government's seemingly deteriorating fiscal stance is an upside risk.



|                           | Mar-18 | Jun-18 | Sep-18 | Dec-18 | Mar-19 | Jun-19 | Sep-19 | Dec-19 | Mar-20 | Jun-20 | Sep-20 | Dec-20 | Mar-21 | Average |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------|
| <b>Official Bank Rate</b> |        |        |        |        |        |        |        |        |        |        |        |        |        |         |
| Upside risk               | 0.00   | 0.00   | 0.25   | 0.25   | 0.25   | 0.25   | 0.25   | 0.25   | 0.25   | 0.25   | 0.25   | 0.25   | 0.25   | 0.21    |
| Arlingclose Central Case  | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50    |
| Downside risk             | 0.00   | 0.00   | 0.00   | 0.00   | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.17   |
| <b>3-month LIBID rate</b> |        |        |        |        |        |        |        |        |        |        |        |        |        |         |
| Upside risk               | 0.10   | 0.10   | 0.25   | 0.25   | 0.25   | 0.25   | 0.25   | 0.25   | 0.25   | 0.25   | 0.25   | 0.25   | 0.25   | 0.23    |
| Arlingclose Central Case  | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50    |
| Downside risk             | -0.10  | -0.15  | -0.15  | -0.15  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.22   |
| <b>1-yr LIBID rate</b>    |        |        |        |        |        |        |        |        |        |        |        |        |        |         |
| Upside risk               | 0.15   | 0.20   | 0.30   | 0.30   | 0.30   | 0.30   | 0.30   | 0.30   | 0.30   | 0.30   | 0.30   | 0.30   | 0.30   | 0.28    |
| Arlingclose Central Case  | 0.70   | 0.70   | 0.70   | 0.80   | 0.80   | 0.80   | 0.80   | 0.80   | 0.80   | 0.80   | 0.80   | 0.80   | 0.80   | 0.78    |
| Downside risk             | -0.20  | -0.30  | -0.30  | -0.30  | -0.30  | -0.30  | -0.30  | -0.30  | -0.30  | -0.30  | -0.30  | -0.15  | -0.15  | -0.26   |
| <b>5-yr gilt yield</b>    |        |        |        |        |        |        |        |        |        |        |        |        |        |         |
| Upside risk               | 0.25   | 0.25   | 0.25   | 0.30   | 0.35   | 0.35   | 0.35   | 0.35   | 0.35   | 0.35   | 0.35   | 0.40   | 0.40   | 0.33    |
| Arlingclose Central Case  | 0.75   | 0.80   | 0.80   | 0.80   | 0.85   | 0.90   | 0.90   | 0.95   | 0.95   | 1.00   | 1.05   | 1.10   | 1.15   | 0.92    |
| Downside risk             | -0.20  | -0.25  | -0.25  | -0.25  | -0.35  | -0.40  | -0.40  | -0.40  | -0.40  | -0.40  | -0.40  | -0.40  | -0.40  | -0.35   |
| <b>10-yr gilt yield</b>   |        |        |        |        |        |        |        |        |        |        |        |        |        |         |
| Upside risk               | 0.25   | 0.25   | 0.25   | 0.30   | 0.35   | 0.35   | 0.35   | 0.35   | 0.35   | 0.35   | 0.35   | 0.40   | 0.40   | 0.33    |
| Arlingclose Central Case  | 1.25   | 1.25   | 1.25   | 1.25   | 1.30   | 1.30   | 1.35   | 1.40   | 1.45   | 1.50   | 1.55   | 1.55   | 1.60   | 1.38    |
| Downside risk             | -0.25  | -0.25  | -0.25  | -0.25  | -0.30  | -0.35  | -0.40  | -0.40  | -0.40  | -0.40  | -0.40  | -0.40  | -0.40  | -0.34   |
| <b>20-yr gilt yield</b>   |        |        |        |        |        |        |        |        |        |        |        |        |        |         |
| Upside risk               | 0.25   | 0.25   | 0.25   | 0.30   | 0.35   | 0.35   | 0.35   | 0.35   | 0.35   | 0.35   | 0.35   | 0.40   | 0.40   | 0.33    |
| Arlingclose Central Case  | 1.85   | 1.85   | 1.85   | 1.85   | 1.90   | 1.90   | 1.95   | 1.95   | 2.00   | 2.05   | 2.05   | 2.05   | 2.10   | 1.95    |
| Downside risk             | -0.30  | -0.25  | -0.25  | -0.30  | -0.35  | -0.40  | -0.45  | -0.50  | -0.50  | -0.50  | -0.50  | -0.50  | -0.50  | -0.41   |
| <b>50-yr gilt yield</b>   |        |        |        |        |        |        |        |        |        |        |        |        |        |         |
| Upside risk               | 0.25   | 0.25   | 0.25   | 0.30   | 0.35   | 0.35   | 0.35   | 0.35   | 0.35   | 0.35   | 0.35   | 0.40   | 0.40   | 0.33    |
| Arlingclose Central Case  | 1.70   | 1.70   | 1.70   | 1.70   | 1.75   | 1.80   | 1.85   | 1.90   | 1.95   | 1.95   | 1.95   | 1.95   | 2.00   | 1.84    |
| Downside risk             | -0.30  | -0.25  | -0.25  | -0.30  | -0.35  | -0.40  | -0.45  | -0.50  | -0.50  | -0.50  | -0.50  | -0.50  | -0.50  | -0.41   |



## **7. Treasury Management Scheme of Delegation**

### **(i) Full Council**

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.
- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;

### **(ii) Audit and Accounts Committee**

- reviewing the treasury management policy and procedures and making recommendations to the responsible body;
- receiving and reviewing regular monitoring reports and acting on recommendations; and
- approving the selection of external service providers and agreeing terms of appointment.

## **8. The Treasury Management Role of the Section 151 Officer**

### **The S151 (responsible) officer**

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