Subject: **Treasury Management Strategy 2020/21**

Report to: Policy and Resources Committee – 4th February 2020

Full Council – 20th February 2020

Report by: Finance Director

SUBJECT MATTER/RECOMMENDATIONS

To consider and recommend to Council the 2020/21 Treasury Management Strategy and Annual Investment Strategy.

RECOMMENDATIONS

It is recommended that the Policy and Resources Committee agree and recommend to Council:

- The TMS for 2020/21
- The Annual Investment Strategy (section 4)
- Operational Boundary and Authorised Limits (Appendix C)

1. INTRODUCTION/BACKGROUND

1.1 The Council is required to determine annually its Treasury Management Strategy (TMS). The TMS for 2020/21 financial year is attached and includes the following:

- Annual Investment Strategy (section 4)
- Operational Boundary and Authorised Limits (Appendix C)

1.2 The Council continues to maintain an under-borrowed position, which means 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. The strategy is prudent as investment returns are low and counterparty risk is relatively high. An under borrowing position is forecast to continue.

1.3 The Council is required to operate a balanced budget, whereby cash raised during the year will meet the cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk appetite, providing adequate liquidity initially before considering investment return.

1.4 The second main function of the treasury management service is the funding of the Council's planned capital plans. These capital plans provide a guide to the borrowing need of the Council, informing the longer term cash flow planning, to ensure the Council can meet its capital spending obligations.

1.5 The management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet the Council risk or cost objectives.

1.6 The treasury strategy has been informed by the current capital programme and updates to the programme as included within the budget report which is being recommended elsewhere on the agenda.

1.7 The revenue implications of the strategy have been included in the General Fund and HRA budgets for 2020/21.

2. FINANCIAL AND RISK IMPLICATIONS

2.1 Detailed within the Strategy Document.

3. CONCLUSIONS

3.1 The Council is required to determine the TMS, as covered within the attached reports Treasury Management Strategy, Annual Investment Strategy and Operational Boundary and Authorised Limits

4. BACKGROUND PAPERS

4.1 The Council is required to determine annually its Treasury Management Strategy.

Area for consideration	**Comment**
Monitoring Officer Consultation:	
Section 151 Officer Consultation:	Yes
Existing Council Policies:	Yes
Financial Implications:	Contained within the detail of the report
Legal Implications (including human rights):	Yes
Risk Implications:	No
Equality Issues/EQIA assessment:	No
Crime & Disorder:	No
Every Child Matters:	No

Treasury Management Strategy Statement 2020/21.

1. Introduction

1.1 Treasury management is the management of the Council's cash flows, borrowing and investments, and the associated risks. The Council has 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.

1.2 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. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

1.3 Investments held for service purposes or for commercial profit are considered in a different report, the Investment Strategy.

1.4 Appendix A and B provide more detailed commentary on economic context and interest rate forecasts.

2. Current Position and Projection

2.1 On 31st December 2019, the Council held £116.8 million of borrowing and £15 million of treasury investments, excluding the investment in Equinox. Table 1 below provides a summary of the Council's treasury portfolio at the end of December 2019.

Table 1: Councils treasury portfolio as at 31st December 2019	**Principal £000**	**Average Interest Rate %**
Call accounts	100	0.60%
Building Society	1,000	0.68%
Money Market Funds	12,000	0.68%
DMO	910	0.50%
Property Fund	1,000	4.38%
Total Investments	**15,010**	
Long –term PWLB loans	71,388	3.15 - 4.40%
Long-term loans other	14,897	3.35 - 4.44%
Short term borrowing	30,504	0.75 - 1.10%
Total Borrowing	**116,789**	
Net Borrowing	**101,779**	

2.2 Future forecast borrowing is shown below in the balance sheet analysis in table 2. The forecast changes in these sums have been informed by future housing revenue account and general fund capital programmes and are detailed in the Capital Strategy.

Table 2: Balance sheet summary and forecast	**31.3.19** **Actual** **£m**	**31.3.20** **Estimate** **£m**	**31.3.21** **Forecast** **£m**	**31.3.22** **Forecast** **£m**	**31.3.23** **Forecast** **£m**
General Fund CFR	50.907	62.854	83.540	84.573	82.648
HRA CFR	82.077	84.216	87.747	91.846	94.995
Total CFR	132.984	147.070	171.287	176.419	177.643
Less: *Other debt liabilities	(0.898)	(0.803)	(0.718)	(0.634)	(0.549)
Borrowing CFR	**132.086**	**146.267**	**170.569**	**175.785**	**177.094**
Less: External borrowing **	(121.851)	(108.767)	(86.179)	(82.587)	(82.492)
Internal (over) borrowing	**10.235**	**37.500**	**84.390**	**93.198**	**94.602**
Less: Usable reserves***	(26.997)	(26.924)	(26.002)	(25.890)	(26.914)
Less: Working capital***	(3.219)	(14.000)	(14.000)	(14.000)	(14.000)
Treasury investments (or New borrowing)	**13.543**	**(3.424)**	**44.388**	**53.308**	**53.688**

* 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
***revised from 18/19 Treasury Management Outturn following audit of 2018/19 accounts

2.3 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.

2.4 The Council has an increasing CFR due to the timing of the approved capital programme, but minimal investments and will therefore be required to borrow up to £54m over the forecast period.

2.5 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 2 shows that the Council expects to comply with this recommendation during 2019/20, and Appendix C illustrates the Operational Boundary and Authorised Limits.

3. Borrowing Strategy

3.1 The Council currently holds £116.789 million of loans, a decrease of £9 million on the previous year, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in Table 2 shows that the Council expects to borrow up to £44m in 2020/21 if it used all its internal resources (i.e. usable reserves and working capital shown in Table 2). However, as the Council will need to maintain investments of at least £10m to remain a Professional Client under MiFID II (see paragraph 6.8), this net borrowing requirement will rise to £54m. The Council may also borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £181 million as per the Councils operational boundary and authorised limits (detailed in Appendix C).

3.2 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. With short-term interest rates lower than long-term borrowing rates, the Council has felt it was more cost effective in the near term to use internal resources, or to borrow short-term loans.

3.3 **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.

3.4 By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of 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 2020/21 with a view to keeping future interest costs low, even if this causes additional cost in the short-term. The cost of carry analysis performed by the Council's treasury management advisors Arlingclose has not indicated any value in borrowing in advance for future year's planned expenditure and therefore none has been undertaken.

3.5 The Council has previously raised the majority of its long-term borrowing from the PWLB but the government increased PWLB rates by 1% in October 2019 making it now a relatively expensive option. The Council will now look to borrow any long-term loans from other sources including banks and local authorities and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code.

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

3.7 In addition, the Council may borrow further short-term loans to cover unplanned cash flow shortages.

3.8 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 Norfolk Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local Council bond issues

3.9 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

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

3.11 LOBOs: The Council holds £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. The next date for this option is 2nd November 2024.

3.12 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.

4. Investment Strategy

4.1 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 investments balance average is £20 million, and similar levels are expected to be maintained in the forthcoming year.

4.2 Objectives: The CIPFA Code requires 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.

4.3 If the UK enters into a recession in 2020/21, 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.

4.4 **Strategy:** Given the increasing risk and very low returns from short-term unsecured bank investments, the Council aims to [further] diversify into more secure and/or higher yielding asset classes during 2020/21. This is especially the case for the estimated £10m that is available for longer-term investment. All of the Council's surplus cash (average £20m) is currently invested in a mixture of short-term secured and unsecured bank deposits, money market funds and £1 million invested in a longer-term pooled fund. This diversification will represent a substantial change in strategy over the coming year.

4.5 **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.

4.6 The Council may invest its surplus funds with any of the counterparty types in table 3 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 3: 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	£1.5m 3 years	£2m 20 years	n/a	£1m 20 years	£1.5m 20 years
AA+	£1.5m 1 years	£2m 10 years	n/a	£1m 10 years	£1.5m 10 years
AA	£1.5m 1 years	£2m 5 years	n/a	£1m 5 years	£1.5m 10 years
AA-	£1.5m 1 years	£2m 4 years	n/a	£1m 4 years	£1.5m 10 years
A+	£1.5m 1 years	£2m 3 years	n/a	£1m 3 years	£1.5m 5 years
A	£1.5m 1 years	£2m 2 years	n/a	£1m 2 years	£1.5m 5 years
A-	£1.5m 6 months	£2m 13 months	n/a	£1m 13 months	£1m 5 years
None	£1m 6 months	n/a	n/a	£0.5m 5 years	£1m 5 years
UK Govt		UK Local Council £2m 2 years (per council)			
Pooled funds		£3m per fund			

This table must be read in conjunction with the notes below

4.7 **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.

4.8 **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.

4.9 **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.

4.10 **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.

4.11 **Corporates:** Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made either following an external credit assessment and will be subject to individual business cases and not for treasury management purpose but for service purpose.

4.12 **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.

4.13 **Pooled funds:** Shares or units in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods. The limit may be exceeded at times due to higher retained cash balances than anticipated. Considering our strategic goals of security, liquidity and return we would choose the Money Market Funds as the most appropriated to achieve the strategic goal.

4.14 **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.

4.15 **Operational bank accounts:** The Council may incur operational exposures, for example though 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. Balances will therefore be kept as low as possible without affecting operations. 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.

4.16 **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.

4.17 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.

4.18 **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.

4.19 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.

4.20 **Investment limits:**

4.21 The Council's revenue reserves available to cover investment losses are forecast to be £15 million on 31st March 2020. In order to reduce the 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 £2 million, other pooled funds for which the limit per fund is £3m and for UK central government where there is no limit. 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 4: Investment limits	**Cash limit**
Any single organisation, except the UK Central Government	£2m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£2m per group
Any group of pooled funds under the same management	£6m per manager
Negotiable instruments held in a broker's nominee account	£4m per broker
Foreign countries	£1.5m per country
Registered providers and registered social landlords	£2m in total
Unsecured investments with building societies	£1.5m in total
Loans to unrated corporates	£1m in total
Money market funds	£12m in total

4.22 Cash Flow/Liquidity Management:

4.23 The Council officers maintain a detailed cash flow forecast for each coming year revising it as more information becomes available. This informs the short-term investments such as those to cover precept payments. The forecast is compiled on a prudent basis with receipts under-estimated and payments over-estimated to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. The long-term investment strategy is based on the Councils medium term strategy.

5. Treasury Management Indicators

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

5.2 **Security:** The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average [credit rating / credit score] 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	A

5.3 **Liquidity:** The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments it can borrow each quarter without giving prior notice.

Liquidity risk indicator	Target £m
Liquid short-term deposits	£11.000
Bank Overdraft	£0.250

5.4 **Interest rate exposures:** This indicator is set to control the Council's exposure to interest rate risk. The [upper limits on the one-year revenue impact of a 1% rise or fall in interest rates] will be:

Interest rate risk indicator	Limit £000
Upper limit on one-year revenue impact of a 1% rise in interest rates	50
Upper limit on one-year revenue impact of a 1% fall in interest rates	94

5.5 The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.

5.6 **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:

Refinancing rate risk indicator	Upper limit	Lower limit
Under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	60%	0%
5 years and within 10 years	80%	0%
10 years and above	100%	0%

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

5.8 **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	2020/21	2021/22	2022/23
Limit on principal invested beyond year end	£12m	£12m	£12m

6. Other Treasury Management Issues

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

6.2 Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the *Localism Act 2011* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

6.3 The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

6.4 Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

6.5 In line with the CIPFA Code, the Council will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.

6.6 **Policy on apportioning interest for HRA:** On 1st April 2012, the Council notionally split each of its existing long-term loans into General Fund and HRA pools. Annually a calculation is performed to allocate interest between the General Fund and HRA.

6.7 **Markets in Financial Instruments Directive (MiFID II):** The Council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the Chief Financial Officer believes this to be the most appropriate status.

7. Financial Implications

7.1 The budget for investment income in 2020/21 is £297 thousand, £176 thousand relating to treasury investments based on an average investment portfolio of £20 million. The majority of which is invested in low risk short term investments with of an average interest rate of 0.68%. A further £1 million is invested in a long- term pooled investment fund where the value changes with market prices and have a notice period. The budget for debt interest paid for General Fund is £1.278 million and HRA is £2.861 million in 2020/21.

Actual levels of investments and borrowing, and actual interest rates are monitored during the year as part of the budget monitoring process.

7.2 Other Options Considered

7.3 The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Section 151 Officer believes that the 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

Appendix A

Economic background and interest rate forecast

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 2020/21. The General Election has removed some uncertainty within the market, however following the expected Withdrawal Bill, uncertainties around the future trading relationship with the EU remain.

GDP growth rose by 0.4% in the third quarter of 2019 from -0.2% in the previous three months with the annual rate falling further below its trend rate to 1.1% from 1.2%. Services, construction and production added positively to growth, by 0.5%, 1.2% and 0.1% respectively, while agriculture recorded a fall of 0.1%. Looking ahead, the Bank of England's Monetary Policy Report (formerly the Quarterly Inflation Report) forecasts economic growth to pick up during 2020 as Brexit-related uncertainties dissipate and provide a boost to business investment helping GDP reach 1.6% in Q4 2020, 1.8% in Q4 2021 and 2.1% in Q4 2022.

The headline rate of UK Consumer Price Inflation remained the same in November 2019 at 1.5% year-on-year, the same as October 2019, however continuing to fall from highs of 2.1% in July and April 2019 as accommodation services and transport continued to contribute to a level of inflation below the BOE target of 2%. Labour market data continues to be positive. The ILO unemployment rate continues to hold at historic lows at 3.8%, its lowest level since 1975. The 3-month average annual growth rate for pay excluding bonuses rose to 3.5% in November 2019 providing some evidence that a shortage of labour is supporting wages. However, adjusting for inflation this means real wages were only up by 0.9% in October 2019 and only likely to have a moderate impact on household spending.

Domestic inflationary pressures have abated, as domestic gas and electricity price freezes have taken effect until 2020. The price of oil has fallen through the year, despite a rise in prices in December 2019. The limited inflationary pressure from real wages will likely keep inflation below the Bank of England target of 2%. The Bank of England maintained Bank Rate to 0.75% in November following a 7-2 vote by the Monetary Policy Committee. Despite keeping rates on hold, MPC members did confirm that if Brexit uncertainty drags on or global growth fails to recover, they are prepared to cut interest rates as required. Moreover, the downward revisions to some of the growth projections in the Monetary Policy Report suggest the Committee may now be less convinced of the need to increase rates even if there is a Brexit deal.

The US economy has continued to perform relatively well compared to other developed nations; however, the Federal Reserve has started to unwind its monetary tightening through 2019. The Federal Reserve has cut rates three times to 1.5% - 1.75%, to stimulate growth as GDP growth has started to fall (to 2.1%).

The fallout from the US-China trade war continues which, risks contributing to a slowdown in global economic activity in 2019. Recent suggestions have been an initial compromise and potential unwinding of tariffs; however, this can change quickly. Slow growth in Europe, combined with changes in leadership at the ECB and IMF has led to a change of stance in 2019. Quantitative easing has continued and been extended.

Credit outlook

The recent Bank of England stress tests assessed all seven UK banking groups. The tests scenarios include deep simultaneous recessions in the UK and global economies that are more severe overall than the global financial crisis, combined with large falls in asset prices and a separate stress of misconduct costs. All seven banks passed the test on both a CET1 ratio and a leverage ratio basis. Major banks have steadily increased their capital for many years now. However, there are a number of shortcomings in the Bank's approach; timeliness as the results are over 11 months of out date when they are published, being based on end-2018 balance sheets; ringfencing, as the tests ignore the restrictions on transferring capital between ringfenced "retail" banks and non-ringfenced "investment" banks within the larger groups and; coverage – the tests should be expanded to cover a wider range of UK banks and building societies.

The Bank of England will seek to address some of these issues in 2020, when Virgin Money/Clydesdale will be added to the testing group and separate tests will be included of ringfenced banks.

Challenger banks hit the news headlines in 2019 with Metro Bank and TSB Bank both suffering adverse publicity and falling customer numbers.

Looking forward, the potential for a "no-deal" Brexit and/or a global recession remain the major risks facing banks and building societies in 2020/21 and a cautious approach to bank deposits remains advisable.

Interest rate forecast

The Council's treasury management adviser Arlingclose is forecasting that Bank Rate will remain at 0.75% until the end of 2022. The risks to this forecast are deemed to be significantly weighted to the downside, particularly given the upcoming general election, the need for greater clarity on Brexit and the continuing global economic slowdown. The Bank of England, having previously indicated interest rates may need to rise if a Brexit agreement was reached, stated in its November Monetary Policy Report and its Bank Rate decision (7-2 vote to hold rates) that the MPC now believe this is less likely even in the event of a deal.

Gilt yields have risen but remain at low levels and only some very modest upward movement from current levels are expected based on Arlingclose's interest rate projections. The central case is for 10-year and 20-year gilt yields to rise to around 1.00% and 1.40% respectively over the time horizon, with broadly balanced risks to both the upside and downside. However, short-term volatility arising from both economic and political events over the period is a near certainty.

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

Appendix B

Economic & Interest Rate Forecast January 2020

- The global economy has entered a period of weaker growth in response to political issues. The UK economy continues to experience slower growth due to both Brexit uncertainty and the downturn in global activity. In response, global and UK interest rate expectations are low.
- Some improvement in global economic data and a more positive outlook for US/China trade negotiations has prompted worst case economic scenarios to be pared back.
- The new Conservative UK government will progress with achieving Brexit on 31st January 2020. The more stable political environment will prompt a partial return in business and household confidence in the short term, but the subsequent limited Brexit transitionary period, which the government is seeking to enforce, will create additional economic uncertainty.
- UK economic growth stalled in Q4 2019. Inflation is running below target at 1.5%. The inflationary consequences of the relatively tight labour market have yet to manifest, while slower global growth should reduce the prospect of externally driven pressure, although escalating geopolitical turmoil could continue to push up oil prices.
- The first few months of 2020 will indicate whether the economy benefits from restored confidence. The government will undertake substantial fiscal easing in 2020/21, which should help support growth in the event of a downturn in private sector activity.
- The weak outlook for the UK economy and current low inflation have placed **pressure on the MPC to loosen monetary policy**. Two MPC members voted for an immediate cut in the last two MPC meetings of 2019. The evolution of the economic data and political moves over the next few months will inform policy, but **upside risks to Bank Rate are very limited**.
- Central bank actions and escalating geopolitical risks will produce volatility in financial markets, including bond markets.

Forecast:

- Arlingclose has maintained the Bank Rate forecast at 0.75% for the foreseeable future. Substantial risks to this forecast remain, arising primarily from the government's policy around Brexit and the transitionary period.
- Arlingclose judges that the risks are weighted to the downside.
- Gilt yields remain low due to the soft UK and global economic outlooks. US monetary policy and UK government spending will be key influences alongside UK monetary policy.
- We expect gilt yields to remain at relatively low levels for the foreseeable future and judge the risks to be broadly balanced.

	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.21**
Arlingclose Central Case	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**
Downside risk	-0.50	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	**-0.73**
3-month money market rate														
Upside risk	0.10	0.10	0.25	0.25	0.25	0.25	0.25	0.25	0.30	0.30	0.30	0.30	0.30	**0.25**
Arlingclose Central Case	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**
Downside risk	-0.50	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	**-0.73**
1yr money market rate														
Upside risk	0.10	0.20	0.20	0.20	0.20	0.20	0.20	0.25	0.30	0.30	0.30	0.30	0.30	**0.23**
Arlingclose Central Case	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**
Downside risk	-0.30	-0.50	-0.55	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	**-0.60**
5yr gilt yield														
Upside risk	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.45	0.45	0.45	**0.37**
Arlingclose Central Case	**0.50**	**0.50**	**0.50**	**0.55**	**0.60**	**0.60**	**0.60**	**0.60**	**0.60**	**0.60**	**0.60**	**0.60**	**0.60**	**0.57**
Downside risk	-0.35	-0.50	-0.50	-0.55	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	**-0.56**
10yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	**0.37**
Arlingclose Central Case	**0.75**	**0.75**	**0.80**	**0.80**	**0.85**	**0.85**	**0.90**	**0.90**	**0.95**	**0.95**	**1.00**	**1.00**	**1.00**	**0.88**
Downside risk	-0.40	-0.40	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	**-0.45**
20yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	**0.37**
Arlingclose Central Case	**1.20**	**1.20**	**1.25**	**1.25**	**1.25**	**1.30**	**1.30**	**1.30**	**1.35**	**1.35**	**1.35**	**1.40**	**1.40**	**1.30**
Downside risk	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	**-0.45**
50yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	**0.37**
Arlingclose Central Case	**1.20**	**1.20**	**1.25**	**1.25**	**1.25**	**1.30**	**1.30**	**1.30**	**1.35**	**1.35**	**1.35**	**1.40**	**1.40**	**1.30**
Downside risk	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	**-0.45**

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 1.80%

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

Appendix C

Operational Boundary and Authorised limits

Operational boundary	**2019/20 Estimate £m**	**2020/21 Estimate £m**	**2021/22 Estimate £m**	**2022/23 Estimate £m**
Debt	£150.000	£174.000	£179.000	£181.000
Other long-term liabilities	£2.000	£2.000	£2.000	£2.000
Total	**£152.000**	**£176.000**	**£181.000**	**£183.000**

Authorised limit	**2019/20 Estimate £m**	**2020/21 Estimate £m**	**2021/22 Estimate £m**	**2022/23 Estimate £m**
Debt	£155.000	£179.000	£184.000	£186.000
Other long-term liabilities	£2.000	£2.000	£2.000	£2.000
Total	**£157.000**	**£181.000**	**£186.000**	**£188.000**