APPENDIX G

TREASURY MANGEMENT STRATEGY, INCLUDING INVESTMENT STRATEGY, BORROWING STRATEGY AND MRP POLICY STATEMENT

1. Executive Summary

1.1 The Council is required to approve a Treasury Management Strategy Statement for 2018/19 before 1 April 2018. In accordance with the constitution the Governance and Audit Committee have scrutinised the Council's Treasury Management Strategy and Policies at their meeting in January and have recommended for approval of Council.

1.2 The main elements of the Treasury Management Strategy are;

1.2.1 The Borrowing Strategy (para 3.4)

The key objectives of the Council's Borrowing Strategy are;

- To ensure that future external debt is affordable and sustainable within the long term within the revenue budget constraints.
- to borrow in advance of need to fund Non Treasury Investment (Commercial Properties) to support delivery of core services, through the generation of additional income, where returns can meet the cost of borrowing.
- to support schemes with a socio-economic value ie for the regeneration and growth of the District.
- to support significant service investment where the cost of borrowing will be offset by efficiencies and/or cost savings
- to potentially borrow in advance of need so that external debt (fixed rate funding) is arranged whilst interest rates are lower than they are projected to be over the next few years; and
- all external debt undertaken will be repaid on loan maturities

1.2.2 The Investment Strategy (para 4.4)

The main objective of the strategy is the security, liquidity and finally yield of the investment, in the context of the Councils risk appetite and through the mitigation of risks and in the context of risk appetite.

1.2.3 The Minimum Revenue Provision Policy (MRP) (Appendix A)

The Council will repay an element of borrowing, on a prudent basis, annually in accordance with the MRP Policy as detailed below;

- Asset Life Method – debt repaid over the life of the asset

- Asset Life – Annuity Method – for regeneration schemes or admin projects where revenue benefits are only realised in future years or increase in future years, and will be based on an appropriate rate comparable with PWLB Rates
- Loan Principal repayment will be proxy for MRP for loans funded from borrowing
- Borrowing for Non-Treasury Activity – MRP will be considered on a case by case basis as the intention is that the asset will be sold within the short/medium term and the capital receipt utilised to repay borrowing, therefore MRP relating to these assets will be £0.

  Note: To mitigate the risk of loss of the capital receipt not meeting outstanding debt, a Valuation Volatility Reserve has been created to fund any shortfall.

1.3 CIPFA has recently revised its “Prudential Code” and Treasury Management Code of Practice, in addition the Ministry of Housing, Communities and Local Government (MHCLG) has issued guidance under S15(1)(a) of the Local Government Act 2003 to which local authorities are required to “have regard” to such guidance.

1.4 These documents are particularly focused on ‘non-treasury’ investments, especially the purchase of investment property and commercial activities that aim to generate income, but which may require external borrowing (or the use of cash balances (internal borrowing) to finance such activities.

1.5 To provide transparency the Treasury Management Strategy now includes at 4.7 the Non-Treasury Investment Strategy in the context of the Commercial Portfolio Strategy previously approved by Corporate Policy and Resources Committee.

1.6 The Treasury Management Strategy including the Borrowing Strategy, Investment Strategy and Minimum Revenue Provision Policy are detailed below;

TREASURY MANGEMENT STRATEGY
Minimum Revenue Provision Policy and Annual Investment Strategy

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1 INTRODUCTION

1.1 Background

The Council is required to operate a balanced budget, in that cash raised during the year will meet it cash expenditure. The treasury management function is to ensure that cash flow is adequately planned, ensuring cash is available when needed to meet our liabilities. Any surplus monies are invested in approved high level counterparties, financial instruments or externally managed funds commensurate with the Council's risk appetite. Ensuring security of investment and providing adequate liquidity before considering investment returns.

The second element of the treasury management function is to ensure the ability to fund the Council's capital investment decisions. A 5 year Capital Programme is therefore developed to provide a guide to the Council's borrowing need after taking account of the availability of other sources of funding, i.e. external grant, earmarked reserves, capital receipts, revenue and capital resources. The management of this longer term cash flow involves arranging short and long term borrowing (external borrowing) or may utilise longer term cash flow surpluses in lieu of external borrowing (internal borrowing).

The Councils Corporate Plan identifies the Corporate Objectives of the Council and which then informs capital investment requirements. The 2018/19 to 2022/23 Capital Programme therefore includes significant capital investment which will require resourcing, from revenue, earmarked reserves, capital receipts, grant income, and borrowing.

The Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as;

"*the management of the Council's investments and cash flows, its banking, money market and capital market transactions; the effective control of risks associated with those activities; and the pursuit of optimum performance consistent with those risks"*

The treasury management activity involves substantial sums of money, which it borrows and invests. This exposes the Council to potential large financial risk, which can include the loss of invested funds, or the revenue consequence of changes in interest rates. Therefore the successful identification, control and monitoring of risk are integral to this function and include credit and counterparty risk, liquidity risk, market or interest rate risk, refinancing risk and legal and regulatory risk.

1.2 Reporting requirements

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

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

- the 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 – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision. In addition, the Corporate Policy and Resources Committee will receive quarterly update reports.

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

Scrutiny

The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Governance and Audit Committee.

1.3 Treasury Management Strategy for 2018/19

The strategy for 2018/19 covers two main areas:

Capital issues
- the capital plans and the prudential indicators;
- the Minimum Revenue Provision (MRP) policy. (included at Appendix A)

Treasury management issues
- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- the policy on use of external service providers.

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

1.4 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. This is mandatory training for the Governance and Audit Committee and is delivered annually. This training was undertaken on 16 January 2018. Further training will be arranged as required.

The training needs of treasury management officers are periodically reviewed.

1.5 Treasury management consultants

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 organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

2 THE CAPITAL PRUDENTIAL INDICATORS 2018/19 – 2020/21

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

2.1 Capital expenditure

This prudential indicator is a summary of the Council's capital expenditure plans which are included in the approved Capital Programme and which are the key drivers to treasury management activity. The output of the programme is reflected in the Council's prudential indicators, which are designed to provide Members with an overview and Members are asked to approve the capital expenditure forecasts:

Capital expenditure By Cluster £m	**2016/17 Actual**	**2017/18 Estimate**	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**
People	1.808	1.176	4.913	9.096	1.074
Places	0.552	4.188	10.190	11.419	0.466
Policy and Resources	0.131	1.366	0.353	0.010	0.080
Commercial Investment Properties	0.093	6.000	10.000	4.000	0.000
Total	**2.584**	**12.730**	**25.456**	**24.525**	**1.620**

Capital expenditure can be financed from a range of external and internal sources. External sources include private sector contributions ie S106 developer agreements, as well as government grants. Internal sources include capital receipts, earmarked reserves, and revenue contributions.

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.

Financing of capital expenditure £m	2016/17 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Capital receipts	0.405	0.905	0.700	0.325	0.440
External Grants	0.660	1.729	3.592	0.810	0.945
S106	0.000	0.158	0.000	0.000	0.000
Earmarked Reserves	1.459	2.161	6.024	4.103	0.235
Revenue Resources	0.025	0.002	0.000	0.000	0.000
Borrowing need for the year	**0.035**	**7.775**	**15.140**	**19.287**	**0.000**
Total Capital Financing	**2.584**	**12.730**	**25.456**	**24.525**	**1.620**

Other long-term liabilities. The above financing need excludes other long term liabilities, such as leasing arrangements which already include borrowing instruments**.**

The forecast of Revenue and Capital Reserves after taking into account contributions to and from these reserves for both capital and revenue purposes are detailed in the table below:

Year End Resources £m	2016/17 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
General Fund Balance	4.838	2.707	2.352	2.322	2.322
Earmarked Reserves	13.334	12.443	10.326	7.398	7.954
Total Revenue Reserves	**18.172**	**15.150**	**12.678**	**9.720**	**10.276**
Capital receipts	2.895	2.434	1.977	1.980	1.868
Capital Grants Unapplied	0.153	0.006	0.006	0.006	0.006
Total Capital Reserves	**3.048**	**2.440**	**1.983**	**1.986**	**1.874**
Total Useable Reserves	**21.220**	**17.590**	**14.661**	**11.706**	**12.150**

2.2 The Council's borrowing need (the Capital Financing Requirement)

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.

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.

The CFR includes any other long-term liabilities (e.g. finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility by the lease provider and so the Council is not required to separately borrow for these schemes. The Council currently has £0.027m of such schemes within the CFR.

The Council is asked to approve the CFR projections below:

£m	2016/17 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Capital Financing Requirement					
Accounting Adj	1.065	1.065	1.065	1.065	1.065
Finance Leases	0.122	0.027	0.000	0.000	0.000
Prudential Borrowing	0.032	7.681	22.756	42.025	41.696
Total CFR	**1.219**	**8.773**	**23.821**	**43.090**	**42.761**
Of which: Commercial Portfolio	0	6.000	16.000	20.000	20.000

Movement in CFR represented by					
Net financing need for the year (above)	0.035	7.775	15.141	19.287	0.000
Less MRP and other financing movements	0.223	0.221	0.093	0.018	0.329
Movement in CFR	**-0.188**	**7.554**	**15.048**	**19.269**	**-0.329**

Note: the MRP includes finance lease annual principal payments

1. BORROWING

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 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.

1.1 Core funds and expected investment balances

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.

Year End Resources £m	**2016/17 Actual**	**2017/18 Estimate**	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**
CFR	1.219	8.773	23.821	43.090	42.760
Less Leases	0.122	0.027	0.000	0.000	0.000
Borrowing CFR	**1.097**	**8.746**	**23.821**	**43.090**	**42.760**
Less PWLB Borrowing	0.000	7.000	21.297	38.547	38.548
Over(-)/Under Borrowing	**1.097**	**1.746**	**2.524**	**4.543**	**4.212**
General Fund Balance	-4.838	-2.707	-2.352	-2.322	-2.322
Earmarked Reserves	-13.334	-12.443	-10.326	-7.398	-7.954
Capital receipts	-2.895	-2.434	-1.977	-1.980	-1.868
Capital Grants Unapplied	-0.153	-0.006	-0.006	-0.006	-0.006
Provisions	-1.000	-1.000	-1.000	-1.000	-1.000
Working capital*	1.301	-0.265	-0.265	-0.265	-0.265
Expected investments (-) /Borrowing	**-19.822**	**-17.109**	**-13.402**	**-8.428**	**-9.203**

*Working capital balances shown are estimated year-end; these may be higher mid-year

1.2 Current portfolio position

The Council's treasury portfolio position at 31 March 2017, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), and internal borrowing as a percentage of the CFR.

£m	2016/17 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
External Debt					
Debt at 1 April	0.000	0.000	7.000	21.298	38.548
Expected change in Debt	0.000	7.000	14.298	17.250	0.000
Other long-term liabilities (OLTL)	0.342	0.122	0.027	0.000	0.000
Expected change in OLTL	-0.220	-0.095	-0.027	0.000	0.000
Gross external debt at 31 March	**0.122**	**7.027**	**21.298**	**38.548**	**38.548**
Internal Borrowing (at 31 March)	0.032	0.682	1.525	3.562	3.562
The Capital Financing Requirement	**1.219**	**8.773**	**23.821**	**43.090**	**42.761**
Internal Borrowing %	**2.63**	**7.77**	**6.40**	**8.27**	**8.33**

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.

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

3.3 Treasury Indicators: limits to borrowing activity

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

Operational boundary £m	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
External Debt	7.775	22.916	44.202	44.202
Other long term liabilities	0.027	0.000	0.000	0.000
Operational Boundary	**7.802**	**22.916**	**44.202**	**44.202**

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.

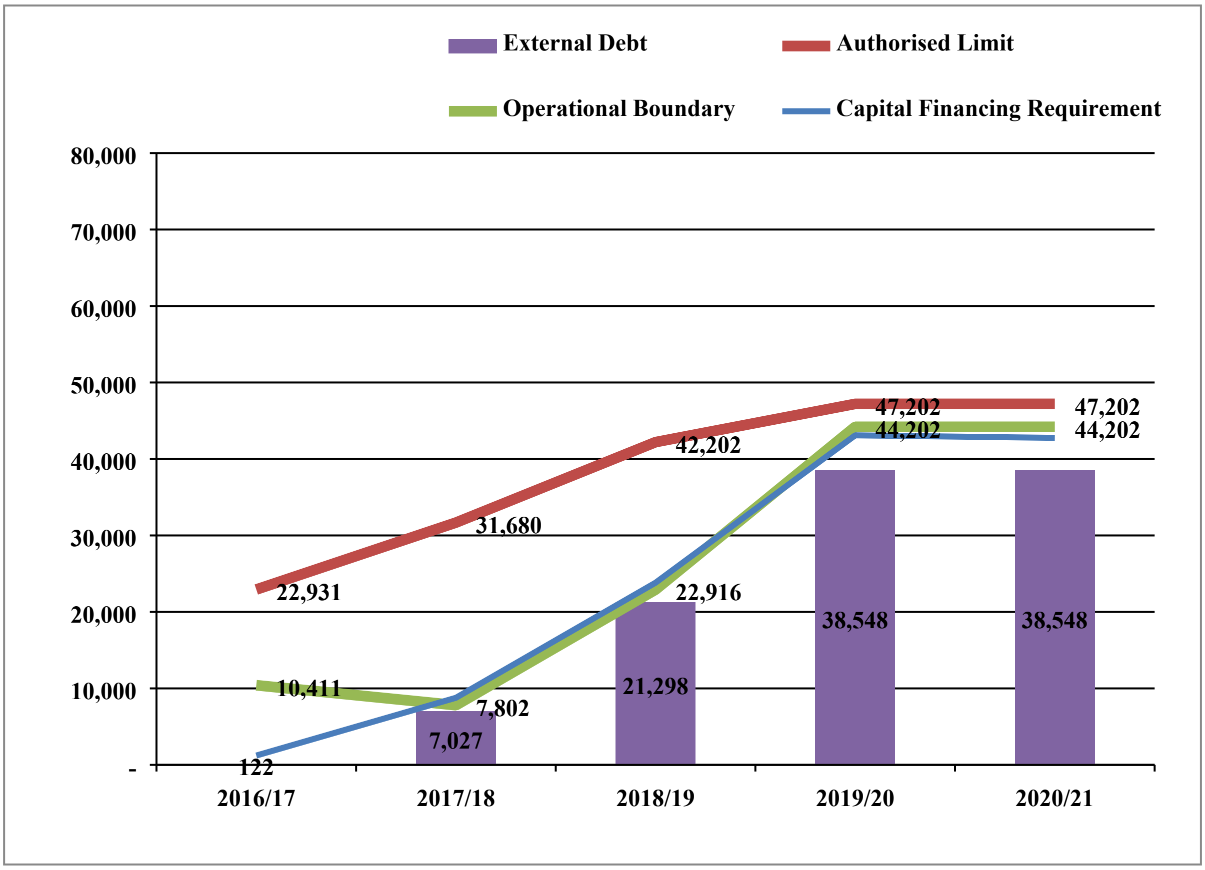
It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

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:

Authorised limit £m	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Gross Debt*	31.653	42.202	47.202	47.202
Other long term liabilities	0.027	0.000	0.000	0.000
Authorised Limit	**31.680**	**42.202**	**47.202**	**47.202**

**Gross debt estimates allow for external borrowing in advance of need for up to a maximum of two years and includes additional headroom of £5m for unexpected cashflow movements.*

The graph below shows our projections of CFR and borrowing;



3.4 Prospects for interest rates

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 our central view.

	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank rate	0.50%	0.75%	0.75%	1.00%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.50%
5yr PWLB rate	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%
10yr PWLB rate	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%
25yr PWLB rate	2.80%	2.90%	3.00%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB rate	2.60%	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%

(A more detailed interest rate forecast and economic commentary are set out in appendices B and C)

As expected, the Monetary Policy Committee (MPC) delivered a 0.25% increase in Bank Rate at its meeting on 2 November. This removed the emergency cut in August 2016 after the EU referendum. The MPC 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.

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 MPC meeting when financial markets reacted by accelerating their expectations for the timing of Bank Rate increases. 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 authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt;
- There will remain a cost of carry 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

The Borrowing Strategy covers the relevant prudential and treasury indicators, and the current and projected debt positions as detailed above.

The key objectives of the Council's Borrowing Strategy are;

- To ensure that future external debt is affordable and sustainable within the long term within the revenue budget constraints.

- to borrow to support commercial aspirations, where returns can meet the cost of borrowing.
- to support schemes with a socio-economic value ie for the regeneration and growth of the District.
- to support significant service investment where the cost of borrowing will be offset by efficiencies and/or cost savings
- to potentially borrow in advance of need so that external debt (fixed rate funding) is arranged whilst interest rates are lower than they are projected to be over the next few years; and
- all external debt undertaken will be repaid on loan maturities

The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with external loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.

Against this background and the risks within the economic forecast, caution will be adopted with the 2018/19 treasury operations. The Director of Resources 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 to be in the next few years.

Any decisions will be reported to the appropriate decision making body at the next available opportunity.

3.6 Policy on borrowing in advance of need

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.

Borrowing in advance will be made within the constraints that:

- It will be limited to no more than 75% of the expected increase in borrowing need (CFR) over the three year planning period; and
- The authority would not look to borrow more than 24 months in advance of need.

Non-Treasury investments in the form of acquisitions of Commercial Investment Properties are funded from borrowing and are made to generate a net contribution to revenue to support ongoing delivery of core services.

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

3.7 Municipal Bond Agency

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

4.0 ANNUAL INVESTMENT STRATEGY

4.1 Investment policy

The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the 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.

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.

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.

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.

Investment instruments identified for use in the financial year are listed in appendix 5.4 under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the Council's treasury management practices – schedules.

4.2 Creditworthiness policy

This Council applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard & Poor's. The credit ratings of counterparties are supplemented with the following overlays:

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

This modelling approach combines credit ratings, credit Watches and credit Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. 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 1.5
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 100 days
- No colour not to be used

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

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

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.

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.

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.

The primary principle covering the Council's investment criteria is the security of it's investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing the investment counterparties with adequate security and monitoring their security. This is set out in the specified and non-specified investment sections below; and
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may be prudently committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

The Director of Resources will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

Credit rating information is supplied by Link Asset Services, our treasury consultants, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating Watches (notification of a likely change), rating Outlooks (notification of possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing.

The criteria for providing a pool of high quality investment counterparties (both specified and non specified investments) is:

- Banks 1 – good credit quality – the Council will only use banks which:
  i. Are UK banks; and/or
  ii. Are non-UK and domiciled in a country which has a minimum sovereign Long Term rating of AA

  And have, as a minimum the following Fitch, Moody's and Standard & Poors credit ratings (where rated):

    i. Short Term – F1
    ii. Long Term – A

- Banks 2 – Part nationalised UK bank, can be used provided the bank continues to be part nationalised or it meets the ratings in Banks 1 above.
- Banks 3 – The Council's own banker for transactional purposes if the bank falls below the above criteria, although in this case the balances will be minimised in both monetary size and time invested.
- Bank subsidiary and treasury operation – The Council will use these where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above.
- Building Societies – The Council will use all societies which:
  i. Meet the ratings for banks outlined above;

- Money Market Funds (MMFs) – AAA
- Enhanced Money Market Funds (EMMFs) – AAA
- UK Government (including gilts, treasury bonds and the DMADF)
- Local Authorities, parish councils etc
- Supernational institutions
- Local Authority Property Asset Fund (CCLA)
- Corporate Bond Funds
- Covered Bonds
- Local Authority Bills

Use of additional information other than credit ratings. Additional requirements under the Code require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating Watches/Outlooks) will be applied to compare the relative security of differing investment counterparties.

Time and monetary limits applying to investments. The time and monetary limits for institutions on the Council's counterparty list are as follows (these will cover both specified and non-specified investments). It should be noted that in the case of Lloyds Bank, our current bankers, that as well as allowing £5m fixed term investment in that one institution that there is flexibility to hold, in current account balances at Lloyds Bank, up to £1m 'cash' on any one day:

	Fitch	Moody's	Standard & Poors	Money Limit	Time Limit
Banks 1 – up to 1 year	F1	P1	A1	£5m per counterparty at Group level	1 year
Banks 1 – over 1 year	AA	Aa2	AA	£2m maximum exposure	1 year to 5 years
Banks 2 – UK part nationalised				£5m per counterparty at Group Level	1 year
Banks 3 – Council's own bank if not covered by 1 or 2				£1m	1 Day
Other Local Authorities				£5m per counterparty	5 years
Bank of England DMADF				No limit	6 mths
Gilts/Treasury Bills – where no loss of principal if held to maturity				£5m maximum exposure	5 years
Supranational				£5m per counterparty	1 year
Quality Corporate Bonds Funds				£2m	5 years
Local Authority Property Asset Funds				£4m	5 years
Certificates of Deposit				£2m	5 years
Covered Bonds				£1m	5 years
Local Authority Bills				£2m	1 year
	Fund rating			Money and/or % Limit	Time Limit
Money market funds	AAA			£5m per counterparty	Overnight
Enhanced money market funds	AAA			£5m	5 years

4.3 Country limits

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA from Fitch. The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix E. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

In addition

- No more than £2m will be placed with any non-UK country at any time;
- Limits in place above will apply to a group of companies;
- Sector limits will be monitored regularly for appropriateness

4.4 Investment strategy

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). Longer term investment will be undertaken where it is anticipated that levels of reserves and cashflows are adequate over the medium term.

Investment returns expectations.

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

- 2017/18 0.50%
- 2018/19 0.75%
- 2019/20 1.00%
- 2020/21 1.25%

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:

	Now
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%

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

The Council is expecting to have an average investment portfolio of £14.714m throughout 2018/19 and expects to receive investment income totalling £0.223m as shown below

Treasury Investment Portfolio	Average Portfolio £m	Interest Rate %	Interest £'000
Liquidity Investments	6.000	0.40	0.024
Short Term Investments	5.714	0.70	0.040
Long Term Investments	3.000	5.29	0.159
Total Investment Income (2018/19)			**0.223**

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.

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

Maximum principal sums invested > 365 days			
£m	**2018/19**	**2019/20**	**2020/21**
Principal sums invested > 365 days	£6m	£6m	£6m

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

These benchmarks are simple guides to maximum risk, so they may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the mid-year or Annual Report.
Security - The Council's maximum security risk benchmark for the current portfolio, when compared to these historic default tables, is:

- 0.06% historic risk of default when compared to the whole portfolio.

Liquidity – in respect of this area the Council seeks to maintain:

- Liquid short term deposits of at least £4m available with a week's notice.
- Weighted average life benchmark is expected to be 0.25 years, with a maximum of 1 years.

Yield - local measures of yield benchmarks are;

- Investments – internal returns above the 7 day LIBID rate

And in addition that the security benchmark for each individual year is:

	1 year	2 years	3 years	4 years	5 years
Maximum	**0.07%**	**0.19%**	**0.36%**	**0.55%**	**0.77%**

Note: This benchmark is an average risk of default measure, and would not constitute an expectation of loss against a particular investment.

4.6 End of year investment report

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

4.7 Non-Treasury Investments (Commercial Property)

Any investment in Commercial Properties will be in accordance with the Commercial Portfolio Strategy and are being acquired to support delivery of services in a financially sustainable organisation. The MTFP assumes a £20m investment will generate a £600k net contribution to revenue (after the costs of borrowing have been met.)

Appropriate experts will be engaged as required.

All assets will be assessed against 7 criteria and the Director of Resources will have delegated Authority to complete on the acquisition of assets which score 50 or more out of 70. Any asset which falls below this threshold or registers a zero against any criteria may still be considered but specific justification will need to be provided and the decision to proceed taken to the Corporate Policy and Resources Committee for approval.

An annual review will be undertaken of the Commercial Property Portfolio to ascertain whether its fair value is sufficient to provide security against loss against the capital investment, and therefore adequate to meet the cost of outstanding borrowing.

Under the Minimum Revenue Provision (MRP) Policy, there will be no annual MRP charge for borrowing undertaken to finance Commercial Properties, however this will be reviewed on a case by case basis.

A Valuation Volatility Earmarked Reserve has been created to mitigate any loss of capital investment upon the sale of an asset, to meet the cost of any shortfall against outstanding debt. A proportion of the annual revenue income generated from the investment will be allocated for risk provision.

A Commercial Contingency revenue budget has been included within the MTFP to mitigate the risk of not achieving the desired level of yield from the Portfolio.

These investment assets are not deemed to be liquid over the short term but are likely to be held for the medium term of 5-10 years.

A number of prudential indicators in relation to these investments are contained within the Treasury and Prudential Indicators.

Strategy

Working with the commercial property consultant, Cushman & Wakefield, officers have developed an investment strategy for the Council that aims to balance risk across the portfolio whilst achieving the target returns required.

The strategy includes;

1. To acquire an investment portfolio of circa 8 commercial property assets in lot sizes of £1.0m to £4.0m, targeting an average lot size of circa £2.5m across the portfolio and total investment of £20.0m.

2. Authority to complete on acquisitions should be delegated to the Director of Resources reporting to the Leader of the Council, provided that the purchase is within agreed criteria. All assets will be assessed against these criteria and the Director of Resources will have delegated Authority to complete on the acquisition of assets which score 50 or more out of 70. Any asset which falls below this threshold or registers a zero against any criteria may still be considered but specific justification will need to be provided and the decision to proceed taken to the Corporate Policy and Resources Committee for approval. An example of how this scoring criteria will be applied is provided at Appendix D of the attached report.

3. A combination of reserves and borrowing will be used to fund acquisitions. Business case modelling will be developed using an opportunity cost of capital based on debt funded through Prudential Borrowing. The business case will be made on the basis of borrowing the full amount each time to ensure that resources are able to be recycled.

4. All assets will be acquired against a target hold period of 5 to 10 years with consideration given to asset management to enhance/protect value over the period of ownership (and any additional resource required/expected in this respect) and risks relating to disposal after the proposed hold period. A proportion of the income will be allocated for risk provision. Further returns would depend on investment performance relative to target and might be achieved through release of the risk provision and/or capital returns.

5. The financial position will be thoroughly monitored throughout the hold period and adequate response made to any change in market conditions and portfolio performance. Decisions regarding the funding of acquisitions will be made by the Director of Resources / s.151 officer and will be based on:

    - An analysis of disposal value risk after an assumed hold period

- The expectation that the asset will generate a capital return that tracks inflation or better with a provision for risk should this not be achieved

6. Access to suitably qualified/experienced resource is essential for successful delivery and management of the risks involved. Resources should be identified and ring-fenced to the activity. The property and asset team is currently being restructured to ensure that sufficient resources available to manage the existing assets and the new additions that would be acquired in line with this strategy.

5 APPENDICES

A Prudential and treasury indicators and MRP statement
B Interest rate forecasts
C Economic background
D Treasury management practice 1 – credit and counterparty risk management
E Approved countries for investments
F Treasury management scheme of delegation
G The treasury management role of the section 151 officer

APPENDIX A

5.1 THE CAPITAL PRUDENTIAL AND TREASURY INDICATORS 2018/19 – 2020/21 AND MRP STATEMENT

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

5.2 Capital expenditure

Capital expenditure By Cluster £m	2016/17 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
People	1.808	1.176	4.913	9.096	1.074
Places	0.552	4.188	10.190	11.419	0.466
Policy and Resources	0.131	1.366	0.353	0.010	0.080
Commercial Investment Properties	0.093	6.000	10.000	4.000	0.000
Total	**2.584**	**12.730**	**25.456**	**24.525**	**1.620**

5.3 Minimum revenue provision (MRP) policy statement

The Council is required to pay off an element of the accumulated General Fund capital spend funded from borrowing (the CFR) each year through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

CLG regulations have been issued which require the full Council to approve **an 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 MRP Statement;

From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be*:*

- **Asset life method** – MRP will be charged, and therefore debt repaid over the expected useful life of the asset financed from borrowing 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) (option 3);

- **Asset life method – Annuity Method**
  Under this approach the debt is repaid over the expected useful life of the asset financed from borrowing. For, regeneration schemes or administrative projects, where revenue benefits are only realised in future years or increase in future years, and will be based on an appropriate rate.

- **Loan Principal repayment as proxy for MRP**
  The council considers that where borrowing has funded loan advances, the loan principal repaid (or in the event of default the realisation of security) as a

capital receipt will be utilised to repay the borrowing and therefore negates the requirement to set aside an annual MRP charge.

- **Borrowing for Non-Treasury Investments**
  Where the Council borrows and anticipates a capital receipt will be realised within the short/medium term, ie for the acquisition of Commercial Investment Properties funded from borrowing, where the asset is to be held for a set period, and a capital receipt is expected to be realized at the end of this period, then the requirement to set aside a MRP to repay the debt will be considered on a case by case basis and in such cases, and with the agreement of the Auditor, MRP may not be applied subject to taking into account any risks, project profiles and revenue income streams from the investment.

  This is considered a prudent charge as the assets will be held for medium term period and the debt will be repaid upon sale of the asset.

  To mitigate the risk of loss of capital upon sale of any Commercial Investment Property, should the capital receipt not meeting outstanding debt, a Valuation Volatility Reserve has been created to fund any shortfall.

- **Finance Leases**
  Repayment of principal included in finance lease repayments are applied as MRP**.**

These options provide for a reduction in the borrowing need over approximately the asset's life.

5.4 Affordability prudential indicators

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:

a. 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 net of investment income) against the net revenue stream.

£m	2016/17 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Net Revenue Expenditure £m	**15.403**	**13.297**	**15.434**	**13.042**	**13.028**
Interest Payable	0	0	0.372	0.883	1.174
Interest Receivable (-)	-0.266	-0.172	-0.223	-0.183	-0.158
MRP	0.223	0.126	0.065	0.018	0.329
Total Capital Financing Charges	**-0.043**	**-0.046**	**0.214**	**0.718**	**1.345**
% Ratio	**-0.28**	**-0.34**	**1.39**	**5.50**	**10.33**

b. Of which: element of Ratio of financing costs to net revenue stream relating to Non-Treasury Investments

£m	2016/17 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Net Revenue Expenditure £m	**15.403**	**13.297**	**15.434**	**13.042**	**13.028**
Interest Payable	0	0	0.289	0.496	0.559
Interest Receivable (-)	0	0	0	0	0
MRP	0	0	0	0	0
Total Capital Financing Charges	**0**	**0**	**0.289**	**0.496**	**0.559**
% Ratio	**0**	**0**	**1.87**	**3.81**	**4.29**

The estimates of financing costs include current commitments and the proposals in this budget report.

Interest receivable excludes interest from loans.

c. Incremental impact of capital investment decisions on council tax

This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in this budget report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period.

Incremental impact of capital investment decisions on the band D council tax

£	2016/17 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Council tax - band D	-1.31	-1.55	-6.77	-19.96	-18.88

Of which: Incremental impact of Non-Treasury Investments

£	2016/17 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Council tax - band D	0	-2.73	-9.24	-19.41	-20.33

5.5 Treasury indicators for debt

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

- 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 to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits. The Council is asked to approve the following treasury indicators and limits:

£m	**2018/19**	**2019/20**	**2020/21**
Interest rate exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates: • **Debt only** • **Investments only**	 100% 75%	 100% 75%	 100% 75%
Limits on variable interest rates • **Debt only** • **Investments only**	 25% 100%	 25% 100%	 20% 100%
Maturity structure of fixed interest rate borrowing 2018/19			
		Lower	**Upper**
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%
Maturity structure of variable interest rate borrowing 2018/19			
		Lower	Upper
Under 12 months		0%	100%
12 months to 2 years		0%	100%
2 years to 5 years		0%	0%
5 years to 10 years		0%	0%
10 years to 20 years		0%	0%
20 years to 30 years		0%	0%
30 years to 40 years		0%	0%
40 years to 50 years		0%	0%

APPENDIX B

INTEREST RATE FORECASTS 2017 – 2020

Link Asset Services Interest Rate View	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate View	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%
3 Month LIBID	0.40%	0.40%	0.40%	0.40%	0.60%	0.60%	0.60%	0.70%	0.90%	0.90%	1.00%	1.20%	1.20%	1.20%
6 Month LIBID	0.50%	0.50%	0.50%	0.60%	0.80%	0.80%	0.80%	0.90%	1.00%	1.00%	1.10%	1.30%	1.30%	1.40%
12 Month LIBID	0.70%	0.80%	0.80%	0.90%	1.00%	1.00%	1.10%	1.10%	1.30%	1.30%	1.40%	1.50%	1.50%	1.60%
5yr PWLB Rate	1.50%	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
10yr PWLB Rate	2.10%	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
25yr PWLB Rate	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.50%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%
Bank Rate														
Link Asset Services	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%
Capital Economics	0.50%	0.50%	0.75%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	-	-	-	-	-
5yr PWLB Rate														
Link Asset Services	1.50%	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
Capital Economics	1.70%	1.90%	2.30%	2.60%	2.90%	2.90%	2.90%	2.90%	2.90%	-	-	-	-	-
10yr PWLB Rate														
Link Asset Services	2.10%	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
Capital Economics	2.30%	2.60%	2.80%	3.10%	3.30%	3.30%	3.30%	3.30%	3.30%	-	-	-	-	-
25yr PWLB Rate														
Link Asset Services	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
Capital Economics	2.95%	3.15%	3.45%	3.65%	3.90%	3.90%	3.90%	3.90%	3.90%	-	-	-	-	-
50yr PWLB Rate														
Link Asset Services	2.50%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%
Capital Economics	2.80%	3.10%	3.30%	3.60%	3.80%	3.80%	3.80%	3.80%	3.80%	-	-	-	-	-

Please note – The current PWLB rates and forecast shown above have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012

The overall longer run trend is for gilt yields and 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 PWLB 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.

Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts (and MPC decisions) will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

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 PWLB rates currently include:

- Bank of England monetary policy 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.
- The result of the October 2017 Austrian general election is likely to result in a strongly anti-immigrant coalition government. In addition, the new Czech prime minister is expected to be Andrej Babis who is strongly against EU 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 EU integration and centralisation of EU policy. This, in turn, could spill over into impacting the Euro, EU 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 PWLB rates, especially for longer term PWLB 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.

APPENDIX C

ECONOMIC BACKGROUND

GLOBAL OUTLOOK. World growth looks to be on an encouraging trend of stronger performance, rising earnings and falling levels of unemployment. In October, the IMF 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 QE-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 QE debt purchases will be over several years. They need to balance their timing to neither squash economic recovery by taking too rapid and too strong action, or, 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 QE. 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 GDP 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, QE 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 GDP 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 confounded pessimistic forecasts of weak growth by coming in at 1.8%, only marginally down on the 1.9% rate for 2016**. In 2017, quarter 1 came in at only +0.3% (+1.8% y/y), quarter 2 +0.3% (+1.5% y/y), quarter 3 +0.4% (+1.5% y/y) and Q4 was +0.5% (+1.5% y/y). The outstanding performance came from the manufacturing sector which showed a 1.3% increase in Q4 and +3.1% y/y helped by an increase in

exports due to the lower value of sterling over the last year and robust economic growth in our main trade partners, the EU and US. It is also notable that there has been a progressive acceleration in total GDP growth during the year which gives ground for optimism looking forward into 2018.
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 CPI 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. Inflation fell to 3.0% in December.) This marginal revision in the Bank's forecast can hardly justify why the MPC 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 MPC 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 EU 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 MPC 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 EU referendum drops out of the CPI 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 MPC 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 EU 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 QE 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 MPC 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 MPC took that action. However, other commentators regard this emergency action by the MPC 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 PWC 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.

EZ. 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 ECB eventually cutting its main rate to -0.4% and embarking on a massive programme of QE. However, growth picked up in 2016 and has now gathered substantial strength and momentum thanks to this stimulus. GDP 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 December inflation was 1.4%. 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 QE 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 started erratically with quarter 1 coming in at an annualised rate of only 1.2%, quarter 2 at 3.1%, quarter 3 3.2% and Q4 2.6%. This gave an overall figure for annual growth in 2017 of 2.6%, an acceleration from 1.5% in 2016. Unemployment in the US has also fallen to the lowest level for seventeen 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 five 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. GDP 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 EU member until March 2019 with access to the single market and tariff free trade between the EU and UK. Different sectors of the UK economy will leave the single market and tariff free trade at different times during the two year transitional period.
- The UK and EU would attempt to negotiate, among other agreements, a bi-lateral trade agreement over that period.
- The UK would aim for a negotiated agreed withdrawal from the EU, although the UK could also exit without any such agreements in the event of a breakdown of negotiations.
- If the UK exits without an agreed deal with the EU, World Trade Organisation rules and tariffs could apply to trade between the UK and EU - but this is not certain.
- On full exit from the EU: the UK parliament would repeal the 1972 European Communities Act.
- The UK will then no longer participate in matters reserved for EU members, such as changes to the EU's budget, voting allocations and policies.

APPENDIX D TREASURY MANAGEMENT PRACTICE (TMP1) – CREDIT AND COUNTERPARTY RISK MANAGEMENT

The CLG issued Investment Guidance in 2010, and this forms the structure of the Council's policy below. These guidelines do not apply to either trust funds or pension funds which operate under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Council to have regard to the CIPFA publication Treasury Managemen in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. This Council adopted the code on 01/03/2010 and will apply its principles to all investment activity. In accordance with the Code, the Director of Finance has produced its treasury management practices (TMPs). This part, TMP 1 (1) covering investment counterparty policy requires approval each year.

Annual investment strategy – The key requirement of both the Code and investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of the following:

- The strategy guidelines for choosing and placing investments, particularly non-specified investments
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments that the Council will use. These are high security (i.e. high credit rating, although this is defined by the Council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

The investment policy proposed for the Council is:

Strategy guidelines – The main strategy guidelines are contained in the body of the treasury strategy statement.

SPECIFIED INVESTMENTS: All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum 'high' quality criteria where applicable. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

1) The UK Government (such as Debt Management Account deposit facility, UK Treasury Bills or a Gilt with less than one year to maturity).
2) Supranational bonds of less than one year's duration
3) A local authority, parish council or community council
4) Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency. For category 4 this covers pooled investment vehicles, such as money market funds, rated AAA by Standard & Poors, Moody's and/or Fitch rating agencies

Within these bodies, and in accordance with the Code, the Council has set additional criteria to set the time and amount of monies which will be invested in these bodies. These criteria are set out in the main report.

NON-SPECIFIED INVESTMENTS: These are any investments which do not meet the specified investment criteria. The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Non specified investment would include any sterling investments with:

	Non Specified Investment Category	Limit £
A	**Gilt Edged Securities** with a maturity of greater than one year. These are Government Bonds and so provide the highest security of investment and the repayment of principal on maturity. Similar to category (a) above, the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.	£5m
B	**The Council's own banker** if it fails to meet the basic credit criteria. In this instance balances will be minimised as far as possible	£1m
C	**Any Bank or Building Society** that has a minimum long term credit rating of AA, for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).	£2m
D	Enhance Money Market Funds AA rated	£2m
E	Corporate Bond Funds	£2m
F	Local Authority Property Asset Fund	£4m
G	Certificates of Deposit	£2m
H	Covered Bonds	£1m
I	Property Funds – The use of these instruments can be deemed to be capital expenditure, and as such will be an application (spending) of capital resources. This Authority will seek guidance on the status of any fund it may consider using	£4m

This Authority will seek further advice on the appropriateness and associated risks with investments in these categories.

The monitoring of investment counterparties – The credit rating of counterparties will be monitored regularly. The Council receives credit rating information (changes, rating watches and rating outlooks) from Link Asset Services as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Director of Finance, and if required new counterparties which meet the criteria will be added to the list.

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.

Accounting treatment of investments. The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

APPENDIX E

APPROVED COUNTRIES FOR INVESTMENTS (As at 22.02.2018)

AAA

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

AA+

- Finland

AA

- Abu Dhabi (UAE)
- France
- U.K.

AA-

- Belgium
- Qatar

APPENDIX F

TREASURY MANAGEMENT SCHEME OF DELEGATION

(i) Full Council

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual Treasury Management Strategy.

(ii) Corporate Policy and Resources Committee

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;
- approving the selection of external service providers and agreeing terms of appointment.

(iii) Governance and Audit Committee

- review and scrutiny of the Treasury Management Strategy, policy and procedures and making recommendations to the full Council.

APPENDIX G

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.