

**TREASURY MANAGEMENT STRATEGY STATEMENT -  
MINIMUM REVENUE PROVISION POLICY STATEMENT and  
ANNUAL INVESTMENT STRATEGY 2018/19**

**1.0 INTRODUCTION:**

**1.1 Background**

1.1.1 The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. The first 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 low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

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

1.1.3 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. ”

**1.2 Reporting Requirements**

1.2.1 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. In addition quarterly review reports provide a regular update to Cabinet.

**Prudential and Treasury Indicators and Treasury Strategy (this report)**

1.2.2 The first, and most important report covers:

- the capital plans (including prudential indicators);
- a Minimum Revenue Provision (MRP) Policy (how residual capital expenditure is charged to revenue over time);
- the Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

**A Mid Year Treasury Management Report**

1.2.3 This will update Members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy is meeting the strategy or whether any policies require revision. In addition, this Council will receive quarterly update reports.

## **An Annual Treasury Report**

- 1.2.4 This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

### **Scrutiny**

- 1.2.5 The above reports are required to be adequately scrutinised by Members before being recommended to the Council. This role is undertaken by Cabinet, in addition to this scrutiny role, Audit, Governance and Standards Committee also scrutineers this report.

## **1.3 Treasury Management Strategy for 2018/19**

- 1.3.1 The strategy for 2018/19 covers two main areas:

### **(a) Capital Issues**

- the capital plans and the prudential indicators
- the Minimum Revenue Provision (MRP) policy

### **(b) Treasury Management Issues**

- the current treasury position
- treasury indicators which will 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
- the investment strategy
- credit worthiness policy
- policy on use of external service providers
- Member training

- 1.3.2 These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, the CIPFA Treasury Management Code and the Department for Communities and Local Government Minimum Revenue Provision Guidance and Department for Communities and Local Government Investment guidance.

## **1.4 REVISED CIPFA TREASURY MANAGEMENT AND PRUDENTIAL CODES 2017 AND OUTSTANDING CONSULTATION EXERCISES**

- 1.4.1 At this stage it should be noted that in December 2017, CIPFA issued a revised Treasury Management Code of Practice and a revised Prudential Code. These revisions have particularly focused on non-treasury investments and especially on the purchase of property with a view to generating income. Such purchases could involve undertaking external borrowing to raise the cash to finance these purchases, or the use of existing cash balances. Both actions would affect treasury management.

- 1.4.2 Consequently the specific roles of the chief financial officer - Director of Finance (S151 Officer) at this Council - have been extended, in accordance with the revised Codes, to include a series of new roles in respect of investment in non-treasury investments (non-financial assets) and also the new requirement to provide a capital strategy. Further detail is attached at Annex E.

- 1.4.3 In addition, the revised Codes have clarified a clear separation between treasury and non-treasury investments and also on the role of the treasury management team. Therefore, the Treasury Management Strategy Statement will focus solely on treasury, (financial), investments and will not include any level of detail on non-treasury investments as there is no specific requirement in the Codes to include such material.
- 1.4.4 CIPFA has issued a statement that accepts that the issue of revised codes at this late stage in the current 2018-19 budget cycle will make it very difficult for most authorities to fully implement both codes. Accordingly, full implementation is not expected until 2019-20 across all authorities. Therefore, at this Council in due course, further information will be provided to Members during 2018/19 on non-treasury investments to deal with significant purchases, their objectives, how they have been appraised, how they have been financed, and what powers were used to undertake these purchases, as well as the capital strategy.
- 1.4.5 From 2019-20, all local authorities are required to prepare an additional report - a Capital Strategy report - which is intended to 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
- 1.4.6 The aim of this report is to ensure that all elected members on the full council fully understand the overall strategy, governance procedures and risk appetite entailed by this Strategy and have sufficient detail to allow all members to understand how stewardship, value for money, prudence, sustainability and affordability will be secured.

## **2.0 THE CAPITAL PRUDENTIAL INDICATORS 2018/19 – 2020/21:**

- 2.1 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 their understanding of the Capital Programme.

### **Capital Expenditure**

- 2.2 This prudential Indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts.

<b>Capital Expenditure</b>	<b>2016/17 Actual</b>	<b>2017/18 Estimate</b>	<b>2018/19 Estimate</b>	<b>2019/20 Estimate</b>	<b>2020/21 Estimate</b>
Total	18,951,104	6,087,595	12,998,530	1,383,840	1,395,000

- 2.3 Other long term liabilities. The above financing need excludes other long term liabilities, such as Private Finance Initiatives and leasing arrangements which already include borrowing instruments. The Council has no Private Finance Initiatives or leases.

- 2.4 The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need. In 2018/19, borrowing may occur to support the Capital programme, mainly due to the loan to the local Housing Association.

<b>Capital Expenditure £</b>	<b>2016/17 Actual</b>	<b>2017/18 Estimate</b>	<b>2018/19 Estimate</b>	<b>2019/20 Estimate</b>	<b>2020/21 Estimate</b>
Total	18,951,104	6,087,595	12,998,530	1,383,840	1,395,000
<b>Financed by:</b>					
Capital receipts	1,235,802	2,833,010	1,370,824	358,882	366,549
Capital grants	274,406	847,606	2,008,070	400,000	400,000
Capital reserves	1,173,636	1,306,979	639,850	541,840	548,000
Revenue	67,260	0	79,786	83,118	80,451
<b>Net financing need for the year</b>	<b>16,200,000</b>	<b>1,100,000</b>	<b>8,900,000</b>	<b>0</b>	<b>0</b>

### **The Council's Borrowing Need (the Capital Financing Requirement)**

- 2.5 The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply 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 its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.
- 2.6 The CFR does not increase indefinitely as the Minimum Revenue Provision (MRP) is a statutory annual revenue charge which broadly reduces the indebtedness in line with each assets life, and so charges the economic consumption of capital assets as they are used.
- 2.7 For the past few years, the CFR has remained at zero as the Council has been debt free and has had no underlying borrowing requirement. In 2016/17, due to the capital expenditure with regards to the loan to the local Housing Association and the loan to the Business Improvement District, the CFR is required as this is a prudent approach to the need to borrow. This also provides the Council with the flexibility to use borrowing to support the capital programme if it chooses to do so but still allows the use of surplus funds. If external borrowing is taken, consideration is given to the Treasury Management environment to ensure that the best option is achieved in relation to interest rates in the short and long term.
- 2.8 The CFR includes any other long term liabilities (e.g. Private Finance Initiative schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has no such Private Finance Initiative schemes or Finance Leases.

2.9 The Council is asked to approve the CFR projections below:-

	2016/17 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
<b>Capital Financing Requirement</b>					
<b>Capital Financing Requirement</b>	<b>26,200,000</b>	<b>27,300,000</b>	<b>36,200,000</b>	<b>36,200,000</b>	<b>36,200,000</b>
<b>Movement in the Capital Financing Requirement</b>	<b>16,200,000</b>	<b>1,100,000</b>	<b>8,900,000</b>	<b>0</b>	<b>0</b>
<b>Movement in Capital Financing Requirement represented by</b>					
Net financing need for the year (above)	<b>16,200,000</b>	<b>1,100,000</b>	<b>8,900,000</b>	<b>0</b>	<b>0</b>
Less Minimum Revenue Provision and other financing movements	0	0	0	0	0
<b>Movement in the Capital Financing Requirement</b>	<b>16,200,000</b>	<b>1,100,000</b>	<b>8,900,000</b>	<b>0</b>	<b>0</b>

#### **Minimum Revenue provision (MRP) Policy Statement**

- 2.10 It is a statutory requirement that the Council reports on the Minimum Revenue Position and explains this policy. The Minimum Revenue Provision Policy describes that the Council is required to pay off an element of the accumulated General Fund capital spend each year (the Capital Financing Requirement) through a revenue charge known as the Minimum Revenue Provision – MRP. The Council is also allowed to undertake additional voluntary payments if required. This is known as the Voluntary Revenue Provision - VRP.
- 2.11 This Council in 2018/19 will have a Capital Financing Requirement of £36,200,000 to support the total capital programme, however borrowing is only likely to occur where insufficient surplus funds are available.
- 2.12 Communities of Local Government (CLG) Regulations have been issued which require the Full Council to approve a Minimum Revenue Provision (MRP) Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following Minimum Revenue Provision Statement:
- 2.13 For capital expenditure incurred before 1 April 2008, or which in the future will be Supported Capital Expenditure, the Minimum Revenue Provision policy will be:
- **Based on Capital Financing Requirement** – Minimum Revenue Provision will be based on the Capital Financing Requirement. This option provides for an approximate 4% reduction in the borrowing need (Capital Financing Requirement) each year.

- 2.14 From 1 April 2008 for all unsupported borrowing (including Private Finance Initiative and finance leases) the Minimum Revenue Provision policy will be:
- **Asset Life Method** – Minimum Revenue Provision will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction). This option provides for a reduction in the borrowing need over approximately the asset's life.
- 2.15 Repayments included in annual Private Finance Initiative scheme or finance leases are applied as Minimum Revenue Provision (MRP), though this Council does not expect to have these repayments in 2018/19 or in the foreseeable future.
- 2.16 The Capital Financing Requirement for the loan to the local Housing Association will be a maximum of £35,000,000 in 2018/19 and future years. The agreement with the local Housing Association states they will make bullet repayments to the Council at years 5, 10, 15, 20 and 25. The bullet repayments made throughout the life of the loan will be set aside by the Council when received to ensure that prudent provision is made for regular repayment. These regular bullet points will be earmarked and used as the Minimum Revenue Provision that the Council needs to make on a regular basis to reduce the Capital Financing Requirement. Therefore, if a total of £35,000,000 is loaned to the local Housing Association by the end of 2018/19, the first time the MRP charge will be made to the revenue account to reduce the level of CFR will be 2020/21 and at regular intervals thereafter. The Capital Financing Requirement for the Business Improvement District will be a maximum of £1,200,000, making the total £36,200,000, as with the loan to the Local Housing Association, the loan to the Business Improvement District of £1,200,000 also sets aside receipts received to repay the borrowing that has been incurred on an annual basis for the next 5 years.

#### **Core funds and expected investment balances**

- 2.17 The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances. Working capital balances (Debtors and Creditors) shown in the table are included in 'Other' which is the estimated position at the year end; these may fluctuate during the year. The Council will run its cash close to zero, therefore reducing its external borrowing costs as interest rates for investments remain at a low level.

<b>Year End Resources £000</b>	<b>2016/17 Actual</b>	<b>2017/18 Estimate</b>	<b>2018/19 Estimate</b>	<b>2019/20 Estimate</b>	<b>2020/21 Estimate</b>
Fund balances / reserves	11,744,311	10,959,248	10,105,628	9,916,903	10,656,518
Capital receipts	2,665,698	1,779,961	1,404,137	1,575,255	1,518,706
Provisions	-	-	-	-	-
Other	10,589,991	2,660,791	2,690,235	2,707,842	2,024,776
<b>Total core funds</b>	<b>25,000,000</b>	<b>15,400,000</b>	<b>14,200,000</b>	<b>14,200,000</b>	<b>14,200,000</b>
Under/over borrowing	<b>25,000,000</b>	<b>15,400,000</b>	<b>14,200,000</b>	<b>14,200,000</b>	<b>14,200,000</b>
<b>Expected investments</b>	-	-	-	-	-

## Affordability Prudential Indicators

2.18 The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators:

2.19 **Ratio of financing costs to net revenue stream.** This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs) against the net revenue stream.

%	2016/17 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Ratio	0	0	0	0	0

2.20 The estimates of financing costs include current commitments and the proposals in this report. The table shows that there is no ratio between the capital cost and net revenue stream because the borrowing which will potentially be undertaken is for the loan to the local Housing Association. Ultimately this will not be a cost to the Council as the agreement between the Council and the local Housing Association will cover the costs incurred.

## 3.0 BORROWING:

3.1 The capital expenditure plans set out in Section 2 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 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.

### 3.2 **Current Portfolio Position**

3.2.1 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. At the end of 2015/16 the Council was debt free. In 2016/17 borrowing occurred at £1,200,000 to support the capital programme as described in section 2 above. The estimated position for 2017/18 and future years is also reflected in the table below:

£	2016/17 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
<b>External Debt</b>					
Debt at 1 April	0	1,200,000	11,900,000	22,000,000	22,000,000
Expected change in Debt	1,200,000	10,700,000	10,100,000	0	0
<b>Actual gross debt at 31 March</b>	<b>1,200,000</b>	<b>11,900,000</b>	<b>22,000,000</b>	<b>22,000,000</b>	<b>22,000,000</b>
<b>The Capital Financing Requirement</b>	<b>26,200,000</b>	<b>27,300,000</b>	<b>36,200,000</b>	<b>36,200,000</b>	<b>36,200,000</b>
<b>Under / (over) borrowing</b>	<b>25,000,000</b>	<b>15,400,000</b>	<b>14,200,000</b>	<b>14,200,000</b>	<b>14,200,000</b>

3.2.2 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 or speculative purposes.

3.2.3 The Director of Finance (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 the budget report.

### 3.3 Treasury Indicators: Limits to Borrowing Activity

3.3.1 **The Operational Boundary.** 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. Prior to 2016/17, the Council was debt free and had no borrowing, however in 2016/17 £1,200,000 was taken as described in section 2 above. In order to give the Council complete flexibility these limits for borrowing activity are always set at the beginning of each financial year.

<b>Operational boundary</b>	<b>2017/18 Estimate</b>	<b>2018/19 Estimate</b>	<b>2019/20 Estimate</b>	<b>2020/21 Estimate</b>
Debt	29,800,000	39,000,000	39,000,000	39,000,000
Other long term liabilities	600,000	600,000	600,000	600,000
<b>Total</b>	<b>35,800,000</b>	<b>39,600,000</b>	<b>39,600,000</b>	<b>39,600,000</b>

3.3.2 **The 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.

1. This is 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.
2. The Council is asked to approve the following Authorised Limit. This limit is set to give the Council complete flexibility and also to encompass the maximum amount of borrowing that could occur for the capital programme:

<b>Authorised limit £</b>	<b>2017/18 Estimate</b>	<b>2018/19 Estimate</b>	<b>2019/20 Estimate</b>	<b>2020/21 Estimate</b>
Debt	40,000,000	40,000,000	40,000,000	40,000,000
Other long term liabilities	1,000,000	1,000,000	1,000,000	1,000,000
<b>Total</b>	<b>41,000,000</b>	<b>41,000,000</b>	<b>41,000,000</b>	<b>41,000,000</b>

### 3.4 Prospects for Interest Rates and Economic Background

3.4.1 The Economic Background is attached at Annex C3 which includes the Brexit timetable and and economic update.



3.4.2 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. The following table gives Link Asset Services central view.

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)			
		5 year	10 year	25 year	50 year
Dec 2017	0.50	1.50	2.10	2.80	2.50
Mar 2018	0.50	1.60	2.20	2.90	2.60
Jun 2018	0.50	1.60	2.30	3.00	2.70
Sep 2018	0.50	1.70	2.40	3.00	2.80
Dec 2018	0.75	1.80	2.40	3.10	2.90
Mar 2019	0.75	1.80	2.50	3.10	2.90
Jun 2019	0.75	1.90	2.60	3.20	3.00
Sep 2019	0.75	1.90	2.60	3.20	3.00
Dec 2019	1.00	2.00	2.70	3.30	3.10
Mar 2020	1.00	2.10	2.70	3.40	3.20
Jun 2020	1.00	2.10	2.80	3.50	3.30
Sep 2020	1.25	2.20	2.90	3.50	3.30
Dec 2020	1.25	2.30	2.90	3.60	3.40
Mar 2021	1.25	2.30	3.00	3.60	3.40

3.4.3 As expected, the Monetary Policy Committee (MPC) delivered a 0.25% increase in Bank Rate at its meeting on 2 November 2017. This removed the emergency cut in August 2016 after the European Union referendum. The Monetary Policy Committee also gave forward guidance that they expected to increase Bank rate only twice more by 0.25% by 2020 to end at 1.00%. The Link Asset Services forecast as above includes increases in Bank Rate of 0.25% in November 2018, November 2019 and August 2020.

The overall longer run trend is for gilt yields and Public Works Loan Board (PWLB) rates to rise, albeit gently. It has long been expected, that at some point, there would be a more protracted move from bonds to equities after a historic long-term trend, over about the last 25 years, of falling bond yields. The action of central banks since the financial crash of 2008, in implementing substantial Quantitative Easing, added further impetus to this downward trend in bond yields and rising bond prices. Quantitative Easing has also directly led to a rise in equity values as investors searched for higher returns and took on riskier assets. The sharp rise in bond yields since the US Presidential election in November 2016 has called into question whether the previous trend may go into reverse, especially now the Fed. has taken the lead in reversing monetary policy by starting, in October 2017, a policy of not fully reinvesting proceeds from bonds that it holds when they mature.

Until 2015, monetary policy was focused on providing stimulus to economic growth but has since started to refocus on countering the threat of rising inflationary pressures as stronger economic growth becomes more firmly established. The Fed. has started raising interest rates and this trend is expected to continue during 2018 and 2019. These increases will make holding US bonds much less attractive and cause their prices to fall, and therefore bond yields to rise. Rising bond yields in the US are likely to exert some upward pressure on bond yields in the UK and other developed economies. However, the degree of that upward pressure is likely to be dampened by how strong or weak the prospects for economic growth and rising inflation are in each country, and on the degree of progress towards the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

From time to time, gilt yields – and therefore Public Works Loan Board rates - can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis and emerging market developments. Such volatility could occur at any time during the forecast period.

3.4.4 Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts (and Monetary Policy Committee 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 European Union, 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.

3.4.5 The overall balance of risks to economic recovery in the UK is probably to the downside, particularly with the current level of uncertainty over the final terms of Brexit.

Downside risks to current forecasts for UK gilt yields and Public Works Loan Board rates currently include:

- The Bank of England takes action too quickly over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- Geopolitical risks, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.
- A resurgence of the Eurozone sovereign debt crisis, possibly Italy, due to its high level of government debt, low rate of economic growth and vulnerable banking system.
- Weak capitalisation of some European banks.
- Germany is still without an effective government after the inconclusive result of the general election in October. In addition, Italy is to hold a general election on 4 March 2018 and the anti European Union populist Five Star party is currently in the lead in the polls, although it is unlikely to get a working majority on its own. Both situations could pose major challenges to the overall leadership and direction of the European Union as a whole and of the individual respective countries. Hungary will hold a general election in April 2018.
- The result of the October 2017 Austrian general election has now resulted in a strongly anti-immigrant coalition government. In addition, the Czech ANO party became the largest party in the October 2017 general election on a platform of being strongly against European Union migrant quotas and refugee policies. Both developments could provide major impetus to other, particularly former Communist bloc countries, to coalesce to create a major block to progress on European Union integration and centralisation of European Union policy. This, in turn, could spill over into impacting the Euro, European Union financial policy and financial markets.
- Rising protectionism under President Trump
- A sharp Chinese downturn and its impact on emerging market countries

The potential for upside risks to current forecasts for UK gilt yields and Public Works Loan Board rates, especially for longer term Public Works Loan rates include: -

- 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 we currently expect.
- UK inflation returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.
- 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 Quantitative Easing, 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.

### **Investment and borrowing rates**

- Investment returns are likely to remain low during 2018/19 but to be on a gently rising trend over the next few years.
- Borrowing interest rates increased sharply after the result of the general election in June and then also after the September Monetary Policy Committee meeting when financial markets reacted by accelerating their expectations for the timing of Bank Rate increases. Since then, borrowing rates have eased back again somewhat. Apart from that, 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 the Council 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 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.

### **3.5 Borrowing Strategy**

- 3.5.1 In 2015/16 the Council was debt free, however in 2016/17 borrowing of £1,200,000 occurred in line with the capital programme as described in section 2 above. The maximum amount of borrowing as stated above in section 2 in line with the Capital financing requirement is £36,200,000. Therefore the Council may use its surplus funds to support the capital programme or borrow in accordance with the capital financing requirement. If surplus funds are utilised rather than borrowing then this means that the capital borrowing needed (the Capital Financing Requirement), will not be fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow will be used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is relatively high.
- 3.5.2 If the Council does undertake borrowing then interest rates will be viewed from 1 year to 50 years, in accordance with the interest rates available from the markets as well as the Governments Public Works Loans Board. For 2018/19 interest rates span between 5 years at 1.70%, 10 at 2.30%, 25 at 3.00% or 50 years at 2.80%. The interest rates trend is to increase slightly across all years as the 2018/19 year progresses. Therefore, in the current volatile money market, the borrowing target rate for 2018/19 is set at 3.10%. External borrowing will be considered throughout the financial year when interest rates seem most favourable.

3.5.3 Against this background and the risks within the economic forecast, caution will be adopted with the 2018/19 treasury operations. The Director of Finance 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 lower than they are projected in the next few years.*

Any decisions will be reported to the appropriate to Cabinet at the next available opportunity.

### **3.6 Policy on Borrowing in Advance of Need**

3.6.1 The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

3.6.2 Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the quarterly, mid-year or annual reporting mechanism.

### **3.7 Debt Rescheduling**

3.7.1 It is not anticipated that in 2018/19 that debt rescheduling will occur. The Council current only has long term debt of £1,200,000. However, in order to cover all possibilities in the Treasury Management Strategy Statement it should be noted that short term borrowing rates will be considerably cheaper than longer term fixed interest rates, therefore, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings would need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premium charges would be incurred).

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

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

3.7.3 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.

3.7.4 All rescheduling will be reported to Cabinet, at the earliest meeting following its action.

### 3.8 Municipal Bond Agency

3.8.1 It is likely that the Municipal Bond Agency, currently in the process of being set up, will be offering loans to Local Authorities sometime in the future. It is also hoped that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB).

The Council could therefore potentially make use of this new source of borrowing as and when appropriate to fund all or part of the borrowing required for the two previously mentioned schemes.

### 3.9 Treasury Management Limits on Activity

3.9.1 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:-

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments;
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- Maturity structure of borrowing. These gross limits are set in place to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

3.9.2 The Council is asked to approve the following treasury indicators and limits in the table below. These limits take into account the potential borrowing to support the capital programme as previously described in section 2 above and also provide the flexibility for additional borrowing when overnight temporary borrowing needs to occur. It should be noted that at this stage options have been left open when borrowing will occur due to the current volatility in the market.

<b>Maturity Structure of interest rate borrowing 2018/19</b>		
	<b>Lower</b>	<b>Upper</b>
Under 12 months	0%	100%
12 months to 2 years	0%	100%
2 years to 5 years	0%	100%
5 years to 10 years	0%	100%
10 years to 20 years	0%	100%
20 years to 30 years	0%	100%
30 years to 40 years	0%	100%
40 years to 50 years	0%	100%

### 4.0 Annual Investment Strategy

#### 4.1 Investment Policy

4.1.1 The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, then return.

- 4.1.2 In accordance with the above guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term Ratings.
- 4.1.3 Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as “credit default swaps” and overlay that information on top of the credit ratings.
- 4.1.4 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.
- 4.1.5 Investment instruments identified for use in the financial year are listed in Annex C1 under the ‘specified’ and ‘non-specified’ investments categories. Counterparty limits will be as set through the Council’s treasury management practices – schedules.
- 4.1.6 With regards to counterparty limits and the amount of surplus funds to be placed with any one counterparty or group of counterparties, specific advice has been taken from the Council’s Treasury Management Advisors (Link Asset Services) due to the difficulty in placing surplus funds in the current economic environment. Therefore the Counterparty limits are detailed as follows:
- **Individual Limits** – These limits will be set at 30% of total investments or £3m per counterparty whichever is the higher. There are three exceptions to this policy:
    - (a) with counterparties that are backed by the Government – Royal Bank of Scotland, Natwest, Ulster Bank – (and therefore are more secure) there will be a 40% limit or £5m per counterparty whichever is the higher.
    - (b) with the Council’s own bank - Lloyds - and associated banks in the Lloyds group – Bank of Scotland – there will be a 40% limit or £5m per counterparty whichever is the higher
    - (c) with the Debt Management Agency Deposit there will be an unlimited amount with this organisation due to its high level of security.

It should be noted that it is expected during 2018/19, that the status of the current counterparties backed by the Government in (a) above may change. If this occurs a report will be brought to Cabinet at the earliest opportunity with the revised limits.

- **Group Limits** – this policy recognises that individual counterparties (banks/financial institutions etc), whilst being sound in themselves, may be part of a larger group. This brings with it added risks where parent institutions may be in difficulties. Therefore, due to the reduced surplus balances available for investment, the group limit will also be as stated for the individual limits as it is important to diversify the risk to a variety of counterparties.

## 4.2 Creditworthiness policy

- 4.2.1 This Council applies the creditworthiness service provided by Link Asset Services – the Council’s Treasury Management Advisors. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody’s and

Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

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

4.2.2 This modelling approach combines credit ratings, credit Watches and credit Outlooks in a weighted scoring system which is then combined with an overlay of Credit Default Swap (CDS) spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:

- 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 1.50
- 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

Y	Pi1	Pi2	P	B	O	R	G	N/C
1	1.25	1.5	2	3	4	5	6	7
Up to 5yrs	Up to 5yrs	Up to 5yrs	Up to 2yrs	Up to 1yr	Up to 1yr	Up to 6mths	Up to 100days	No Colour

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

4.2.4 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.

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

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

4.2.6 Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information, information on any external support for banks to help support its decision making process.

### 4.3 Country Limits

- 4.3.1 The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch (or equivalent), other than the UK where the Council has set no limit. The list of countries that qualify using this AA- credit criteria, as at the date of this report, are shown in Annex C2. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.
- 4.3.2 The UK sovereign rating is currently AA and following advice from Link Asset Services, the Council's Treasury Management Advisors, and the Council will still operate with UK counterparties.
- 4.3.3 The Council has determined that, other than the United Kingdom where no limit will apply, a maximum of 30% of total investments or £3.0m whichever is the lower will be invested in a single institution of a AAA sovereign rated country
- 4.3.4 In addition, this policy restricts the total of investments in foreign countries to 40% of the total investments.

### 4.4 Investment Strategy

#### 4.4.1 In-house funds

Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

#### 4.4.2 Investment returns expectations

Bank Rate is forecast to remain unchanged at 0.50% until Quarter 4 2018 and not rise above 1.25% by Quarter 1 2021. Bank Rate forecasts for financial year ends (March) are:

- 2017/2018 0.50%
- 2018/2019 0.75%
- 2019/2020 1.00%
- 2020/2021 1.25%

4.4.3 The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows:

- 2017/18 0.40%
- 2018/19 0.60%
- 2019/20 0.90%
- 2020/21 1.25%
- 2021/22 1.50%
- 2022/23 1.75%
- 2023/24 2.00%
- Later years 2.75%

4.4.4 The overall balance of risks to these forecasts is currently skewed to the upside and are dependent on how strong Gross Domestic Product growth turns out, how quickly inflation pressures rise and how quickly the Brexit negotiations move forward positively.

#### 4.4.5 Investment Treasury Indicator and Limit

Total principal funds invested for greater than 365 days. 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.



4.4.6 The Council is asked to approve the treasury indicator and limit: -

<b>Maximum principal sums invested &gt; 365 days</b>			
<b>£</b>	<b>2018/19</b>	<b>2019/20</b>	<b>2020/21</b>
Principal sums invested > 365 days	£1,000,000	£1,000,000	£1,000,000

4.4.7 For its cash flow generated balances, the Council will seek to utilise its business reserve instant access and notice accounts, money market funds and short dated deposits (overnight to 100 days) in order to benefit from the compounding of interest.

#### **4.5 Investment Risk Benchmarking**

4.5.1 This Council will use an investment benchmark to assess the investment performance of its investment portfolio of 7 day, 1, 3, 6 or 12 month LIBID.

#### **4.6 End of year investment report**

At the end of the 2017/18 financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

#### **5.0 Policy on the Use of External Service Providers and Training**

##### **5.1 Policy on the Use of External Service Providers**

5.1.1 The Council uses Link Asset Services, Treasury Solutions as its external treasury management advisors. The Council recognises that responsibility for treasury management decisions remains with the Council at all times and will ensure that undue reliance is not placed upon our external service providers. It is also recognised that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

##### **5.2 Training**

5.2.1 The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This applies to cabinet members and members on scrutiny committee. During 2018/19, members will be offered training to provide an overview of treasury management and also any specific treasury management are they would choose. This training can be provided by Council officers or by the external service provider – Link Asset Services. The training needs of treasury management officers in the Council are periodically reviewed and officers have the opportunity to attend seminars and update services from Link Asset Services.

**TREASURY MANAGEMENT PRACTICE – TMP1**  
**CREDIT AND COUNTERPARTY RISK MANAGEMENT**  
**- SPECIFIED AND NON-SPECIFIED INVESTMENTS AND LIMITS**

**1.0 SPECIFIED INVESTMENTS:**

1.1 All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum 'high' quality criteria where applicable.

**2.0 NON-SPECIFIED INVESTMENTS:**

2.1 These are any investments which do not meet the Specified Investment criteria. A maximum of 100% will be held in aggregate in non-specified investment

**3.0 INVESTMENT INSTRUMENTS:**

3.1 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.

3.2 The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

	<b>Minimum credit criteria / colour band</b>	<b>** Max % of total investments/ £ limit per institution</b>	<b>Max. maturity period</b>
DMADF – UK Government	N/A	100%	6 months
UK Government gilts	UK sovereign rating		12 months
UK Government Treasury bills	UK sovereign rating		12 months
Bonds issued by multilateral development banks	AAA (or state your criteria if different)		6 months
Money Market Funds CNAV	AAA	100%	Liquid
Money Market Funds LVAV	AAA		Liquid
Money Market Funds VNAV	AAA		Liquid
Ultra-Short Dated Bond Funds with a credit score of 1.25	AAA	100%	Liquid

Ultra-Short Dated Bond Funds with a credit score of 1.5	AAA	100%	Liquid
Local authorities	N/A	100%	12 months
Term deposits with banks and building societies	Blue Orange Red Green No Colour		12 months 12 months 6 months 100 days Not for use
CDs or corporate bonds with banks and building societies	Blue Orange Red Green No Colour		12 months 12 months 6 months 100 days Not for use
Gilt funds	UK sovereign rating		

**A) – SPECIFIED**

<b><i>Institution / Counterparty</i></b>	<b><i>Minimum 'High' Credit Criteria</i></b>	<b><i>Use</i></b>
Debt Management Agency Deposit Facility	--	In-house
Term deposits – local authorities	--	In-house
Term deposits – banks and building societies	Coded: Orange on Link Asset Services' Matrix. Fitch's rating: Short-term F1+, Long-term AA- Or equivalent rating from Standard & Poors and Moody's	In-house
UK Part nationalised banks	Coded: Blue on Link Asset Services' Matrix. Fitch's rating: Short-term F1+, Long-term AA- Or equivalent rating from Standard & Poors and Moody's	In-house and Fund Mangers
Banks part nationalised by high credit rated (sovereign rating) countries – non UK	Coded: Blue on Link Asset Services' Matrix. Fitch's rating: Long-term AAA, Or equivalent rating from Standard & Poors and Moody's	In-house and Fund Mangers

Collateralised deposit	Coded: Orange on Link Asset Services' Matrix / UK Sovereign rating	In-house and Fund Managers
UK Government Gilts	UK Sovereign rating	In-house buy and hold and Fund Managers
Bonds issued by multilateral development banks	Coded: Orange on Link Asset Services' Matrix / Long term AAA	In-house buy and hold and Fund Managers
Bonds issued by a financial institution which is guaranteed by the UK Government	UK Sovereign rating	In-house buy and hold and Fund Managers
Sovereign bond issues (other than the UK Government)	Coded: Orange on Link Asset Services' Matrix / Long term AAA	In-house buy and hold and Fund Managers
Treasury Bills	UK Sovereign rating	Fund Managers
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs): -		
1. Money Market Funds (CNAV)	MMF rating	In-house and Fund Managers
2a. Money Market Funds (LVNAV)	MMF rating	In-house and Fund Managers
2b. Money Market Funds (VNAV)	MMF rating	In-house and Fund Managers
3. Ultra-Short Bond Funds with a credit score of 1.25	Bond fund rating	In-house and Fund Managers
4. Ultra-Short Bond Funds with a credit score of 1.50	Bond fund rating	In-house and Fund Managers
5. Bond Funds	Bond fund rating	In-house and Fund Managers
6. Gilt Funds	Bond fund rating	In-house and Fund Managers

**NON-SPECIFIED INVESTMENTS:**

A maximum of 100% can be held in aggregate in non-specified investment

1. Maturities of ANY period

<b>Institution / Counterparty</b>	<b>Minimum Credit Criteria</b>	<b>Use</b>	<b>Max % of total investments</b>	<b>Max. maturity period</b>
Term deposits – banks and building societies	Coded: red (6mths) and green (3mths) on Link Asset Services' Matrix. Fitch's rating: Short-term F1, Long-term A-, Or equivalent rating from Standard & Poors and Moody's	In-house	100%	3-6 Months
Fixed term deposits with variable rate and variable maturities: -Structured deposits	Coded: orange (1yr) red (6mths) and green (3mths) on Link Asset Services' Matrix. Fitch's rating: Short-term F1, Long-term A-, Or equivalent rating from Standard & Poors and Moody's	In-house	40%	1 Year
Certificates of deposits issued by banks and building societies.	Coded: orange (1yr) red (6mths) and green (3mths) on Link Asset Services' Matrix. Fitch's rating: Short-term F1, Long-term A-, Or equivalent rating from Standard & Poors and Moody's	In-house buy and hold and Fund Managers	30%	1 Year
Commercial paper other	Coded: orange (1yr) red (6mths) and green (3mths) on Link Asset Services' Matrix. Fitch's rating: Short-term F1, Long-term A-, Or equivalent rating from Standard & Poors and Moody's	In-house	30%	1 Year

Corporate Bonds	Coded: orange (1yr) red (6mths) and green (3mths) on Link Asset Services' Matrix. Fitch's rating: Short-term F1, Long-term A-, Or equivalent rating from Standard & Poors and Moody's	In-house and Fund Managers	30%	1 Year
Floating Rate Notes:	Long-term AAA	Fund Managers	N/A – Capital Expenditure	N/A – Capital Expenditure
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)				
Corporate Bond Fund	-	In house and Fund Managers		
Property fund: the use of these investments would constitute capital expenditure	-	Fund Managers	N/A – Capital Expenditure	N/A – Capital Expenditure

## 2. Maturities in excess of 1 year

<b>Institution / Counterparty</b>	<b>Minimum Credit Criteria</b>	<b>Use</b>	<b>Max % of total investments</b>	<b>Max. maturity period</b>
Term deposits – local authorities	--	In-house	30%	> 1 year
Term deposits – banks and building societies	Coded: Purple (2yrs) on Link Asset Services' Matrix. Fitch's rating: Short-term F1+, Long-term AA- Or equivalent rating from Standard & Poors and Moody's	In-house	30%	> 1 year
Certificates of deposits issued by banks and building societies	Coded: Purple(2yrs) on Link Asset Services' Matrix / Short-term F1+, Long-term AA-	Fund Managers	30%	> 1 year
UK Government Gilts	UK Sovereign rating	In-house and Fund Managers	30%	> 1 year

Bonds issued by multilateral development banks	Long term AAA	In-house and Fund Managers	30%	> 1 year
Sovereign bond issues (i.e. other than the UK Government)	Long term AAA	In-house and Fund Managers	30%	> 1 year
Corporate Bonds	Long term AAA	In-house and Fund Managers	30%	> 1 year
Collective Investment Schemes structure as open Ended Investment Companies (OEICs)				
1. Bond Funds	Long-term AAA	In-house and Fund Managers	30%	> 1 year
2. Gilt Funds	Long-term AAA	In-house and Fund Managers	30%	> 1 year

**APPROVED COUNTRIES FOR INVESTMENT**  
**Current List as at 15 January 2018**

Link Asset Services has advised that Councils should only use approved counterparties from countries with a minimum sovereign credit rating determined by the Council. This Council has determined that it will only use those countries with the sovereign rating of AA- or higher other than the UK where the Council has set no limit. This list will be monitored at least weekly (and for information purposes only, includes other sovereign ratings)

Based on lowest available rating

AAA

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Finland
- Hong Kong
- U.S.A.

AA

- Abu Dhabi (UAE)
- France
- UK

AA-

- Belgium
- Qatar



**ECONOMIC BACKGROUND AND BREXIT TIMETABLE****GLOBAL OUTLOOK**

World growth looks to be on an encouraging trend of stronger performance, rising earnings and falling levels of unemployment. In October, the International Monetary Fund upgraded its forecast for world growth from 3.2% to 3.6% for 2017 and 3.7% for 2018.

In addition, inflation prospects are generally muted and it is particularly notable that wage inflation has been subdued despite unemployment falling to historically very low levels in the UK and US. This has led to many comments by economists that there appears to have been a fundamental shift downwards in the Phillips curve (this plots the correlation between levels of unemployment and inflation e.g. if the former is low the latter tends to be high). In turn, this raises the question of what has caused this? The likely answers probably lay in a combination of a shift towards flexible working, self-employment, falling union membership and a consequent reduction in union power and influence in the economy, and increasing globalisation and specialisation of individual countries, which has meant that labour in one country is in competition with labour in other countries which may be offering lower wage rates, increased productivity or a combination of the two. In addition, technology is probably also exerting downward pressure on wage rates and this is likely to grow with an accelerating movement towards automation, robots and artificial intelligence, leading to many repetitive tasks being taken over by machines or computers. Indeed, this is now being labelled as being the start of the fourth industrial revolution.

**KEY RISKS****Central bank monetary policy measures**

Looking back on nearly ten years since the financial crash of 2008 when liquidity suddenly dried up in financial markets, it can be assessed that central banks' monetary policy measures to counter the sharp world recession were successful. The key monetary policy measures they used were a combination of lowering central interest rates and flooding financial markets with liquidity, particularly through unconventional means such as Quantitative Easing (QE), where central banks bought large amounts of central government debt and smaller sums of other debt.

The key issue now is that that period of stimulating economic recovery and warding off the threat of deflation is coming towards its close and a new period has already started in the US, and more recently in the UK, on reversing those measures i.e. by raising central rates and (for the US) reducing central banks' holdings of government and other debt. These measures are now required in order to stop the trend of an on-going reduction in spare capacity in the economy, and of unemployment falling to such low levels that the re-emergence of inflation is viewed as a major risk. It is, therefore, crucial that central banks get their timing right and do not cause shocks to market expectations that could destabilise financial markets. In particular, a key risk is that because Quantitative Easing driven purchases of bonds drove up the price of government debt, and therefore caused a sharp drop in income yields, this then also encouraged investors into a search for yield and into investing in riskier assets such as equities. This resulted in bond markets and equity market prices both rising to historically high valuation levels simultaneously. This, therefore, makes both asset categories vulnerable to a sharp correction. It is important, therefore, that central banks only gradually unwind their holdings of bonds in order to prevent destabilising the financial markets. It is also likely that the timeframe for central banks unwinding their holdings of Quantitative Easing 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, alternatively, 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.

There is also a potential key question over whether economic growth has become too dependent on strong central bank stimulus and whether it will maintain its momentum against a backdrop of rising interest rates and the reversal of Quantitative Easing. In the UK, a key vulnerability is the low level of productivity growth, which may be the main driver for increases in wages; and decreasing consumer disposable income, which is important in the context of consumer expenditure primarily underpinning UK Gross Domestic Product growth.

A further question that has come to the fore is whether an inflation target for central banks of 2%, is now realistic given the shift down in inflation pressures from internally generated inflation, (i.e. wage inflation feeding through into the national economy), given the above mentioned shift down in the Phillips curve.

- Some economists favour a shift to a lower inflation target of 1% to emphasise the need to keep the lid on inflation. Alternatively, it is possible that a central bank could simply 'look through' tepid wage inflation, (i.e. ignore the overall 2% inflation target), in order to take action in raising rates sooner than might otherwise be expected.
- However, other economists would argue for a shift UP in the inflation target to 3% in order to ensure that central banks place the emphasis on maintaining economic growth through adopting a slower pace of withdrawal of stimulus.
- In addition, there is a strong argument that central banks should target financial market stability. As mentioned previously, bond markets and equity markets could be vulnerable to a sharp correction. There has been much commentary, that since 2008, Quantitative Easing has caused massive distortions, imbalances and bubbles in asset prices, both financial and non-financial. Consequently, there are widespread concerns at the potential for such bubbles to be burst by exuberant central bank action. On the other hand, too slow or weak action would allow these imbalances and distortions to continue or to even inflate them further.
- Consumer debt levels are also at historically high levels due to the prolonged period of low cost of borrowing since the financial crash. In turn, this cheap borrowing has meant that other non-financial asset prices, particularly house prices, have been driven up to very high levels, especially compared to income levels. Any sharp downturn in the availability of credit, or increase in the cost of credit, could potentially destabilise the housing market and generate a sharp downturn in house prices. This could then have a destabilising effect on consumer confidence, consumer expenditure and Gross Domestic Product growth. However, no central bank would accept that it ought to have responsibility for specifically targeting house prices.

## UK

After the UK surprised on the upside with strong economic growth in 2016, growth in 2017 has been disappointingly weak; quarter 1 came in at only +0.3% (+1.8% y/y), quarter 2 was +0.3% (+1.5% y/y) and quarter 3 was +0.4% (+1.5% y/y). The main reason for this has been the sharp increase in inflation, caused by the devaluation of sterling after the European Union referendum, feeding increases in the cost of imports into the economy. This has caused, in turn, a reduction in consumer disposable income and spending power and so the services sector of the economy, accounting for around 80% of Gross Domestic Product, has seen weak growth as consumers cut back on their expenditure. However, more recently there have been encouraging statistics from the manufacturing sector which is seeing strong growth, particularly as a result of increased demand for exports. It has helped that growth in the European Union, our main trading partner, has improved significantly over the last year while robust world growth has also been supportive. However, this sector only accounts for around 10% of Gross Domestic Product so expansion in this sector will have a much more muted effect on the overall Gross Domestic Product growth figure for the UK economy as a whole.

While the Bank of England is expected to give forward guidance to prepare financial markets for gradual changes in policy, the Monetary Policy Committee, (MPC), meeting of 14 September 2017 managed to shock financial markets and forecasters by suddenly switching to a much more aggressive tone in terms of its words around warning that Bank Rate will need to rise soon. The Bank of England Inflation Reports during 2017 have clearly flagged up that it expected Consumer

Price Index inflation to peak at just under 3% in 2017, before falling back to near to its target rate of 2% in two years' time. The Bank revised its forecast for the peak to just over 3% at the 14 September meeting. (Inflation actually came in at 3.1% in November so that may prove now to be the peak.) This marginal revision in the Bank's forecast can hardly justify why the Monetary Policy Committee became so aggressive with its wording; rather, the focus was on an emerging view that with unemployment having already fallen to only 4.3%, the lowest level since 1975, and improvements in productivity being so weak, that the amount of spare capacity in the economy was significantly diminishing towards a point at which they now needed to take action. In addition, the Monetary Policy Committee took a more tolerant view of low wage inflation as this now looks like a common factor in nearly all western economies as a result of automation and globalisation. However, the Bank was also concerned that the withdrawal of the UK from the European Union would effectively lead to a decrease in such globalisation pressures in the UK, and so this would cause additional inflationary pressure over the next few years.

At Its 2 November meeting, the Monetary Policy Committee duly delivered a 0.25% increase in Bank Rate. It also gave forward guidance that they expected to increase Bank Rate only twice more in the next three years to reach 1.0% by 2020. This is, therefore, not quite the 'one and done' scenario but is, nevertheless, a very relaxed rate of increase prediction in Bank Rate in line with previous statements that Bank Rate would only go up very gradually and to a limited extent.

However, some forecasters are flagging up that they expect growth to accelerate significantly towards the end of 2017 and then into 2018. This view is based primarily on the coming fall in inflation, (as the effect of the effective devaluation of sterling after the European Union referendum drops out of the Consumer Price Index statistics), which will bring to an end the negative impact on consumer spending power. In addition, a strong export performance will compensate for weak services sector growth. If this scenario was indeed to materialise, then the Monetary Policy Committee would be likely to accelerate its pace of increases in Bank Rate during 2018 and onwards.

It is also worth noting the contradiction within the Bank of England between action in 2016 and in 2017 by two of its committees. After the shock result of the European Union referendum, the Monetary Policy Committee (MPC) voted in August 2016 for emergency action to cut Bank Rate from 0.50% to 0.25%, restarting £70bn of Quantitative Easing purchases, and also providing UK banks with £100bn of cheap financing. The aim of this was to lower borrowing costs, stimulate demand for borrowing and thereby increase expenditure and demand in the economy. The Monetary Policy Committee felt this was necessary in order to ward off their expectation that there would be a sharp slowdown in economic growth. Instead, the economy grew robustly, although the Governor of the Bank of England strongly maintained that this was because the Monetary Policy Committee took that action. However, other commentators regard this emergency action by the Monetary Policy Committee as being proven by events to be a mistake. Then in 2017, we had the Financial Policy Committee (FPC) of the Bank of England taking action in June and September over its concerns that cheap borrowing rates, and easy availability of consumer credit, had resulted in too rapid a rate of growth in consumer borrowing and in the size of total borrowing, especially of unsecured borrowing. It, therefore, took punitive action to clamp down on the ability of the main banks to extend such credit! Indeed, a Price Waterhouse Coopers report in October 2017 warned that credit card, car and personal loans and student debt will hit the equivalent of an average of £12,500 per household by 2020. However, averages belie wide variations in levels of debt with much higher exposure being biased towards younger people, especially the 25 -34 year old band, reflecting their lower levels of real income and asset ownership.

One key area of risk is that consumers may have become used to cheap rates since 2008 for borrowing, especially for mortgages. It is a major concern that some consumers may have over extended their borrowing and have become complacent about interest rates going up after Bank Rate had been unchanged at 0.50% since March 2009 until falling further to 0.25% in August 2016. This is why forward guidance from the Bank of England continues to emphasise slow and gradual increases in Bank Rate in the coming years. However, consumer borrowing is a particularly vulnerable area in terms of the Monetary Policy Committee getting the pace and

strength of Bank Rate increases right - without causing a sudden shock to consumer demand, confidence and thereby to the pace of economic growth.

Moreover, while there is so much uncertainty around the Brexit negotiations, consumer confidence, and business confidence to spend on investing, it is far too early to be confident about how the next two to three years will actually pan out.

## **Euro Zone**

Economic growth in the eurozone (EZ), (the UK's biggest trading partner), had been lack lustre for several years after the financial crisis despite the European Central Bank eventually cutting its main rate to -0.4% and embarking on a massive programme of Quantitative Easing. However, growth picked up in 2016 and has now gathered substantial strength and momentum thanks to this stimulus. Gross Domestic Product growth was 0.6% in quarter 1 (2.1% y/y), 0.7% in quarter 2 (2.4% y/y) and +0.6% in quarter 3 (2.6% y/y). However, despite providing massive monetary stimulus, the European Central Bank is still struggling to get inflation up to its 2% target and in November inflation was 1.5%. It is therefore unlikely to start on an upswing in rates until possibly 2019. It has, however, announced that it will slow down its monthly Quantitative Easing purchases of debt from €60bn to €30bn from January 2018 and continue to at least September 2018.

## **USA**

Growth in the American economy was notably erratic and volatile in 2015 and 2016. 2017 is following that path again with quarter 1 coming in at only 1.2% but quarter 2 rebounding to 3.1% and quarter 3 coming in at 3.2%. Unemployment in the US has also fallen to the lowest level for many years, reaching 4.1%, while wage inflation pressures, and inflationary pressures in general, have been building. The Fed has started on a gradual upswing in rates with four increases in all and four increases since December 2016; the latest rise was in December 2017 and lifted the central rate to 1.25 – 1.50%. There could then be another four increases in 2018. At its September meeting, the Fed said it would start in October to gradually unwind its \$4.5 trillion balance sheet holdings of bonds and mortgage backed securities by reducing its reinvestment of maturing holdings.

## **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.

## **JAPAN**

Gross Domestic Product growth has been gradually improving during 2017 to reach an annual figure of 2.1% in quarter 3. However, it is still struggling 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.

## **Brexit timetable and process**

- March 2017: UK government notifies the European Council of its intention to leave under the Treaty on European Union Article 50
- March 2019: initial two-year negotiation period on the terms of exit. In her Florence speech in September 2017, the Prime Minister proposed a two year transitional period after March 2019.
- UK continues as a full European Union member until March 2019 with access to the single market and tariff free trade between the European Union and UK. Different sectors of the UK economy will leave the single market and tariff free trade at different times during the two year transitional period.

- The UK and European Union 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 European Union, 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 European Union, World Trade Organisation rules and tariffs could apply to trade between the UK and European Union - but this is not certain.
- On full exit from the European Union: the UK parliament would repeal the 1972 European Communities Act.
- The UK will then no longer participate in matters reserved for European Union members, such as changes to the European Union's budget, voting allocations and policies.

**TREASURY MANAGEMENT SCHEME OF DELEGATION**

**APPENDIX: Treasury management scheme of delegation**

**(i) Full Council**

- receiving and reviewing reports on treasury management policies, practices and activities
- approval of annual strategy and annual outturn

**(ii) Cabinet**

- approval of/amendments to the Council's adopted clauses, treasury management policy statement and treasury management practices (recommendations to Council)
- budget consideration and approval (recommendations to Council)
- approval of the division of responsibilities
- receiving and reviewing regular monitoring reports and acting on recommendations
- receiving annual treasury management strategy, annual outturn, quarterly reports and also adhoc reports on treasury management policies, practices and activities
- reviewing and scrutinising the treasury management policy and procedures and making recommendations to full Council.

**(iii) Audit, Governance and Standards Committee**

- reviewing and scrutinising the treasury management policy and procedures and making recommendations to Cabinet.

**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;
- recommending the appointment of external service providers.
- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe *(to be determined in accordance with local priorities. This is not included for the 2018/19 Budget round due to the late publication of the CIPFA code.*
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money – this will occur in 2019/20.
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the Council
- ensure that the Council has appropriate legal powers to undertake expenditure on non-financial assets and their financing
- ensuring the proportionality of all investments so that the Council does not undertake a level of investing which exposes the Council to an excessive level of risk compared to its financial resources
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees, this will be developed in due course due to the late publication of the CIPFA code for the 2018/19 budget round.
- ensuring that members are adequately informed and understand the risk exposures taken on by the Council
- ensuring that the Council has adequate expertise, either in house or externally provided, to carry out the above
- creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed.