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Wednesday, 23 January 2019

Notice of Reports Received following Publication of Agenda.

Audit Committee

Thursday, 31st January, 2019 at 2.00 pm,
County Hall, The Rhadyr, Usk, NP15 1GA

Attached are reports that the committee will consider as part of the original agenda but were submitted to democratic services following publication of the agenda.

Item No	Item	Pages
8.	**Treasury Strategy**	1 - 30

Paul Matthews
Chief Executive

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Agenda Item 8

monmouthshire county council sir fynwy

REPORT

SUBJECT:	**Treasury Policy and Strategy Report 2019/20**
DIRECTORATE:	**Resources**
MEETING:	**Audit Committee**
DATE:	**31st January**
DIVISION/WARDS AFFECTED:	**Countywide**

1. PURPOSE:

1.1 To agree the 2019-20 Treasury policy and strategic framework for officers to follow. This is to ensure that an appropriate level of care is taken of the Authority's funds and that a prudent budget is set to cover these activities.

2. RECOMMENDATIONS:

2.1 That Audit Committee considers and endorses

- the proposed Treasury Management and Minimum Revenue Provision Policy Statement for 2019/20 (Appendix 1);and
- the proposed Treasury Management Strategy 2019/20 (Appendix 2) including the Investment & Borrowing Strategies,

for onward circulation and approval by full Council.

2.2 That Audit Committee continues to review the Council's treasury activities on behalf of the Council by receiving the mid-year report and year-end report.

3. UPDATE SINCE LAST REPORTING:

3.1 A number of new codes of practice, regulations and guidance notes have been issued recently or are in the process of being drafted. There are a number of actions resulting from these which are likely to impact upon Treasury management considerations including:

- Preparation of a capital strategy for the Council to tie together related strategies as required by the revised prudential code.
- Reference within the Capital Strategy of the management of non-treasury investments and the control of the associated risks in line with the requirements of the revised treasury management code. A property investment Strategy has already been produced.
- Reviewing the mechanism which approve reports relating to treasury matters.

- Reporting 19/20’s prudential indicators more widely than just the Treasury Strategy. (It is proposed to include in final budget report to Council).

3.2 So far in 2018/19, the Authority has invested £1 million in one mixed asset class pooled fund, the Kames fund. This proposal was presented to the November 2018 Audit Committee. A second investment of £1 million is expected to be made shortly. These 2 funds over the 5 years to September 18 yielded an average of 4.5% income return and 5.5% total return per annum so are attractive, with the income return typically being steady. They do however not have their capital values guaranteed. Capital values can and do fluctuate up and down. Cumulative capital gains could be negative at the end of 2018/19. This is the reason that these investments are entered into with the intention of holding them for 3-5 years. It is believed over this period that cumulative capital gains will be positive. It is the intention of the Authority to use an earmarked reserve at year end to absorb some/all of these capital gains and losses to smooth out the effect of these capital movements on the revenue account, if desirable when closing the annual accounts for 2018/19.

4 Treasury Management Policy Statement and Treasury Management Strategy

4.1 The Council or its delegated body (Audit Committee) must receive as a minimum a semi-annual report and an annual report after its close on treasury management activities. This condition continues to be met by existing practices

4.2 Similarly the Treasury management strategy is traditionally considered by Audit Committee and volunteered to full Council for approval. The Code now requires that full Council also approve annually an Investment Strategy. It is proposed to subsume the Investment strategy within the Treasury strategy, and continue for Audit Committee to review proposals and endorse or otherwise the Strategy for approval by full Council. Appendix 2 contains the Councils detailed proposed investment strategy.

4.3 Overall responsibility for treasury management remains with the Full Council. In application, that body delegates the execution and administration of treasury management decisions to the Head of Finance (S151 officer) or deputy who will act in accordance with the treasury management policy statement (appendix 1) and treasury management practices and CIPFA’s Standard of Professional Practice on treasury management.

4.4 As stated in the treasury management policy statement, the Council adopts the key recommendations of CIPFA’s Code of Practice for Treasury Management in the Public Services (the “Code”) (as revised in 2017) which is designed to provide effective control of the risks of treasury management activities, prioritising security and liquidity of investments above yield. It includes the requirement for a number of treasury management indicators.

4.5 The Council also adheres to the Prudential Code for Capital Finance in Local Authorities (as revised in 2011) which outlines requirements for the manner in which capital spending plans are to be considered and approved. Authorities are required to demonstrate value for money when borrowing in advance of need and ensure the security of such funds. The Prudential Code further requires the Council to set a number of prudential indicators which can be reported either through the Treasury report or as part of the capital budget consideration. The Council will report such through the report that agrees the annual budget.

4.6 The revised Prudential Code and Treasury Management Code were issued in December 2018. The LA (Capital Finance and Accounting) (Wales) (Amendment) Regulations 2018 came into force in March 2018. Changes required as a result, are being incorporated into the relevant revised strategies.

Considerations influencing the strategy

4.7 The limits proposed in the 2019/20 treasury strategy have not changed significantly from the 2018/19 strategy which means that most of our investments will be limited to £2 million per counterparty – see the table 'Approved Investment counterparties & Limits' in Appendix 2 para 5.6 onwards. The counterparty rating limits and investment maturities in this table are ultimate limits and are further informed by bespoke periodic advice from our treasury advisers as to sustainability and financial robustness of specific counterparties.

4.8 The section on External context within the treasury strategy in Appendix 2, Section 2 explains the backdrop which has been considered when setting the limits for borrowing & investing. These include:

- The effect of the Brexit process on Sterling, GDP and UK growth & the likelihood that European banks may create UK subsidiaries to trade in the UK.
- The increase in Bank of England interest rate up to 0.75% with further increases forecast over the coming years.
- CPI (Consumer Price index) is now 2.4%, higher than this time last year.
- The big four UK banks have now separated their retail banking functions from their Investment banking activities during 2018. The retail element being "ring-fenced" to protect retail investors.
- The Authority has chosen to take Professional status under the MifID II regulations, which came into force on the 3rd January 18, with its counterparties and other financial institutions.
- Money market funds which the Authority uses to hold a lot of its overnight cash are gradually moving from CNAV (constant net asset value) to LVNAV (Low volatility net asset value). It is believed that this will not have a significant effect on the Authority.

Annual Minimum Revenue Provision (MRP) Policy Statement

4.11 The annual Minimum Revenue Provision is the mechanism used for spreading the capital expenditure financed by borrowing over the years to which benefit is provided. Regulations state that the authority must calculate for the current financial year an amount of minimum revenue provision which it considers to be prudent. In addition there is the requirement for an Annual Minimum Revenue Provision Policy Statement to be drafted and submitted to full Council. This is attached in Appendix 1, Section 4.

4.12 Additionally Welsh Government is consulting on changes to MRP guidance, this may have an impact upon treasury practice longer term but requirements have not yet been confirmed to influence 2019-20 Treasury Strategy.

5. REASONS:

5.1 The Authority is required to produce a treasury management policy and strategy and an annual investment strategy in order to comply with the Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code").

5.2 The Authority is required to produce an MRP policy statement in order to comply with the Local Authorities (Capital Finance and Accounting) (Wales) Regulations, last amended in 2009.

6. RESOURCE IMPLICATIONS:

6.1 In summary, the Treasury Policy and Strategy remains very similar to previous years, such that the Council remains a net borrower, and utilises internal resources to reduce net borrowing costs, known as internal borrowing.

6.2 It also favours short term recurrent borrowing over longer term fixed rates, given the disparity between short and longer term rates still. Interest rates are anticipated to rise slightly over next year, and the Treasury team is increasingly looking towards advantageous longer term fixed rate deals to keep the loans portfolio diverse and minimise interest rate exposure risk.

6.4 Current treasury activity as at end of December 2018 is also provided in Appendix 4, to illustrate to Members extent of current loans and investments.

6.5 The medium-term treasury budgets contained within the 2019-20 revenue budget proposals to be presented to Council in March 2019, were constructed in accordance with the strategy documents appended to this report. Consequently there are no additional resource implications directly arising from this report.

The Council's Treasury budgets for the next 4 years are illustratively

Subjective Classification	Indicative Base Budget 2019/20	Indicative Base Budget 2020/21	Indicative Base Budget 2021/22	Indicative Base Budget 2022/23
Interest and Investment Income	(205,300)	(206,300)	(206,300)	(208,300)
Interest Payable and Similar Charges	3,397,995	3,409,995	3,478,995	3,475,995
Contributions to Earmarked Reserves	444,378	63,000	63,000	63,000
Contributions from Earmarked Reserves	(534,835)	(95,507)	(218,038)	(88,038)
Charges required under Regulation (MRP)	4,479,760	4,636,760	4,531,760	4,765,760
Fixed Asset Disposal Costs	107,833	0	0	0
Evidence based pressure and virement from services	95,000	95,000	95,000	95,000
Total Appropriations	**7,784,831**	**7,902,948**	**7,744,417**	**8,103,417**

6.6 However there are some key future financial risks on medium-term treasury budgets concerning:

- There remains reliance on utilising capital receipts in the year when predicted, which introduces the potential need to temporarily borrow and add to Council costs if those receipts don't come in in the timeframe volunteered.
- The capital medium term financial plan for 2019/20 has been shared with members as part of the capital budget setting process which won't conclude until late February. Should additions be required funded from borrowing, then Treasury figures and consequences on capital financing requirement and external borrowing requirement would need to be recast.
- The strategy continues to recommend that the chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required. Traditionally this has resulted in Treasury staff undertaking short term recurrent borrowing as short term rates are still more cost effective than equivalent fixed longer term opportunities. It is anticipated that borrowing rates will rise over the next year, and as such this balance will be monitored regularly in order to decide whether to instead borrow additional sums at long-term fixed rates in 2019/20 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.
- It should be noted that as a result of the expenditure plans of the Authority and the forecasts for interest rates in the future, that borrowing costs are expected to rise in the medium/long term. As far as the forecast increased can be predicted they are allowed for in the medium term financial plan.

7 EQUALITY IMPACT ASSESSMENT:

There is no equality impact arising directly from this report.

8 SUSTAINABLE DEVELOPMENT IMPLICATIONS:

None

9 BACKGROUND PAPERS:

Appendix 1 – Treasury Management & Minimum Revenue Provision (MRP) Policy Statement 2019/20

Appendix 2 – Treasury Management Strategy Statement 2019/20 including the Investment & Borrowing Strategies

Appendix 3 – Arlingclose Economic & Interest Rate Forecast December 2018

Appendix 4 – Existing Investment & Debt Portfolio Position

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Appendix 1

TREASURY MANAGEMENT POLICY STATEMENT 2019/20

1 INTRODUCTION AND BACKGROUND

1.1 The Council is required by law to have regard to CIPFA's Treasury Management in the Public Services: Code of Practice 2017 (The Code)...

1.2 Accordingly, the Council will create and maintain, as the cornerstones for effective treasury management:-

- A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities
- Suitable treasury management practices (TMPs), setting out the manner in which the Council will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

1.3 The revised code allows the Audit Committee to approve the treasury strategy providing the Authority produces a capital strategy, while being clear that overall responsibility remains with full council. Full Council is required to approve the investment strategy which is currently included in the same document as the treasury policy and treasury strategy so the combined document will continue to be approved by full Council in the current year.

1.4 The Council delegates responsibility for the implementation, monitoring and scrutiny of its treasury management policy, strategy and practices to the Audit Committee and for the execution and administration of treasury management decisions to the Head of Finance (S151 officer), who will act in accordance with the organisation's policy statement and TMPs and CIPFA's Standard of Professional Practice on Treasury Management.

1.5 As a minimum, the Audit Committee will receive reports on its treasury management policies, practices and activities including, an annual strategy and plan in advance of the year, and a semi-annual report, mid year and an annual report after its close.

2. POLICIES AND OBJECTIVES OF TREASURY MANAGEMENT ACTIVITIES

2.1 The Council defines its treasury management activities as:

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

2.2 This Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

2.3 This Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management."

As CIPFA states the policy statement should also include the Council's high level policies for borrowing and investments:

2.4 The Council's borrowing will be affordable, sustainable and prudent and consideration will be given to the management of interest rate risk, refinancing risk and budgetary risk. The source from which the borrowing is taken and the type of borrowing should allow the Council transparency and control over its debt.

2.5 The Council's primary objective in relation to investments remains the security of capital. The liquidity or accessibility of the Authority's investments followed by the yield earned on investments remain important but are secondary considerations.

3. Approach to Risk Management

3.1 This section identifies the risks that the Council faces as a result of it undertaking treasury management activities.

Liquidity risk
Credit (or counterparty) risk
Interest rate risk
Inflation rate risk
Exchange rate risk
Market risk
Refinancing risk
Procedural risk
Legal and regulatory risk

The Council manages these down to an acceptable level within the regulatory framework through the consideration and application of its treasury strategy and appropriate monitoring against agreed treasury & prudential indicators and limits.

4. MRP Policy Statement 2019/20

4.1 The Welsh Government's Guidance on Minimum Revenue Provision (issued in 2010) places a duty on local authorities to make a prudent provision for debt redemption. Guidance on Minimum Revenue Provision has been issued by the Welsh Ministers and local authorities are required to "have regard" to such Guidance under section 21(1A) of the Local Government Act 2003.

4.2 Authorities are permitted discretion in terms of the charge levied, albeit within certain parameters. A "prudent" period of time for debt repayment is defined as being one which reflects the period over which the associated capital expenditure provides benefits.

The four MRP options available are:

- Option 1: Regulatory Method
- Option 2: CFR Method
- Option 3: Asset Life Method
- Option 4: Depreciation Method

Note: This does not preclude other prudent methods.

MRP in 2019/20:

4.3 Options 1 and 2 can only be used for supported Non-HRA capital expenditure funded from borrowing (i.e. financing costs deemed to be supported through Revenue Support Grant from Central Government). Methods of making prudent provision for unsupported Non-HRA capital expenditure include Options 3 and 4 (which may also be used for supported Non-HRA capital expenditure if the Authority chooses).

4.4 The MRP Statement will be submitted to Council before the start of the 2019/20 financial year. If it is ever proposed to vary the terms of the original MRP Statement during the year, a revised statement should be put to Authority at that time.

MRP on Supported Borrowing funded Expenditure

4.5 The Authority's policy is to apply Option 3 in respect of supported capital expenditure funded from borrowing. A report received by Council on 17th November 2016 approved this change to 2% straight line, asset life basis.

MRP on Unsupported Borrowing funded Expenditure

4.6 The Authority's policy is to apply Option 3 in respect of unsupported capital expenditure funded from borrowing. The MRP is calculated on an annuity basis within the asset life method, whereby the MRP element increases over time to reflect a consistent charge over the assets life taking into account the real value of money.

MRP in respect of leases and PFI

4.7 MRP in respect of leases and Private Finance Initiative schemes brought on Balance Sheet under the CIPFA Accounting Code of Practice will match the annual principal repayment for the associated deferred liability.

The 2019/20 budget proposals reflect these 3 positions.

Appendix 2- Treasury Management Strategy Statement 2019/20

1. Introduction

1.1 Treasury management is the management of the Authority's cash flows, borrowing and investments, and the associated risks. The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Authority's prudent financial management.

1.2 Treasury risk management at the Authority 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). Providing full Council has approved a Capital Strategy, the CIPFA code allows a delegated Audit Committee to approve a treasury management strategy before the start of each financial year. In addition, the Welsh Government (WG) issued revised Guidance on Local Authority Investments in March 2010 that requires the Authority's full Council to approve an investment strategy before the start of each financial year. By being scrutinised by Audit Committee and then approved by full Council, this report fulfils the Authority's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the WG Guidance.

1.3 **Revised strategy:** In accordance with the WG Guidance, the Authority 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 Authority's capital programme or in the level of its investment balance.

2. External Context

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

2.2 UK Consumer Price Inflation (CPI) for October was up 2.4% year/year, slightly below the consensus forecast and broadly in line with the Bank of England's November Inflation Report. The most recent labour market data for October 2018 showed the unemployment rate edged up slightly to 4.1% while the employment rate of 75.7% was the joint highest on record. The 3-month average annual growth rate for pay excluding bonuses was 3.3% as wages continue to rise steadily and provide some pull on general inflation. Adjusted for inflation, real wages grew by 1.0%, a level still likely to have little effect on consumer spending.

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

1.75% over the forecast horizon, providing the UK's exit from the EU is relatively smooth.

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

2.5 While US growth has slowed over 2018, the economy continues to perform robustly. The US Federal Reserve continued its tightening bias throughout 2018, pushing rates to the current 2%-2.25% in September. Markets continued to expect one more rate rise in December, but expectations are fading that the further hikes previously expected in 2019 will materialise as concerns over trade wars drag on economic activity.

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

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

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

2.9 **Interest rate forecast:** Following the increase in Bank Rate to 0.75% in August 2018, the Authority's treasury management adviser Arlingclose is forecasting two more 0.25% hikes during 2019 to take official UK interest rates to 1.25%. The Bank of England's MPC has maintained expectations for slow and steady rate rises over the forecast horizon. The MPC continues to have a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. Arlingclose believes that MPC members consider both that ultra-low interest rates result in other economic problems, and that higher Bank Rate will be a more effective policy weapon should downside Brexit risks crystallise when rate cuts will be required.

2.10 The UK economic environment remains relatively soft, despite seemingly strong labour market data. Arlingclose's view is that the economy still faces a challenging outlook as it exits the European Union and Eurozone growth softens. Whilst assumptions are that a Brexit deal is struck and some agreement reached on transition and future trading arrangements before the UK leaves the EU, the possibility of a "no deal" Brexit still hangs over economic activity *(at the time of writing this commentary in January).* As such, the risks to the interest rate forecast are considered firmly to the downside.

2.11 Gilt yields and hence long-term borrowing rates have remained at low levels but some upward movement from current levels is expected based on Arlingclose's interest rate projections, due to the strength of the US economy and the ECB's forward guidance on higher rates. 10-year and 20-year gilt yields are forecast to remain around 1.7% and 2.2% respectively over the interest rate forecast horizon, however volatility arising from both economic and political events are likely to continue to offer borrowing opportunities.

A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix 3.

2.12 For the purpose of setting the 2019/20 budget, it has been assumed that new investments will attract an average rate of interest of 1.30%, that new short term loans will be borrowed at an average of 1.08% and as an example of long term rates, a new 20 year PWLB annuity loan would be borrowed at 1.92%.

3. Local Context

3.1 On 31st December 2018, the Authority held £159.8m of borrowing and £16.7m of investments. This is set out in further detail at Appendix 4. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

3.2 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 Authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

Table 1: Balance sheet summary and forecast

	31.3.18 Actual £m	31.3.19 Estimate £m	31.3.20 Forecast £m	31.3.21 Forecast £m	31.3.22 Forecast £m	31.3.23 Forecast £m
General Fund CFR	146.1	175.8	196.8	202.1	210.9	209.5
Less: Other debt liabilities *	-1.8	-2.5	-2.5	-2.5	-2.5	-2.5
Loans CFR	**144.3**	**173.3**	**194.3**	**209.7**	**208.4**	**207.1**
Less: Existing External borrowing undertaken (debt)**	-129.0	-111.4	-89.7	-70.2	-62.3	-60.6
Internal borrowing requirement	**15.3**	**61.9**	**104.6**	**139.5**	**146.1**	**146.5**
Less: Usable reserves	-18.2	-16.4	-20.9	-26.7	-27.3	-27.1
Less: Working capital	-14.2	-14.2	-14.2	-14.2	-14.2	-14.2
Net New External borrowing requirement/ (Investments)	**(17.1)**	**31.4**	**69.5**	**98.6**	**104.6**	**105.2**

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

3.3 The Authority will be required to borrow up to £105m over the forecast period above due to the rising CFR and also due to maturing debt. The Authority has an increasing CFR due to annual capital programmes, including £50m of Property Investments (which whilst increasing CFR is expected to be afforded by additional income). £52m of short term loans held at 31st March 2018 will need to be refinanced as well as other current loans maturing later in the forecast period.

Table 2: Summary Comparison of Capital Financing Requirement against Borrowing Anticipation

Loans CFR	**144.3**	**173.3**	**194.3**	**209.7**	**208.4**	**207.1**
Anticipated debt levels (existing external borrowing levels +net new external borrowing requirement)	**111.9**	**142.8**	**159.2**	**168.8**	**166.9**	**165.8**

3.4 CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. Table 2 shows that the Authority expects to comply with this recommendation during 2019/20.

3.5 **Liability benchmark:** To show this information in a different way, a liability benchmark has been calculated showing the lowest level of borrowing required to meet the capital programme. This assumes the same forecasts as table 1 above, but that cash and investment balances are kept at £10m at each year-end to comply with the requirements of a professional investor under Mifid (Markets in Financial Instruments Directive) II.

Table 3: Liability benchmark

	31.3.18 Actual £m	**31.3.19 Estimate £m**	**31.3.20 Forecast £m**	**31.3.21 Forecast £m**	**31.3.22 Forecast £m**	**31.3.23 Forecast £m**
CFR	144.3	173.3	194.3	209.7	208.4	207.1
Less: Usable reserves	-18.2	-16.4	-20.9	-26.7	-27.3	-27.1
Less: Working capital	-14.2	-14.2	-14.2	-14.2	-14.2	-14.2
Plus: Actual/ Target level of Investments	17.1	10.0	10.0	10.0	10.0	10.0
Liability Benchmark	**129.0**	**152.8**	**169.2**	**178.8**	**176.9**	**175.8**

4 Borrowing Strategy

4.1 As mentioned in para 3.1, the Authority held £159.8 million of loans at 31st December 2018, an increase of £30.8 million from 31st March 2018, as part of its strategy for funding previous years' capital programmes. Table 2 shows that the Authority expects its gross borrowing level to fall to £152.8m at 31st March 2019 and then rise again to £169.2m by 31st March 2019 to allow £10m of investments to be maintained.

4.2 The balance sheet forecast in table 1 shows that the Authority anticipates needing £69.5m of loans at 31st March 2020 that it did not hold at the 31st March 2018. Some of this amount relates to existing short term loans which may need to be replaced more than once during that 2 year period. The Authority may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £224.4 million.

4.3 **Objectives:** The Authority'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 Authority's long-term plans change is a secondary objective.

4.4 **Strategy:** Given the significant cuts to public expenditure and in particular to local government funding, the Authority's borrowing strategy continues to aim for a balance between addressing the key issue of affordability and compromising the longer-term stability of the debt portfolio. With short-term interest rates remain 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. A roughly equal balance of long and short term debt is, at the time of writing, taken as the right balance to maintain sufficient long term stability.

4.5 By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal / short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring long term borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Authority with this ‘cost of carry’ and breakeven analysis. Its output may determine whether the Authority borrows additional sums at long-term fixed rates in 2019/20 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

4.6 Alternatively, the Authority may arrange forward starting loans during 2019/20, 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.

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

4.8 Appropriate 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 the Greater Gwent Pension Fund)
- capital market bond investors
- Special purpose companies created to enable local authority bond issues
- CSC Foundry Ltd

4.9 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
- the MIMs (Mutual Investment Model) being developed by Welsh Government

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

4.11 **LOBOs:** The Authority holds £13.6m 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 Authority has the option to either accept the new rate or to repay the loan at no additional cost. All of these LOBOs have options during

2019/20, and although the Authority understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The Authority will take the option to repay LOBO loans at no cost if it has the opportunity to do so. Short term borrowing would be taken out as an interim solution, followed by a long term solution in line with the borrowing strategy above.

4.12 **Short-term and variable rate loans**: These loans leave the Authority 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.

4.13 **Debt rescheduling:** The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Authority 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.

5 Investment Strategy

5.1 The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. From 1st April to 31st December 2018, the Authority's average investment balance was £18m, ranging between £7 and £35 million. The Authority is committed to holding a minimum of £10m as mentioned above due to the Mifid II regulation. Fluctuations above that, from a monthly cycle of + £10m/- £0m and unexpected income are difficult to avoid increasing investment levels. The treasury team aim to keep balances above £20m to a minimum. This is sometimes difficult to avoid if borrowing is taken out to coincide with a specific project or to take advantage of a good rates. When balances do go above £20m, longer term investments are sort to minimise the impact on the bottom line.

5.2 **Objectives:** Both the CIPFA Code and the WG Guidance require the Authority 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 Authority'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 Authority 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.

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

5.4 **Strategy:** Given the increasing risk and very low returns from short-term unsecured bank investments, the Authority aims to continue to diversify into higher yielding asset classes during 2019/20 by using pooled funds. This is especially the case for the estimated £10m that is available for longer-term investment due to the Mifid II regulations. The remainder of the Authority's surplus cash remains invested in short-term unsecured bank deposits, certificates of deposit, with other Local Authorities, the Debt Management Office and money market funds. This diversification builds on the changes started in Q4 of 2018/19.

5.5 **Business models:** Under the new IFRS 9 standard, the accounting for certain investments depends on the Authority's "business model" for managing them. The Authority aims to achieve value from the majority of 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 with the income appearing as a credit in the Surplus or Deficit on Provision of Services (SDPS). The newer pooled fund investments will be held on balance sheet at Fair Value. The movements in Fair Value as well as dividend income are most likely to be seen as a credit or debit to the SDPS. An alternative treatment option is being assessed.

5.6 **Approved counterparties:** The Authority may invest its surplus funds with any of the counterparty types in table 4 below, subject to the cash limits (per counterparty) and the time limits shown. Any formal recommendations received from the Authority's treasury advisors which places additional restrictions on certain counterparties in terms of eligibility or duration of Investments will supersede the limits set below. Any Investments with a maturity of more than one year are classed in WG Guidance as "Non Specified" so explicit approval must be obtained from the S151 Officer or Deputy or more senior line manager and also the Authority's treasury advisors, before being made.

Table 4: Approved investment counterparties and limits

Counterparty / Instrument	Instrument Limit of Portfolio	Counterparty Limit of Portfolio	Country Limit	Other Limits	Maturity Limit
UK Central Government including Debt Mgt deposit facility, Gilts and T Bills.	100%	100%	N/A	N/A	50 Years
Any investment with UK Local Authorities * (irrespective of credit rating)	75%	The higher of £2m or 10% of total investments (at the time of deposit)	N/A	NA	2 Years
'Unsecured' investments with Banks, Building Societies, Other Organisations and Securities whose lowest published rating from Fitch, Moody's and S&P's is (A-) As above but (A) As above but (A+)	75% of total investments at the time of deposit For Non-UK 50% of total investment at the time of deposit	Upper limit of £2m. An additional £1m can be held in the Authority's bank current account to cover the total of credit	£4m per foreign country	Limit for negotiable instruments held in Brokers nominee accounts: the lower of 50% or £10m per	6 months 13 months 2 years

		balances		Broker	
Secured Investments with Banks, Building Societies, Other Organisations and Securities, (including Re-po's) whose lowest published rating from Fitch, Moody's and S&P's is (A-) As above but (A) or (A+)	75% of total investments at the time of deposit (both secured and unsecured) For Non-UK 50% of total investments at the time of deposit (both secured and unsecured)	£4m per counterparty (both secured and unsecured)	£4m per foreign country for all investment types	N/A	13 months 2 years
Deposits with unrated UK Building Societies which have been assessed by our Treasury advisers as comparable with the Building Societies that have an A- credit rating or higher	25% of total investments	£1m per Counterparty	UK only	N/A	6 months
Money Market Funds with a Constant Net Asset Value (CNAV) or Low Volatility NAV if assessed by our Treasury advisers as being of high credit worthiness	50% of total investments at the time of deposit increased to 75% if total investments is £10m or less	The lower of £2m and 10% of investments rounded up to next £0.5m; not exceeding 0.50% of MMF size or 2% for Government MMFs	N/A	N/A	N/A
Pooled funds & Real Estate Investment Trusts (REITS) without credit ratings which are not classed as capital expenditure - if assessed by our Treasury advisers as a suitable investment for a L. A. and as being managed in a way which is consistent with the objectives of the fund	£6m total investment at the time of deposit	£2m per fund	N/A	N/A	N/A

Investments with UK Registered Providers (e.g. Housing Associations) where the lowest published credit rating is A- or higher	£4m of total investments at the time of deposit.	£2m per issuer	N/A	N/A	5 years

* unless advised against lending by our Treasury Advisors

5.7 **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.

5.8 **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.

5.9 **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.

5.10 **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. For other Government entities, see table 4.

5.11 **Corporates:** (See Secured and Unsecured investments in Table 4). 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 or to a maximum of £1,000,000 per company as part of a diversified pool in order to spread the risk widely.

5.12 **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.

5.13 Pooled funds: Shares or units in diversified investment vehicles consisting of any of the above investment types, plus equity shares, property and some minority holdings such as derivatives. 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. Where more than one fund is managed by the same organisation, the limits per counterparty will be applied to all investments in that organisation's funds unless advice is obtained to support an adequate degree of differentiation in approach between funds to reduce correlation between those funds to a similar level as funds in different organisations.

5.14 Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Authority 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 Authority's investment objectives will be monitored regularly.

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

5.16 Operational bank accounts: The Authority 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 £50,000 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 Authority maintaining operational continuity.

5.17 Risk assessment and credit ratings: Credit ratings are obtained and monitored by the Authority'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.

5.18 Other information on the security of investments: The Authority 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 Authority'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.

5.19 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 Authority 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 Authority'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.

5.20 Investment limits: The Authority's revenue reserves available to cover investment losses are forecast to be £13.3 million on 31st March 2019. In order that no more than 31% 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) is £4.0 million for secured investments or £2.0 million for unsecured investments to banks & building societies. These levels are considered prudent. (See Table 4) A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits have also been placed on investments in brokers' nominee accounts and countries. 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.

5.21 Liquidity management: The Authority is a net borrower and does not have an overdraft set up due to the high cost to do so. The Authority therefore uses a detailed excel cash flow forecasting spreadsheet for the current financial year to determine the maximum period for which funds may prudently be invested and the time at which the Authority will need to borrow either long or short term in order to have sufficient liquid cash to make the payments required. This is backed up by a second excel cashflow model showing the net cashflow movements expected per year based on the medium term financial plan. The aim of short term liquidity management is to borrow only when the need arises and therefore to minimise net borrowing costs while still having sufficient free cash to fund required payments. The amount of investments, with duration over one day, held at any one time is a balance between increased returns and the time taken/ dealing costs of identifying and implementing those investments.

5.22 The revised Treasury Management Code requires the Authority to put in place an Investment Strategy for the management and control of the risks associated with non Treasury investments in addition to the Treasury investments described above.

This will be outlined and referenced in the proposed new Capital Strategy. The Authority built a solar farm in 2017/18 and purchased Castlegate business park in 2018/19 in addition to the portfolio of investment properties which the Authority has held for a number of decades.

6 Treasury Management Indicators

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

6.2 Security: The Authority 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 rating / score	A- / 5.0

6.3 Interest rate exposures: The new treasury management code allows the Authority to define its own Interest rate exposure management process and limits. A sensitivity analysis is provided in the Authority's accounts which shows the revenue impact of a 1% rise/fall in interest rates at year end. The indicator below similarly provides the anticipated effect of a 1% rise/fall in interest rates on the revenue account for a year starting 21st Jan 2019 (time of writing). This provides information to the reader about the potential impact of movements in interest rates.

Interest rate risk indicator	
Forecast impact on revenue over the next 12 months of a 1% rise in interest rates	£241,000
Forecast impact on revenue over the next 12 months of a 1% fall in interest rates	-£241,000

6.3 In the medium term financial plan, forecast increases in interest rates have already been taken into account in setting future years' budgets. The sensitivity analysis above indicates the possible value of overspends resulting from further rises in interest rates. As has been previously stated in this report, the Authority aims to strike a balance between saving costs in this/next year and achieving cost certainty in future years by taking out more long term debt. At the time of writing, the medium term forecasts for interest on 3-12 month debt are no higher than the current interest rates on 10-20 year debt so it seems reasonably prudent and cost effective to continue with utilising short term debt. To supplement this prudence, the Treasury team also set a proportionate on net variable rate debt as a percentage of total net debt. As a useful clarification whilst PWLB variable rate debt is 'variable' but 'long term' and LOBO loans can be called in under one year, neither represent an interest rate risk as their rates are above current PWLB maturity loan rates available. Hence they are treated as 'fixed' for the proportionate limit calculation.

Limit on net variable rate debt as a % of total net debt	Forecast £m		Limit £m
	31st Mar 2019	31st Mar 2020	
Variable rate debt	64.2	64.1	
Variable rate investments #	10.0	10.0	
Net variable rate debt	54.2	54.1	
Fixed rate debt	84.9	95.9	
Fixed rate investments	0.0	0.0	
Net fixed rate debt	84.9	95.9	
% net variable rate debt to total net debt	39.0%	36.1%	50%

Investments in pooled funds are excluded as they are only partially interest rate driven.

6.4 The % of net variable rate debt to total net debt is forecast to fall from close to 50% in previous years due to the long term debt taken out/forecast to be taken out to cover the new Property Investments budgeted and also the waste vehicles budgeted.

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

Refinancing risk indicator	Forecast 31st Mar 2019	Lower limit	Upper limit
Under 12 months – LOBO loans	9.1%	0%	60%
Under 12 months – short term loans	32.9%		
Under 12 months – maturing LT loans	1.2%		
12 months and within 24 months – variable rate LT loans	9.1%	0%	20%
12 months and within 24 months – other	3.8%		
24 months and within 5 years	8.1%	0%	40%
5 years and within 10 years	16.0%	0%	30%
10 years and above	20.0%	0%	100%

N.B.Time periods start on the first day of each financial year or the trade date for new loans. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

6.7 Principal sums invested for periods longer than a year: The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on principal sums invested for more than one year to final maturity dates in each financial year will be:

Price risk indicator	2019/20	2020/21	2021/22
Limit on principal invested beyond year end	£6m	£6m	£3m

This excludes Pooled funds which although intended to be held for 3 – 5 years can be redeemed at 6 month notice or less, typically, depending on the fund.

7. Related Matters

7.1 The CIPFA Code requires the Authority to include explicitly the following in its treasury management strategy.

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

- **Markets in Financial Instruments Directive**: The Authority 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 Authority's treasury management activities, the Section 151 officer or deputy believes this to be the most appropriate status.

7.2 A Council must also have regard for any Government Guidance provided. To date Welsh Government has provided the following directions,

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

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

Relatedly, the Authority 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 Authority does not intend to make any treasury investments denominated in foreign currencies nor any defined as capital expenditure. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown in table 5 below.

Table 5: Non-specified investment limits

	Cash limit
Total long-term investments excluding pooled funds	£6m
Total shares in pooled funds excluding Money Market Funds	£6m
Total investments without credit ratings or rated below [A-] (except the UK Government and UK local authorities)	£3m
Total investments (except pooled funds) with institutions domiciled in foreign countries rated below [A-]	£0m

N.B. Money market funds are no longer non-specified investments as they are no longer capital expenditure since the 2018 amendment regulations.

7.3 **Investment training:** The needs of the Authority's treasury management staff for training in investment management are assessed on an ongoing basis as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.
Staff attend training courses, seminars and conferences provided by Arlingclose and CIPFA.

7.4 **Investment advisers:** The Authority 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 assessed at the contract tender stage by comparing to other market leaders and their historical track record. It is then monitored by on-going interaction with treasury personnel. The Authority maintains the quality of the service from its advisors by holding quarterly meetings and tendering periodically.

7.5 **Investment of money borrowed in advance of need**: The Authority 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 Authority 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 Authority's overall management of its treasury risks.
The total amount borrowed will not exceed the authorised borrowing limit of £224.4 million. The maximum period between borrowing and expenditure is expected to be two years, although the Authority is not required to link particular loans with particular items of expenditure.

N.B. This is slightly higher than the highest CFR over the next 3 years £211m. The CFR is lower due to the MRP which is taken off the amounts budgeted to be funded by borrowing to arrive at this figure. The authorised borrowing limit contains contingency to cover such things as unpredictable fluctuations in cash, new projects not in MTFP, capital receipts not materialising, vehicles budgeted to be leased – funded by borrowing

8. Financial Implications

8.1 The budget for investment income in 2019/20 is £205,000, based on an average investment portfolio of £15.8 million at an interest rate of 1.3%. The budget for debt interest paid in 2019/20 is £3.4 million, based on an average debt portfolio of £129.7 million at an average interest rate of 2.6%. If actual levels of investments and borrowing, or actual interest rates, differ from those forecast, performance against budget will be correspondingly different.

9 Other Options Considered

9.1 The WG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The S151 Officer or Deputy, having consulted the Audit Committee, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategic approaches are considered in the following table, together with their financial and risk management implications.

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 3 – Arlingclose Economic & Interest Rate Forecast December 2018
Underlying assumptions:

- Our central interest rate forecasts are predicated on there being a transitionary period following the UK's official exit from the EU.

- The MPC has a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. We believe that MPC members consider that: 1) tight labour markets will prompt inflationary pressure in the future, 2) ultra-low interest rates result in other economic problems, and 3) higher Bank Rate will be a more effective policy weapon if downside risks to growth crystallise.

- Both our projected outlook and the increase in the magnitude of political and economic risks facing the UK economy means we maintain the significant downside risks to our forecasts, despite the potential for slightly stronger growth next year as business investment rebounds should the EU Withdrawal Agreement be approved. The potential for severe economic outcomes has increased following the poor reception of the Withdrawal Agreement by MPs. We expect the Bank of England to hold at or reduce interest rates from current levels if Brexit risks materialise.

- The UK economic environment is relatively soft, despite seemingly strong labour market data. GDP growth recovered somewhat in the middle quarters of 2018, but more recent data suggests the economy slowed markedly in Q4. Our view is that the UK economy still faces a challenging outlook as the country exits the European Union and Eurozone economic growth softens.

- Cost pressures are easing but inflation is forecast to remain above the Bank's 2% target through most of the forecast period. Lower oil prices have reduced inflationary pressure, but the tight labour market and decline in the value of sterling means inflation may remain above target for longer than expected.

- Global economic growth is slowing. Despite slower growth, the European Central Bank is conditioning markets for the end of QE, the timing of the first rate hike (2019) and their path thereafter. More recent US data has placed pressure on the Federal Reserve to reduce the pace of monetary tightening – previous hikes and heightened expectations will, however, slow economic growth.

- Central bank actions and geopolitical risks have and will continue to produce significant volatility in financial markets, including bond markets.

Forecast:

- The MPC has maintained expectations of a slow rise in interest rates over the forecast horizon, but recent events around Brexit have dampened interest rate expectations. Our central case is for Bank Rate to rise twice in 2019, after the UK exits the EU. The risks are weighted to the downside.

- Gilt yields have remained at low levels. We expect some upward movement from current levels based on our central case that the UK will enter a transitionary period following its EU exit in March 2019. However, our projected weak economic outlook and volatility arising from both economic and political events will continue to offer borrowing opportunities.

	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.17**
Arlingclose Central Case	**0.75**	**0.75**	**1.00**	**1.00**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	1.13
Downside risk	0.00	-0.50	-0.75	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	**-0.85**
3-mth money market rate														
Upside risk	0.10	0.10	0.10	0.10	0.15	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	**0.17**
Arlingclose Central Case	**0.90**	**0.95**	**1.10**	**1.30**	**1.40**	**1.40**	**1.40**	**1.35**	**1.35**	**1.35**	**1.35**	**1.35**	**1.35**	1.27
Downside risk	-0.20	-0.45	-0.60	-0.80	-0.90	-0.90	-0.90	-0.85	-0.85	-0.85	-0.85	-0.85	-0.85	**-0.76**
1-yr money market rate														
Upside risk	0.20	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	**0.33**
Arlingclose Central Case	**1.15**	**1.25**	**1.35**	**1.50**	**1.70**	**1.60**	**1.50**	**1.40**	**1.35**	**1.35**	**1.35**	**1.35**	**1.35**	1.40
Downside risk	-0.35	-0.50	-0.60	-0.80	-0.90	-0.90	-0.90	-0.85	-0.85	-0.85	-0.85	-0.85	-0.85	**-0.77**
5-yr gilt yield														
Upside risk	0.25	0.30	0.30	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.37**
Arlingclose Central Case	**1.15**	**1.25**	**1.35**	**1.50**	**1.50**	**1.40**	**1.35**	**1.35**	**1.30**	**1.30**	**1.30**	**1.30**	**1.30**	1.33
Downside risk	-0.50	-0.60	-0.65	-0.80	-0.80	-0.70	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	**-0.66**
10-yr gilt yield														
Upside risk	0.25	0.30	0.30	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.37**
Arlingclose Central Case	**1.50**	**1.65**	**1.70**	**1.80**	**1.80**	**1.75**	**1.75**	**1.70**	**1.70**	**1.70**	**1.70**	**1.70**	**1.70**	1.70
Downside risk	-0.55	-0.70	-0.70	-0.80	-0.80	-0.75	-0.75	-0.70	-0.70	-0.70	-0.70	-0.70	-0.70	**-0.71**
20-yr gilt yield														
Upside risk	0.25	0.30	0.30	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.37**
Arlingclose Central Case	**2.00**	**2.10**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	2.18
Downside risk	-0.60	-0.70	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	**-0.73**
50-yr gilt yield														
Upside risk	0.25	0.30	0.30	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.37**
Arlingclose Central Case	**1.90**	**1.95**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	1.99
Downside risk	-0.60	-0.70	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	**-0.73**

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

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

Upside and downside risk is a common convention when reporting investments, returns and interest rate changes being different than predicted. So an upside risk equates to the extent to which/likelihood that the forecasting assumption will be beneficially outperformed by reality. The opposite is true for a downside risk.

Appendix 4 – Existing Investment & Debt Portfolio Position

	31st Dec 2018 **Actual Portfolio** **£m**	**Average Rate** **%**
External borrowing:		
Public Works Loan Board – Fixed rate	54.6	4.40
Public Works Loan Board – Variable rate	13.5	0.77
LOBO loans from banks	13.6	4.80
Welsh Government Loans	5.2	0.00
Local authority & other LT Loans	5.9	1.10
Local authority & other ST Loans	67.0	0.69
Total external borrowing	**159.8**	**2.31**
Other long-term liabilities:	**2.5**	NA
Total gross external debt	**162.3**	NA
Treasury investments:		
Banks & building societies (unsecured)	4.7	
Government (incl. local authorities)	8.6	
Money Market Funds	3.4	
Total treasury investments	16.7	0.60
Net debt	145.6	