Appendix 3

Treasury Management Strategy Statement 2018/19

Introduction

In April 2002 the Council adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year. CIPFA consulted on changes to the Code in 2017, but has yet to publish a revised Code.

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

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

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

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

External Context

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

Consumer price inflation reached 3.0% in September 2017 as the post-referendum devaluation of sterling continued to feed through to imports. Unemployment continued to fall and the Bank of England's Monetary Policy Committee judged that the extent of spare capacity in the economy seemed limited and the pace at which the economy can grow without generating inflationary pressure had fallen over recent years. With its inflation-control mandate in mind, the Bank of England's Monetary Policy Committee raised official interest rates to 0.5% in November 2017.

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

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

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

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

Interest rate forecast: The Council's treasury adviser Arlingclose's central case is for UK Bank Rate to remain at 0.50% during 2018/19**,** following the rise from the historic low of 0.25%. The Monetary Policy Committee re-emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.

Future expectations for higher short term interest rates are subdued and on-going decisions remain data dependant and negotiations on exiting the EU cast a shadow over monetary policy decisions. The risks to Arlingclose's forecast are broadly balanced on both sides. The Arlingclose central case is for gilt yields to remain broadly stable across the medium term. Upward movement will be limited, although the UK government's seemingly deteriorating fiscal stance is an upside risk.

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

For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 0.3%, and that new long-term loans will be borrowed at an average rate of 2.85%.

Local Context

On 31st December 2017, the Council held £185.5m of borrowing and £29.9m of investments. This is set out in further detail at ***Appendix B***. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance sheet summary and forecast

	31.3.17 Actual £m	31.3.18 Estimate £m	31.3.19 Forecast £m	31.3.20 Forecast £m	31.3.21 Forecast £m
General Fund CFR	38.9	52.3	66.2	67.1	67.1
HRA CFR	155.1	155.1	155.1	155.1	155.1
Total CFR	**194.0**	**207.4**	**221.3**	**222.2**	**222.2**
Less: Other debt liabilities *	-2.3	-1.8	-1.2	-0.6	0
Borrowing CFR	**191.7**	**205.6**	**220.1**	**221.6**	**222.2**
Less: External borrowing **	-185.5	-185.5	-212.0	-212.0	-212.0
Internal borrowing	**6.2**	**20.1**	**8.1**	**9.6**	**10.2**
Less: Usable reserves	43.9	40.7	37.3	37.7	37.7
Less: Working capital	3.6	2.0	2.0	2.0	2.0
Investments	**41.3**	**22.6**	**31.2**	**30.1**	**29.5**

* finance leases, PFI liabilities and transferred debt that form part of the Council's total debt
** shows only loans to which the Council is committed and excludes optional refinancing

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

The Council has an increasing CFR due to the capital programme, but minimal investments and will therefore be required to borrow up to £40m over the forecast period.

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

Borrowing Strategy

The Council currently holds £185.5 million of loans, the same as the previous year, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 1 shows that the Council expects to borrow up to £30m in 2018/19. The Council may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £250 million.

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

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

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

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

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

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

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

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

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

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

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

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

<u>**Investment Strategy**</u>

The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council's investment balance has ranged between £41.3 and £29.9 million, and reduced levels are expected to be seen in the forthcoming year.

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

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

Strategy: Given the increasing risk and very low returns from short-term unsecured bank investments, the Council will aim to diversify its portfolio, but with falling investment balances in the medium-term to fund its capital programme the cash balances will have to remain as fluid as possible. The majority (87%) of the Council's surplus cash is currently invested in short-term unsecured bank deposits and money market funds. This diversification will represent a continuation of the strategy adopted in 2017/18.

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

Table 2: Approved investment counterparties and limits

Credit rating	**Banks unsecured**	**Banks secured**	**Government**	**Corporates**	**Registered Providers**
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£3m 5 years	£3m 20 years	£5m 50 years	£3m 20 years	£1m 20 years
AA+	£3m 5 years	£3m 10 years	£5m 25 years	£3m 10 years	£1m 10 years
AA	£3m 4 years	£3m 5 years	£5m 15 years	£3m 5 years	£1m 10 years
AA-	£3m 3 years	£3m 4 years	£5m 10 years	£3m 4 years	£1m 10 years
A+	£2m 2 years	£3m 3 years	£5m 5 years	£2m 3 years	£1m 5 years
A	£2m 13 months	£3m 2 years	£5m 5 years	£2m 2 years	£1m 5 years
A-	£2m 6 months	£3m 13 months	£2.5m 5 years	£2m 13 months	£1m 5 years
None	£2m 6 months	n/a	£5m 25 years	n/a	£1m 5 years
Pooled funds	£5m per fund				

This table must be read in conjunction with the notes below

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

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

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

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

Corporates: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made following an external credit assessment or to a maximum of £3 million per company as part of a diversified pool in order to spread the risk widely.

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

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

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

Operational bank accounts: The Council may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £5 million per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.

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

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

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

Other information on the security of investments: The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

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

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

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

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

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

Table 3: Non-specified investment limits

	Cash limit
Total long-term investments	£5m
Total investments without credit ratings or rated below A- (except UK Government and local authorities)	£3m
Total investments (except pooled funds) with institutions domiciled in foreign countries rated below AA+	£3m
Total non-specified investments	£11m

Investment limits: The Council's revenue reserves available to cover investment losses are forecast to be £15 million on 31st March 2018. In order that no more than 20% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £3 million. 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	£3m each
UK Central Government	unlimited
Local Authorities	£25m in total
Any group of organisations under the same ownership	£3m per group
Any group of pooled funds under the same management	£5m per manager
Negotiable instruments held in a broker's nominee account	£7m per broker
Foreign countries	£3m per country
Registered providers	£5m in total
Unsecured investments with building societies	£5m in total
Money Market Funds	£15m in total

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

Non-Treasury Investments

Although not classed as treasury management activities and therefore not covered by the CIPFA Code or the CLG Guidance, the Council may also purchase property for investment purposes and may also make loans and investments for service purposes, for example in a loan to the Waste Services Contractor for the purchase of vehicles.

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

The Council's existing non-treasury investments are listed in Appendix B.

Treasury Management Indicators

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

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

	Target
Portfolio average credit rating	A-

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 within a rolling three month period, without additional borrowing.

	Target
Total cash available within 3 months	£10m

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

	2018/19	2019/20	2020/21
Upper limit on fixed interest rate exposure	100%	100%	100%
Upper limit on variable interest rate exposure	75%	75%	75%

Fixed rate investments and borrowings are those where the rate of interest will not change over the life of the transaction. All other instruments are classed as variable rate.

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

	Upper	Lower
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

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

Principal sums invested for periods longer than 364 days: The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

	2018/19	2019/20	2020/21
Limit on principal invested beyond year end	£5m	£3m	£3m

Other Items

There are a number of additional items that the Council is obliged by CIPFA or CLG to include in its Treasury Management Strategy.

Policy on the use of financial derivatives: 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).

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.

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.

Policy on apportioning interest to the HRA: On 1st April 2012, the Council notionally split each of its existing long-term loans into General Fund and HRA pools. In the future, new long-term loans borrowed will be assigned in their entirety to one pool or the other. Interest payable and other costs/income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged/ credited to the respective revenue account. Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. This balance will be measured each month and interest transferred between the General Fund and HRA at the Council's average interest rate on investments, adjusted for credit risk.

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

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

Investment advisers: The Council has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues. The quality of this service is controlled by Director of Resources.

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

The total amount borrowed will not exceed the authorised borrowing limit of £250 million. The maximum period between borrowing and expenditure is expected to be two years, although the Council is not required to link particular loans with particular items of expenditure.

Financial Implications

The budget for investment income in 2018/19 is £45,000, based on an average investment portfolio of £15.5 million at an interest rate of 0.29%. The budget for debt interest paid in 2018/19 is £6.3 million, based on an average debt portfolio of £212 million at an average interest rate of 3%. If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different.

Other Options Considered

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

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

Appendix A – Arlingclose Economic & Interest Rate Forecast November 2017

Underlying assumptions:

- In a 7-2 vote, the MPC increased Bank Rate in line with market expectations to 0.5%. Dovish accompanying rhetoric prompted investors to lower the expected future path for interest rates. The minutes re-emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.

- Further potential movement in Bank Rate is reliant on economic data and the likely outcome of the EU negotiations. Policymakers have downwardly assessed the supply capacity of the UK economy, suggesting inflationary growth is more likely. However, the MPC will be wary of raising rates much further amid low business and household confidence.

- The UK economy faces a challenging outlook as the minority government continues to negotiate the country's exit from the European Union. While recent economic data has improved, it has done so from a low base: UK Q3 2017 GDP growth was 0.4%, after a 0.3% expansion in Q2.

- Household consumption growth, the driver of recent UK GDP growth, has softened following a contraction in real wages, despite both saving rates and consumer credit volumes indicating that some households continue to spend in the absence of wage growth. Policymakers have expressed concern about the continued expansion of consumer credit; any action taken will further dampen household spending.

- Some data has held up better than expected, with unemployment continuing to decline and house prices remaining relatively resilient. However, both of these factors can also be seen in a negative light, displaying the structural lack of investment in the UK economy post financial crisis. Weaker long term growth may prompt deterioration in the UK's fiscal position.

- The depreciation in sterling may assist the economy to rebalance away from spending. Export volumes will increase, helped by a stronger Eurozone economic expansion.

- Near-term global growth prospects have continued to improve and broaden, and expectations of inflation are subdued. Central banks are moving to reduce the level of monetary stimulus.

- Geo-political risks remains elevated and helps to anchor safe-haven flows into the UK government bond (gilt) market.

Forecast:

- The MPC has increased Bank Rate, largely to meet expectations they themselves created. Future expectations for higher short term interest rates are subdued. On-going decisions remain data dependant and negotiations on exiting the EU cast a shadow over monetary policy decisions.

- Our central case for Bank Rate is 0.5% over the medium term. The risks to the forecast are broadly balanced on both sides.

- The Arlingclose central case is for gilt yields to remain broadly stable across the medium term. Upward movement will be limited, although the UK government's seemingly deteriorating fiscal stance is an upside risk.

	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	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.19**
Arlingclose Central Case	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk	0.00	0.00	0.00	0.00	0.00	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	**-0.15**
3-month LIBID rate														
Upside risk	0.10	0.10	0.10	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.22**
Arlingclose Central Case	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk	-0.10	-0.10	-0.15	-0.15	-0.15	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	**-0.20**
1-yr LIBID rate														
Upside risk	0.15	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	**0.27**
Arlingclose Central Case	0.70	0.70	0.70	0.70	0.80	0.80	0.80	0.80	0.80	0.80	0.80	0.80	0.80	0.77
Downside risk	-0.15	-0.20	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.15	-0.15	**-0.26**
5-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	**0.32**
Arlingclose Central Case	0.75	0.75	0.80	0.80	0.80	0.85	0.90	0.90	0.95	0.95	1.00	1.05	1.10	0.89
Downside risk	-0.20	-0.20	-0.25	-0.25	-0.25	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	**-0.33**
10-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	**0.32**
Arlingclose Central Case	1.25	1.25	1.25	1.25	1.25	1.30	1.30	1.35	1.40	1.45	1.50	1.55	1.55	1.36
Downside risk	-0.20	-0.25	-0.25	-0.25	-0.25	-0.30	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	**-0.33**
20-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	**0.32**
Arlingclose Central Case	1.85	1.85	1.85	1.85	1.85	1.90	1.90	1.95	1.95	2.00	2.05	2.05	2.05	1.93
Downside risk	-0.20	-0.30	-0.25	-0.25	-0.30	-0.35	-0.40	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	**-0.38**
50-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	**0.32**
Arlingclose Central Case	1.70	1.70	1.70	1.70	1.70	1.75	1.80	1.85	1.90	1.95	1.95	1.95	1.95	1.82
Downside risk	-0.30	-0.30	-0.25	-0.25	-0.30	-0.35	-0.40	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	**-0.39**

Appendix B – Existing Investment & Debt Portfolio Position

	31.12.17 **Actual Portfolio £m**	31.12.17 **Average Rate %**
External borrowing:		
PWLB – Fixed Rate	153.656	**3.00**
PWLB – Variable Rate	31.800	**0.45**
Total external borrowing	**185.456**	
Other long-term liabilities:		
Finance Leases	2.327	
Total other long-term liabilities	**2.327**	
Total gross external debt	**187.783**	
Treasury investments:		
Banks & building societies (unsecured)	13.937	**0.51**
Government (incl. local authorities)	4.000	**0.32**
Money Market Funds	12.000	**0.22**
Total treasury investments	**29.937**	
Net debt	**157.846**	

Non-treasury investments:		
BIFFA Loan	1.861	**5.00**
Total investments	**31.798**	

Appendix C - Prudential Indicators 2018/19

The Local Government Act 2003 requires the Council to have regard to the CIPFA *Prudential Code for Capital Finance in Local Authorities* (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Council has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

Estimates of Capital Expenditure: The Council's planned capital expenditure and financing may be summarised as follows. Further detail is provided in Cabinet Report C-035-2017/18 – Capital Review 2017/18 – 2021/22.

Capital Expenditure and Financing	2017/18 Revised £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
General Fund	17.010	12.125	1.433	0.540
HRA	23.114	22.786	25.641	15.157
Total Expenditure	**40.124**	**34.911**	**27.074**	**15.697**
Capital Receipts	5.341	4.632	7.712	2.289
Grants	0.666	0.080	0.085	0.090
Reserves	2.233	2.696	3.753	0.000
Revenue	15.499	16.684	14.496	13.168
Borrowing	16.385	10.819	1.028	0.150
Total Financing	**40.124**	**34.911**	**27.074**	**15.697**

Estimates of Capital Financing Requirement: The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose.

Capital Financing Requirement	31.03.18 Revised £m	31.03.19 Estimate £m	31.03.20 Estimate £m	31.03.21 Estimate £m
General Fund	52.3	66.2	67.1	67.1
HRA	155.1	155.1	155.1	155.1
Total CFR	**207.4**	**221.3**	**222.2**	**222.2**

The CFR is forecast to rise by £14.8m over the next three years as capital expenditure financed by debt outweighs resources put aside for debt repayment.

Gross Debt and the Capital Financing Requirement: In order to ensure that over the medium term debt will only be for a capital purpose, the Council should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.

Debt	**31.03.18 Revised £m**	**31.03.19 Estimate £m**	**31.03.20 Estimate £m**	**31.03.21 Estimate £m**
Borrowing	**185.5**	**212.0**	**212.9**	**212.9**

Total debt is expected to remain below the CFR during the forecast period.

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

Operational Boundary	**2017/18 Revised £m**	**2018/19 Estimate £m**	**2019/20 Estimate £m**	**2020/21 Estimate £m**
Borrowing	**240.00**	**260.00**	**260.00**	**260.00**

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

Authorised Limit	**2017/18 Limit £m**	**2018/19 Limit £m**	**2019/20 Limit £m**	**2020/21 Limit £m**
Borrowing	**250.00**	**270.00**	**270.00**	**270.00**

Ratio of Financing Costs to Net Revenue Stream: This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Ratio of Financing Costs to Net Revenue Stream	**2017/18 Revised %**	**2018/19 Estimate %**	**2019/20 Estimate %**	**2020/21 Estimate %**
General Fund	0.60	0.91	0.96	0.93
HRA	16.68	17.37	17.54	17.72

Appendix D – Annual Minimum Revenue Provision Statement 2018/19

Where the Council finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the Council to have regard to the Department for Communities and Local Government's *Guidance on Minimum Revenue Provision* (the CLG Guidance) most recently issued in 2012.

The broad aim of the CLG Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

The CLG Guidance requires the Council to approve an Annual MRP Statement each year, and recommends a number of options for calculating a prudent amount of MRP. The following statement incorporates options recommended in the Guidance as well as locally determined prudent methods.

1. For unsupported capital expenditure incurred after 31st March 2008, MRP will be determined as being equal to the accounting charge for depreciation. *(Option 4 in England and Wales, Option 2 in Northern Ireland)*

2. No MRP will be charged in respect of assets held on a temporary basis where a capital receipt will arise to repay the debt.

3. No MRP will be charged in respect of assets held within the Housing Revenue Account.

During 2016/17 there was £9.3m of unfinanced capital expenditure on non-HRA assets. The first £5m was on land acquired as part of site assemblage, which is an asset held on a temporary basis as set out under 2 above. The remaining £4.3m was incurred on the shopping park and this asset became operational during 2017/18. Given the nature of this asset it will be maintained to a very high standard and accordingly no depreciation will be charged. As no depreciation is being charged it is not appropriate to charge MRP, as set out in 1 above. Additional comfort on the prudent nature of this treatment is provided by the substantial income stream being generated which could be used to repay debt.

During 2017/18 there is likely to be £15m of unfinanced capital expenditure on non-HRA assets. The first £9.5m will be on the shopping park and will be treated as set out in the previous paragraph. The remaining £5.5m will be incurred on the new leisure centre in Waltham Abbey. This asset will not come into operation until 2018/19 and so MRP will not be required until 2019/20. It is anticipated that the full cost of the leisure centre will be £14m and that it will be depreciated over 40 years, consequently £350,000 of CSB growth has been included for the MRP charge commencing in 2019/20.

Based on the Council's latest estimate of its Capital Financing Requirement and the policy set out above no budget for MRP is required for 2018/19 but the MTFS includes £350,000 from 2019/20 onwards.

Appendix E – Current Recommended Sovereign and Counterparty List as at 31/12/2017

Country/ Domicile	Counterparty	Maximum Counterparty Limit £m	Maximum Group Limit (if applicable) £m	Maximum Maturity Limit
UK	Santander UK Plc (Banco Santander Group)	3.0		6 months
UK	Bank of Scotland (Lloyds Banking Group)	3.0	3.0	6 months
UK	Lloyds TSB (Lloyds Banking Group)	3.0		6 months
UK	Barclays Bank Plc	3.0		100 days
UK	Close Brothers Ltd.	3.0		6 months
UK	Goldman Sachs	3.0		100 days
UK	HSBC Bank Plc	3.0		6 months
UK	Standard Chartered	3.0		100 days
UK	Nationwide Building Society	3.0		6 months
UK	Coventry Building Society	3.0		6 months
UK	Leeds Building Society	3.0		100 days
UK	NatWest (Council's current banker – see section above on operational bank accounts)	5.0	5.0	35 days
UK	Royal Bank of Scotland (RBS Group)	5.0		35 days
Australia	Australia and NZ Banking Group	3.0		6 months
Australia	Commonwealth Bank of Australia	3.0		6 months
Australia	National Australia Bank Ltd (National Australia Bank Group)	3.0		6 months
Australia	Westpac Banking Corp	3.0		6 months
Canada	Bank of Montreal	3.0		6 months
Canada	Bank of Nova Scotia	3.0		6 months
Canada	Canadian Imperial Bank of Commerce	3.0		6 months
Canada	Royal Bank of Canada	3.0		6 months
Canada	Toronto-Dominion Bank	3.0		6 months

Finland	Op Corporate Bank	3.0		6 months
Denmark	Danske Bank	3.0		100 days
Germany	Landesbank Hessen-Thuringen	3.0		6 months
Netherlands	ING Bank NV	3.0		100 days
Netherlands	Rabobank	3.0		13 months
Sweden	Nordea Bank AB	3.0		13 months
Sweden	Svenska Handelsbanken	3.0		13 months
Switzerland	Credit Suisse	3.0		100 days
UK	Building Societies	See below		See below

The following 11 building societies have limits of £1m and 100 days – Darlington, Furness, Hinckley & Rugby, Leek, Mansfield, Marsden, Melton Mowbray, National Counties, Newbury, Scottish, Tipton & Coseley.

***Please note this list could change if, for example, a counterparty/country is upgraded, and meets our other creditworthiness tools or a new suitable counterparty comes into the market. Alternatively, if a counterparty is downgraded, this list may be shortened.*

Group Limits - For institutions within a banking group, the authority executes a limit of that of an individual limit of a single bank within that group.

Appendix F – Non-Specified Investments

Instrument	Maximum maturity	Maximum £M	Capital expenditure?	Example
Call accounts, term deposits & CDs with banks, building societies & local authorities which do not meet the specified investment criteria (on advice from TM Adviser)	5 years	3	No	
Deposits with registered providers	5 years	3	No	
Gilts	5 years	3	No	
Bonds issued by multilateral development banks	5 years	2	No	*EIB Bonds, Council of Europe Bonds etc.*
Sterling denominated bonds by non-UK sovereign governments	5 years	2	No	
Money Market Funds and Collective Investment Schemes	5 years	15	No	*Investec Target Return Fund; Elite Charteris Premium Income Fund; LAMIT; M&G Global Dividend Growth Fund*
Corporate loans and debt instruments issued by corporate bodies	5 years	3	No	
Collective Investment Schemes (pooled funds) which do not meet the definition of collective investment schemes in SI 2004 No 534 or SI 2007 No 573	These funds do not have a defined maturity date	3	Yes	*Way Charteris Gold Portfolio Fund; Lime Fund*