

Treasury Management Strategy Statement 2019/20

Introduction

Treasury management is the management of the Council's cash flows, borrowing and investments, and the associated risks. 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 financial risk are therefore central to the Council's prudent financial management.

Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition* (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year. In addition, the Welsh Government (WG) issued revised Guidance on Local Authority 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 WG Guidance.

Revised strategy: In accordance with the WG 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, changes in the Council's capital programme or in the level of its investment balance.

External Context

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

The Bank of England February Inflation report stated a fall in UK Consumer Price Inflation (CPI) to 2.1% in December 2018. The labour market data for November 2018 showed the unemployment rate edged down slightly to 4.0% while the employment rate of 75.8% was the joint highest on record. The 3-month average annual growth rate for pay excluding bonuses was 3.3% as wages continue to rise steadily and provide some pull on general inflation. Adjusted for inflation, real wages grew by 1.1%, a level still likely to have little effect on consumer spending.

The rise in quarterly GDP growth to 0.6% in Q3 from 0.4% in the previous quarter was due to weather-related factors boosting overall household consumption and construction activity over the summer following the weather-related weakness in Q1. At 1.5%, annual GDP growth continues to remain below trend. Looking ahead, the BoE, in its November Inflation Report, expects GDP growth to average around 1.75% over the forecast horizon, providing the UK's exit from the EU is relatively smooth.

Following the Bank of England's decision to increase Bank Rate to 0.75% in August, no changes to monetary policy have been made since. However, the Bank expects that should the economy continue to evolve in line with its November forecast, further increases in Bank Rate will be required to return inflation to the 2% target. The Monetary Policy Committee continues to reiterate that any further increases will be at a gradual pace and limited in extent.

While US growth has slowed over 2018, the economy continues to perform robustly. The US Federal Reserve continued its tightening bias throughout 2018, pushing rates to the current 2.25%-2.50% in December, but expectations are fading that the further hikes previously expected in 2019 will materialise as concerns over trade wars drag on economic activity.

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

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

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

Interest rate forecast: Following the increase in Bank Rate to 0.75% in August 2018, the Council's treasury management adviser Arlingclose is forecasting one more 0.25% hike during 2019 to take official UK interest rates to 1.0%. The Bank of England's MPC has maintained expectations for slow and steady rate rises over the forecast horizon. The MPC continues to have a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. Arlingclose believes that MPC members consider both that ultra-low interest rates result in other economic problems, and that higher Bank Rate will be a more effective policy weapon should downside Brexit risks crystallise when rate cuts will be required.

The UK economic environment remains relatively soft, despite seemingly strong labour market data. Arlingclose's view is that the economy still faces a challenging outlook as it exits the European Union and Eurozone growth softens. Whilst assumptions are that

a Brexit deal is struck and some agreement reached on transition and future trading arrangements before the UK leaves the EU, the possibility of a “no deal” Brexit still hangs over economic activity. As such, the risks to the interest rate forecast are considered firmly to the downside.

Gilt yields and hence long-term borrowing rates have remained at low levels but some upward movement from current levels is expected based on Arlingclose’s interest rate projections, due to the strength of the US economy and the ECB’s forward guidance on higher rates. 10-year and 20-year gilt yields are forecast to remain around 1.85% and 2.2% respectively over the interest rate forecast horizon, however volatility arising from both economic and political events are likely to continue to offer borrowing opportunities.

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

Local Context

On 31st December 2018, the Council held £350.48m of borrowing and £4.23m of investments. This is set out in further detail at **Annex B**. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance sheet summary and forecast

	31.3.18 Actual £m	31.3.19 Estimate £m	31.3.20 Forecast £m	31.3.21 Forecast £m	31.3.22 Forecast £m
General Fund CFR	157.31	156.26	155.15	153.01	150.65
HRA CFR	253.43	275.68	302.65	312.42	327.80
Total CFR	410.74	431.94	457.80	465.43	478.45
Less: Other debt liabilities *	(27.68)	(27.63)	(25.91)	(24.19)	(23.33)
Loans CFR	383.06	404.31	431.89	441.24	455.12
Less: External borrowing **	(364.38)	(337.26)	(306.79)	(304.01)	(300.91)
Internal (over) borrowing	18.68	67.05	125.10	137.23	154.21
Less: Usable reserves & working capital	(32.62)	(36.99)	(28.66)	(27.88)	(27.51)
Investments (New borrowing)	13.94	(30.06)	(96.44)	(109.35)	(126.70)

* finance leases, PFI liabilities and transferred debt that form part of the Council’s total debt

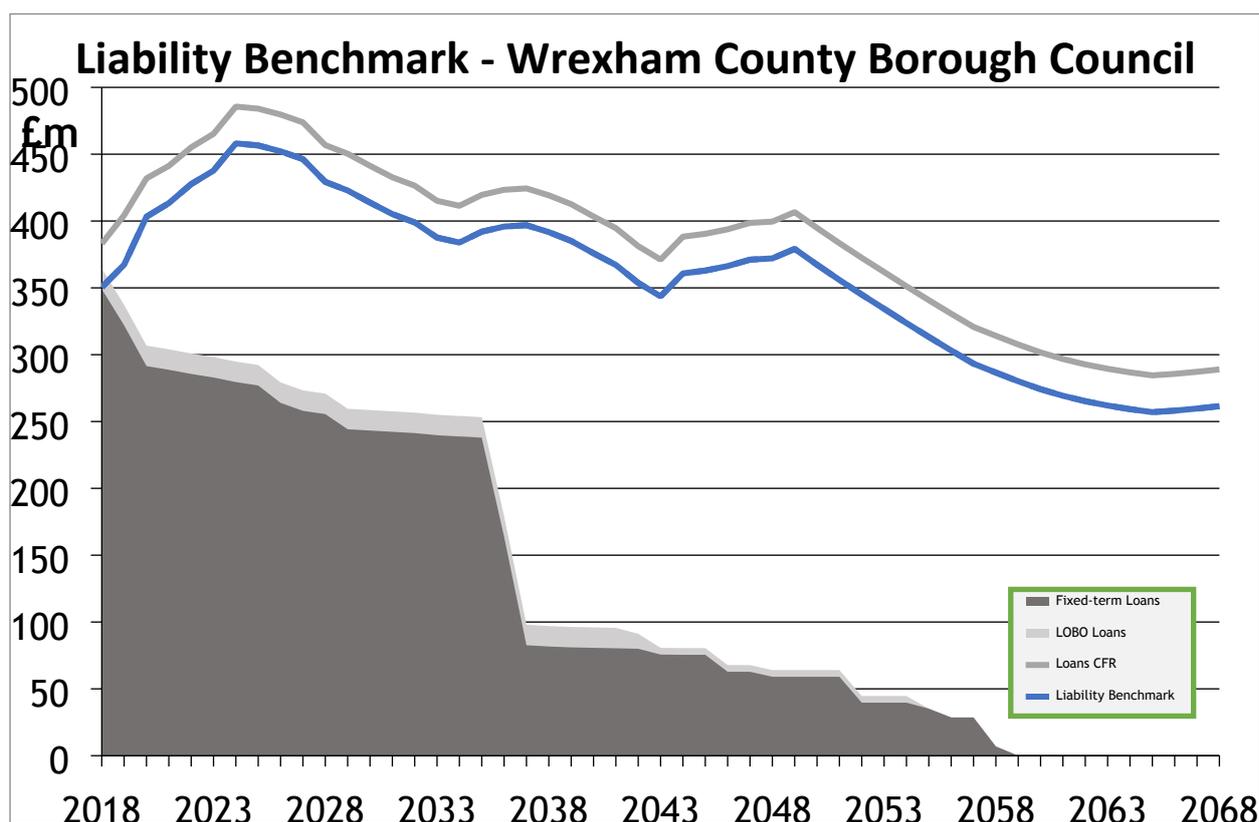
** shows only loans to which the Council is committed and excludes optional refinancing

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The 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 minimal investments and will therefore be required to borrow up to a maximum of £96m over the forecast period.

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

Liability benchmark: The Prudential Code 2017 re-enforces the recommendation in CIPFA's Treasury Risk Management Toolkit for Local Authorities (2012) to use a liability benchmarking exercise; the intention of the benchmark is to measure the authority's projected net loans requirement plus a short term liquidity allowance for future periods.



The above is a graphical representation of Table 1; the Council's need to borrow to fund capital expenditure is represented by Loans CFR line (Capital Financing Requirement). It can be clearly recognised that between the period 2018 and 2058 the Council will need to borrow in order to fund future capital expenditure. The extent to which such borrowing will be required is difficult to forecast beyond the near term, as represented in Table 1; both the table and the graph show that CFR is currently expected to peak in

2021-22 at around £455m for the period reported in this strategy, with actual borrowing at that time sitting at £301m and Reserves at £27m indicating a likely need to borrow at £127m. The Council does not plan to maintain investments at a specific level; rather it looks to manage cash flow to ensure a level of liquidity suitable to meet any short term financing requirements.

Borrowing Strategy

The Council currently holds £350.48million of loans, a decrease of £13.9million on the previous year, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 1 shows that the Council expects to borrow an additional £66m in 2019/20.

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.

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 / 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 2019/20 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

In addition, the Council may borrow further 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
- any other UK public sector body
- UK public and private sector pension funds (except Clwyd Pension Fund)
- capital market bond investors
- Special purpose companies created to enable local authority bond issues

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

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

The 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 authority loans and bank loans, which may be available at more favourable rates.

LOBOs: The Council holds £15.3m 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. All of these LOBOs have options during 2019/20, and although the Council understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The Council will take the option to repay LOBO loans at no cost if it has the opportunity to do so. In June 2018 the Council contacted all lenders with whom it holds these types of instrument to investigate the possibility of renegotiation at zero cost to the Council. At this time settlement terms offered were not advantageous and therefore not taken.

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 interest rate exposure limits 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 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 £0.1million and £25million, it is expected that as the Council moves away from being internally borrowed it will continue to review its borrowing policy in consideration of the benefits between short-term and long term. As a part of this process the cost of financing will be monitored.

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

Strategy: The majority of the Council's surplus cash remains invested in short term unsecured bank deposits, and money market funds. UK adoption of the Bank Recovery and Resolution Directive, and the Deposit Guarantee Scheme Directive requires that the Council continues to follow a policy of maximum diversification of its investments to mitigate any risk of bail-in impacting on its resources. At the time of writing this report Brexit negotiations were very much in the balance, the Council is keeping a watchful eye on the outcome of these negotiations as this will influence policy with institutions (Money Market Funds etc.) domiciled in European Countries.

Business models: Under the new IFRS 9 standard, the accounting for certain investments depends on the Council's "business model" for managing them. The Council aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

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 50 years	n/a	n/a
AAA	£3m 5 years	£3m 20 years	£3m 50 years	£3m 20 years	£3m 20 years
AA+	£3m 5 years	£3m 10 years	£3m 25 years	£3m 10 years	£3m 10 years
AA	£3m 4 years	£3m 5 years	£3m 15 years	£3m 5 years	£3m 10 years
AA-	£3m 3 years	£3m 4 years	£3m 10 years	£3m 4 years	£3m 10 years
A+	£3m 2 years	£3m 3 years	£3m 5 years	£3m 3 years	£3m 5 years
A	£3m 13 months	£3m 2 years	£3m 5 years	£3m 2 years	£3m 5 years
A-	£3m 6 months	£3m 13 months	£3m 5 years	£3m 13 months	£3m 5 years
Unrated Building Societies (On Advice)	£1m 6 Months	n/a	n/a	n/a	n/a
None	n/a	n/a	3m 25 years	n/a	n/a
Pooled funds and real estate investment trusts	£3m per fund or trust				

*This table must be read in conjunction with the notes below

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

Banks unsecured: Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks.

These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

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

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

Corporates: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent.

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

Pooled funds: Shares or units in diversified investment vehicles consisting of 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.

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

Operational bank accounts: The Council may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be monitored to ensure any exposure risk is managed. 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.

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

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.

Investment limits: The Council's revenue reserves available to cover investment losses are forecast to be £20million on 31st March 2019. In order that no more than 15% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £3million. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table 3: Investment limits

	Cash limit
Any single organisation, except the UK Central Government	£3m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£3m per group
Any group of pooled funds under the same management	£3m per manager
Negotiable instruments held in a broker's nominee account	£15m per broker
Foreign countries	£9m per country
Registered providers and registered social landlords	£3m in total
Unsecured investments with building societies	£7m in total
Money market funds	£15m in total
Real estate investment trusts	£9m in total

Liquidity management: The Council uses purpose-built in-house cash flow forecasting solution 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.

Treasury Management Indicators

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

Security: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

Credit risk indicator	Target
Portfolio average credit rating	A

Liquidity: The Council takes every precaution to ensure that an appropriate amount of cash is available to meet unexpected payments over the short to medium term; the Council has not quantified this with a figure for this voluntary indicator as it is felt to make this a determinant of action could unnecessarily influence Treasury Management cash flow decisions.

Interest rate exposures: The risk that fluctuations in the levels of interest rates create an unexpected or unbudgeted burden on the Council's finances, against which the organisation has failed to protect itself. The Council guards against this risk by actively adjusting their exposure to reflect changing market or organisational circumstances. Although the Council does not set limits against which to measure this exposure it pays due regard to the previous set limit of 30% of total debt being exposed to variable interest rates.

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 borrowing will be:

Maturity Structure of Borrowing*	Upper Limit	Lower Limit	Actual Borrowing at 31/12/2018	Actual Borrowing at 31/12/2018
	%	%	£m	%
under 12 months	30	0	58.78	16.77
12 months and within 24 months	20	0	2.78	0.79
24 months and within 5 years	20	0	9.19	2.62
5 years and within 10 years	80	0	34.42	9.82
10 years and within 20 years	80	0	164.12	46.83
20 years and within 30 years	80	0	22.17	6.33
30 years and within 40 years	80	0	59.02	16.84
40 years and within 50 years	80	0	0.00	0.00
50 years and above	90	0	0.00	0.00
Total			350.48	100.00

*Time periods start on the first day after the date quoted in the table. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

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

Price risk indicator	2019/20	2020/21	2021/22
Limit on principal invested beyond year end	£10m	£5m	£5m

Related Matters

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

Financial Derivatives: In the absence of any explicit legal power to do so, the Council will not use standalone financial derivatives (such as swaps, forwards, futures and options). Derivatives embedded into loans and investments, including pooled funds and forward starting transactions, may be used, and the risks that they present will be managed in line with the overall treasury risk management strategy.

Housing Revenue Account:

As a part of the HRAS reform programme the Council was required to take out loans to the value of £146.2m to facilitate the subsidy buy-out. The Council considered the options available for the treatment of the loans pool for the Housing Revenue Account (HRA) and Council Fund (GF). After careful deliberation and due diligence on the options available the Council considered that continuance with the extant one pool approach would be the most equitable moving forward; it was felt that splitting the loans between HRA and CF went against the principal of managing a local authority's debt portfolio as a whole.

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

Government Guidance: Further matters required by the WG Guidance are included in ***Annex C***.

Financial Implications

The budget for investment income in 2019/20 is estimated to be £50,000. The budget for debt interest paid in 2019/20 is estimated to be £14million. If actual levels of investments and borrowing, or actual interest rates, differ from those forecast, performance against budget will be correspondingly different.

Other Options Considered

The WG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Head of Finance, having consulted the Lead Member for Finance, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

Annex A – Arlingclose Economic & Interest Rate Forecast December 2018

Underlying assumptions:

- Our central interest rate forecasts are predicated on there being a transitional period following the UK's official exit from the EU.
- The MPC has a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. We believe that MPC members consider that: 1) tight labour markets will prompt inflationary pressure in the future, 2) ultra-low interest rates result in other economic problems, and 3) higher Bank Rate will be a more effective policy weapon if downside risks to growth crystallise.
- Both our projected outlook and the increase in the magnitude of political and economic risks facing the UK economy means we maintain the significant downside risks to our forecasts, despite the potential for slightly stronger growth next year as business investment rebounds should the EU Withdrawal Agreement be approved. The potential for severe economic outcomes has increased following the poor reception of the Withdrawal Agreement by MPs. We expect the Bank of England to hold at or reduce interest rates from current levels if Brexit risks materialise.
- The UK economic environment is relatively soft, despite seemingly strong labour market data. GDP growth recovered somewhat in the middle quarters of 2018, but more recent data suggests the economy slowed markedly in Q4. Our view is that the UK economy still faces a challenging outlook as the country exits the European Union and Eurozone economic growth softens.
- Cost pressures are easing but inflation is forecast to remain above the Bank's 2% target through most of the forecast period. Lower oil prices have reduced inflationary pressure, but the tight labour market and decline in the value of sterling means inflation may remain above target for longer than expected.
- Global economic growth is slowing. Despite slower growth, the European Central Bank is conditioning markets for the end of QE, the timing of the first rate hike (2019) and their path thereafter. More recent US data has placed pressure on the Federal Reserve to reduce the pace of monetary tightening – previous hikes and heightened expectations will, however, slow economic growth.
- Central bank actions and geopolitical risks have and will continue to produce significant volatility in financial markets, including bond markets.

Forecast:

- The MPC has maintained expectations of a slow rise in interest rates over the forecast horizon, but recent events around Brexit have dampened interest rate expectations. Our central case incorporates the likelihood of the MPC raising rates in the last quarter of 2019 after an extended period of uncertainty or a delay to Brexit.
- Gilt yields have remained at low levels. We expect some upward movement from current levels based on our central case that the UK will enter a transitional period following its EU exit in March 2019. However, our projected weak economic outlook and volatility arising from both economic and political events will continue to offer borrowing opportunities.

	Jan-19	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.33
Arlingclose Central	0.75	0.75	0.75	0.75	1.00	1.00	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.04
Downside risk	0.00	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00	1.00	0.77
3-mth money market rate														
Upside risk	0.00	0.10	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.33
Arlingclose Central	0.92	0.90	0.90	0.95	1.20	1.25	1.35	1.40	1.40	1.40	1.40	1.40	1.40	1.22
Downside risk	0.00	0.50	0.55	0.60	0.85	0.90	0.95	1.00	1.00	1.00	1.00	1.00	1.00	0.80
1-yr money market rate														
Upside risk	0.00	0.10	0.30	0.35	0.35	0.35	0.35	0.50	0.50	0.50	0.50	0.50	0.50	0.37
Arlingclose Central	1.16	1.20	1.20	1.25	1.50	1.60	1.75	1.75	1.70	1.70	1.70	1.70	1.70	1.53
Downside risk	0.00	0.50	0.60	0.60	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	0.80
5-yr gilt yield														
Upside risk	0.00	0.30	0.30	0.35	0.35	0.40	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.39
Arlingclose Central	0.90	0.95	0.95	1.00	1.25	1.30	1.45	1.45	1.40	1.40	1.40	1.40	1.40	1.25
Downside risk	0.00	0.45	0.45	0.50	0.75	0.80	0.95	0.95	0.90	0.90	0.90	0.90	0.90	0.72
10-yr gilt yield														
Upside risk	0.00	0.30	0.30	0.35	0.35	0.40	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.39
Arlingclose Central	1.26	1.30	1.35	1.40	1.65	1.75	1.90	1.85	1.85	1.85	1.85	1.85	1.85	1.67
Downside risk	0.00	0.60	0.65	0.70	0.95	1.00	1.10	1.00	1.00	1.00	1.00	1.00	1.00	0.85
20-yr gilt yield														
Upside risk	0.00	0.30	0.30	0.35	0.35	0.40	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.39
Arlingclose Central	1.66	1.70	1.75	1.80	2.00	2.05	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.03
Downside risk	0.00	0.60	0.65	0.70	0.95	1.00	1.10	1.00	1.00	1.00	1.00	1.00	1.00	0.85
50-yr gilt yield														
Upside risk	0.00	0.30	0.30	0.35	0.35	0.40	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.39
Arlingclose Central	1.62	1.65	1.70	1.75	1.95	2.00	2.15	2.15	2.15	2.15	2.15	2.15	2.15	1.98
Downside risk	0.00	0.60	0.65	0.70	0.95	1.00	1.10	1.00	1.00	1.00	1.00	1.00	1.00	0.85

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

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

Annex B – Existing Investment & Debt Portfolio Position

	31 December 2018 Actual Portfolio £m	31 December 2018 Average Rate %
External borrowing:		
Public Works Loan Board	284.21	4.56
Local authorities	41.00	0.95
LOBO loans from banks	15.30	4.84
Other loans	8.50	5.00
Other	1.47	0.00
Total external borrowing	350.48	
Other long-term liabilities:*		
Private Finance Initiative	25.61	12.59
Finance Leases	2.07	4.41
Total other long-term liabilities	27.68	
Total gross external debt	378.16	
Treasury investments:		
Banks & building societies (unsecured)	3.25	0.58
Money Market Funds	0.98	0.75
Total treasury investments	4.23	
Net debt	373.93	

*Figures taken from 31 March 2018 in view of difficulty in restating these figures in year.

Annex C – Additional requirements of Welsh Government Guidance

Specified investments: The WG 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 defined as capital expenditure. 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 C1 below.

Table C1: Non-specified investment limits

	Cash limit
Total long-term investments	£10m
Total investments without credit ratings or rated below A-, on advice from Treasury Advisors (except the UK Government and UK local authorities)	£2m
Total non-specified investments	£12m

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

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

Investment advisers: The Council has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues. The quality of this service is controlled by regular review meetings and the requisite periodical tendering process.

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 £477.80 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.