monmouthshire COUNTY COUNCIL sir fynwy

REPORT

SUBJECT:	**Treasury Policy and Strategy Report 2020/21**
DIRECTORATE:	**Resources**
MEETING:	**Audit Committee**
DATE:	**13th February 2020**

DIVISION/WARDS AFFECTED: Countywide

1. Purpose:

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

1.2 The purpose of this report is to agree the 2020-21 Treasury policy and Strategy 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 2020/21 (Appendix 1) and
- The proposed Treasury Management Strategy 2020/21 (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 Treasury Management Policy Statement and Treasury Management Strategy

3.1 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.

3.2 The Audit Committee in its role as the Council's delegated body 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

3.3 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 include the Investment strategy within the Treasury strategy and for Audit Committee to continue to review proposals and endorse or otherwise the Strategy for approval by full Council. Appendix 2 contains the Councils detailed proposed investment strategy.

3.4 Overall responsibility for treasury management remains with the Full Council. In effect, that body delegates the execution and administration of treasury management decisions to the Director 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.

3.5 The Council also adheres to the Prudential Code for Capital Finance in Local Authorities (as revised in 2017) 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 are included as part of the capital budget considerations. They are included in Annex C here for information.

3.6 The revised Prudential Code and Treasury Management Code were issued in 2017. The LA (Capital Finance and Accounting) (Wales) (Amendment) Regulations 2018 came into force in March 2018. The Welsh Government Guidance on Local Government Investments has been revised in 2019 and comes into force for the 2020/21 financial year. Changes required by these codes are incorporated into the 2020/21 Treasury Strategy and sits alongside the Authority's Capital Strategy which was approved by Council on 19th September 2019.

3.7 The PWLB increased its lending rates, which are set by reference to UK gilts, by 1% in October 2019. Due to the economic backdrop in the UK and worldwide, in the previous year gilt interest rates had fallen by almost as much, possibly increasing the demand for PWLB borrowing by Local authorities during that year. The treasury team will look at alternative options for borrowing as the need arises.

4 Other Considerations influencing the strategy

4.1 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, Inflation the Bank of England base rate and UK growth & the likelihood that European banks may create UK subsidiaries to trade in the UK.

- Growth in Europe remains soft and in the US, the Federal Reserve began easing monetary policy in 2019 so an upward impact on UK interest rates and growth are not expected during the coming year.

- Achieving a balanced budget continues to be a challenge for the council, so the Authority continued with its investments in strategic pooled funds, investing a total of £3m, to increase returns whilst maintaining a prudent level of security. The income return to date has been above 4%.

4.2 The limits proposed in the 2020/21 treasury strategy have not changed significantly from the 2019/20 strategy which means that most of our investments will be limited to £2 million per counterparty – see table 3 'Approved Investment counterparties & Limits' in Appendix 2. 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.

5 Annual Minimum Revenue Provision (MRP) Policy Statement

5.1 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.

5.2 The Welsh Government issued revised MRP guidance in 2018. This is taken into account by the MRP Statement and Policy.

6 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 2018.

7 Resource Implications:

5.3 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.

5.4 In order to keep the Authority's borrowing costs lower, the external borrowing total is split fairly equally between long and short term recurrent borrowing. The short term borrowing achieves a reduction in cost but causes an increase in interest rate risk. Although interest rates could rise, it is not expected that short term rates over the MTFP window will exceed current long term rates. The Treasury team continues to optimise its loans and investments to reduce the net cost of borrowing/investing while ensuring that security and liquidity levels are maintained at a suitable level and the various risks are properly managed.

5.5 The levels of Treasury debt and investments at the 31st December 2019 are provided in Annex B.

5.6 The medium-term treasury budgets contained within the 2020/21 revenue budget proposals to be presented to Council shortly, 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 indicative treasury budgets for the next 4 years are:

Subjective Classification	Indicative Base Budget 2020/21	Indicative Base Budget 2021/22	Indicative Base Budget 2022/23	Indicative Base Budget 2023/24
Interest and Investment Income	(251,639)	(249,809)	(251,541)	(253,032)
Interest Payable and Similar Charges	4,019,724	4,049,335	4,156,636	4,075,909
Charges required under Regulation (MRP)	6,455,882	6,195,975	6,332,859	6,765,008
Related Evidence based pressures & Disinvestments	(205,000)	219,000	331,000	90,000
Total Treasury Budgets	**10,018,967**	**10,214,501**	**10,568,954**	**10,677,885**

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

- The capital medium term financial plan for 2020/21 has been shared with members as part of the capital budget setting process which won't conclude until February/March. 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 risks associated with rising interest rates are indicated in the Treasury Strategy by the Interest rate risk indicator & limit. This figure is a full 12 month impact on all of the Authority's variable rate loans and loans maturing in the following 12 months, being impacted by a 1% rise in interest rates irrespective of their maturity date. A 1% rise is not considered likely as the Bank of England Base Rate has been 0.5% since March 2009 falling to 0.25% briefly & then rising to 0.75% in August 2018. Further rises have been debated since then but are only expected to be small and gradual if they occur at all. The Authority's treasury management adviser Arlingclose is forecasting that Bank Rate will remain at 0.75% until the end of 2022. A 1% increase from the current level over the MTFP window would be very unexpected. The limit for this Interest rate Indicator has been set at £825,000, higher than the forecast for this indicator over the next 2 years. It should be noted that this indicator could only be reduced by less borrowing which would be difficult to implement or fixing external borrowing costs by taking out more expensive longer term loans. The anticipated future net borrowing costs for the Authority based on anticipated borrowing levels and at forecast rates is incorporated into the 2020/21 Revenue MTFP.

- The Authority continues to make plans to assess the capital receipts which can be obtained from selling property assets. Without these receipts being available to fund capital expenditure, new capital programs will have to be funded by additional borrowing.

8 Equality Impact Assessment

There is no equality impact arising directly from this report.

9 Sustainable Development Implications:

None

10 Background Papers:

Appendix 1 – Treasury Management & Minimum Revenue Provision (MRP) Policy Statement 2020/21

Appendix 2 – Treasury Management Strategy Statement 2020/21 including the Investment & Borrowing Strategies

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Appendix 1

TREASURY MANAGEMENT POLICY STATEMENT AND MINIMUM REVENUE PROVISION POLICY STATEMENTS 2020/21

1 TREASURY MANAGEMENT POLICY STATEMENT

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 Director 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 2020/21

4.1 Where the Authority finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The Welsh Government's Guidance on Minimum Revenue Provision most recently issued in 2018 places a duty on local authorities to make a prudent provision for debt redemption. Local authorities are required to "have regard" to such Guidance under section 21(1A) of the Local Government Act 2003.

4.2 In line with WG guidance, this annual MRP Statement will be submitted to Council before the start of the 2020/21 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.

4.3 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 or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

4.4 MRP options recommended in the Guidance include:

- 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 2020/21:

4.5 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).

4.6 **MRP on Supported Borrowing funded Expenditure**

The Authority's policy is to apply Option 3, the Asset life method in respect of supported capital expenditure funded from borrowing. The charge will be 2% per annum, equivalent to equal installments over a 50 year life.

4.7 **MRP on Unsupported Borrowing funded Expenditure**

The Authority's policy is to apply Option 3, the Asset life method 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 life of the assets taking into account the real value of money. The first MRP charge will be in the year after the asset becomes operational. MRP on purchases of freehold land will be charged over 50 years. MRP on expenditure not related to fixed assets but which has been capitalised by regulation or direction will be charged over 20 years.

These lives may be reduced if it is prudent to do so because the resultant income stream or useful life to the Authority is shorter.

4.8 **MRP in respect of leases and PFI**

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.

4.9 For capital expenditure loans to third parties that are repaid in annual or more frequent instalments of principal, the Council may make nil MRP, but will instead apply the capital receipts arising from principal repayments to reduce the capital financing requirement instead. In years where there is no principal repayment, MRP will be charged in accordance with the MRP policy for the assets funded by the loan, including where appropriate, delaying MRP until the year after the assets become operational. While this is not one of the options in the WG Guidance, it is thought to be a prudent approach since it ensures that the capital expenditure incurred in the loan is fully funded over the life of the assets.

4.10 The 2020/21 budget proposals reflect these positions.

APPENDIX 2

Treasury Management Strategy Statement 2020/21

Introduction

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.

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) which requires the Authority 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 November 2019 that requires the Authority to approve an investment strategy before the start of each financial year. 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.

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, or a material loss in the fair value of a non-financial investment identified as part of the year end accounts preparation and audit process.

External Context

Economic background: The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Authority's treasury management strategy for 2020/21.

UK Consumer Price Inflation (CPI) for September registered 1.7% year on year, unchanged from the previous month. Core inflation, which excludes the more volatile components, rose to 1.7% from 1.5% in August. The most recent labour market data for the three months to August 2019 showed the unemployment rate ticked back up to 3.9% while the employment rate was 75.9%, just below recent record-breaking highs. The headline 3-month average annual growth rate for pay was 3.8% in August as wages continue to rise steadily. In real terms, after adjusting for inflation, pay growth increased 1.9%.

GDP growth rose by 0.3% in the third quarter of 2019 from -0.2% in the previous three months with the annual rate falling further below its trend rate to 1.0% from 1.2%. Services and construction added positively to growth, by 0.6% and 0.4% respectively, while production was flat and agriculture recorded a fall of 0.2%. Looking ahead, the Bank of England's Monetary Policy Report (formerly the Quarterly Inflation Report) forecasts economic growth to pick up during 2020 as Brexit-related uncertainties dissipate and provide a boost to business investment helping GDP reach 1.6% in Q4 2020, 1.8% in Q4 2021 and 2.1% in Q4 2022.

The Bank of England maintained Bank Rate to 0.75% in November following a 7-2 vote by the Monetary Policy Committee. Despite keeping rates on hold, MPC members did confirm that if Brexit uncertainty drags on or global growth fails to recover, they are prepared to cut interest rates as required. Moreover, the downward revisions to some of the growth projections in the Monetary Policy Report suggest the Committee may now be less convinced of the need to increase rates even if there is a Brexit deal.

Growth in Europe remains soft, driven by a weakening German economy which saw GDP fall -0.1% in Q2 and is expected to slip into a technical recession in Q3. Euro zone inflation was 0.8% year on year in September, well below the European Central Bank's target of 'below, but close to 2%' and leading to the central bank holding its main interest rate at 0% while cutting the deposit facility rate to -0.5%. In addition to maintaining interest rates at ultra-low levels, the ECB announced it would recommence its quantitative easing programme from November.

In the US, the Federal Reserve began easing monetary policy again in 2019 as a pre-emptive strike against slowing global and US economic growth on the back of the ongoing trade war with China. At its last meeting the Fed cut rates to the range of 1.50-1.75% and financial markets expect further loosening of monetary policy in 2020. US GDP growth slowed to 1.9% annualised in Q3 from 2.0% in Q2.

Credit outlook: Credit conditions for larger UK banks have remained relatively benign over the past year. The UK's departure from the European Union was delayed three times in 2019 and while there remains some concern over a global economic slowdown, this has yet to manifest in any credit issues for banks. Meanwhile, the post financial crisis banking reform is now largely complete, with the new ringfenced banks embedded in the market.

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

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

Interest rate forecast: The Authority's treasury management adviser Arlingclose is forecasting that Bank Rate will remain at 0.75% until the end of 2022. The risks to this forecast are deemed to be mostly weighted to the downside, due to the continuing need for clarity on Brexit process despite the improved stability provided by the December 2019 election result and also due to the continuing global economic slowdown. The Bank of England, having previously indicated interest rates may need to rise if a Brexit agreement was reached, stated in its November Monetary Policy Report and its Bank Rate decision (7-2 vote to hold rates) that the MPC now believe this is less likely even with a deal being days away at the time of writing.

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

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

For the purpose of setting the budget, it has been assumed that treasury management investments will return an average rate of 1.2% during 2020/2021. This includes £3m of strategic pooled funds returning 4.5%, the balance being short term investments returning 0.7%. ; It has also been assumed - that new long-term loans will be borrowed at an average rate of 2.5% / 2.8% for 10 and 30 year PWLB loans & 0.9% for short term loans mainly from other Local Authorities.

Local Context

On 31st December 2019, the Authority held £178.4m of borrowing, £2.4m of other debt and £20.4m of treasury investments. This is set out in further detail at ***Annex B***. Forecast changes to the Capital Financing Requirement and how this affects these sums over time are shown in the balance sheet analysis in Table 1 below which concludes with the total amount of external new (or replacement) loans required by each year end when compared to 31st March 2019.

Table 1: Balance sheet summary and forecast

	31.3.19 Actual £m	31.3.20 Estimate £m	31.3.21 Forecast £m	31.3.22 Forecast £m	31.3.23 Forecast £m	31.3.24 Forecast £m
General Fund CFR	151.2	160.4	162.2	164.1	178.3	179.3
Commercial Investments CFR	**35.1**	**50.7**	**51.4**	**49.3**	**47.2**	**44.3**
Total CFR	**186.3**	**211.1**	**213.6**	**213.4**	**225.4**	**223.6**
Less: Other debt liabilities *	-2.4	-2.4	-2.4	-2.4	-2.4	-2.4
Loans CFR	**183.9**	**208.7**	**210.2**	**210.0**	**222.0**	**220.2**
Less: Existing external borrowing reducing as matures **	-178.4	-122.7	-87.0	-79.1	-77.3	-73.5
Internal borrowing requirement	**5.5**	**86.0**	**123.1**	**130.9**	**144.7**	**146.8**
Less: Usable reserves	-17.3	-21.0	-26.8	-27.4	-27.2	-27.2
Less: Working capital	-8.7	-8.7	-8.7	-8.7	-8.7	-8.7
Cumulative New External borrowing requirement/ (Investments) – Including Replacement of borrowing at 31/3/2019 maturing	**-20.5**	**56.3**	**87.5**	**94.8**	**108.8**	**110.9**
Anticipated gross borrowing levels ***	**178.4**	**194.0**	**189.6**	**188.8**	**201.1**	**199.3**

* leases and PFI liabilities that form part of the Authority's total debt
** shows only loans to which the Authority is committed and excludes optional refinancing
*** Based on £15m of investments being held but excluding other debt liabilities

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.

The Authority is expected to need to borrow in the region of £111m over the forecast period above due to maturing debt and due to the rising CFR. The Authority has an increasing CFR due to its borrowing funded capital programme, including 21st Century Schools Band B and the completion of the £50m of Property Investments (which whilst increasing CFR is expected to be afforded by additional income).

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. By comparing Anticipated gross borrowing levels to Loans CFR, table 1 shows that the Authority expects to comply with this recommendation during 2020/21.

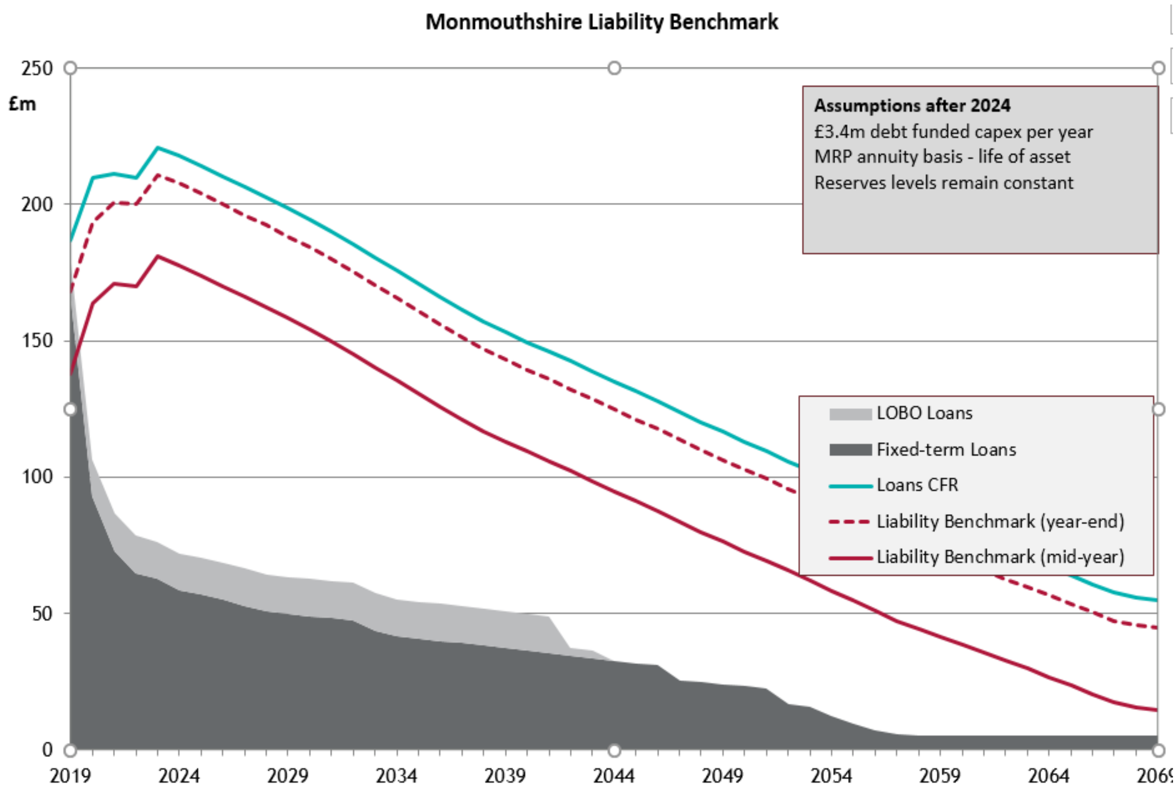
Liability benchmark: This is the lowest level of external borrowing required to fund the capital programme. This assumes the same forecasts as table 1 above, but that cash and investment balances are kept at an average of £15m to comply with the minimum of £10m required of a professional investor under

Mifid II (Markets in Financial Instruments Directive II). This minimum level of borrowing is expected to rise by £5.3m from 1st April 2020 to 31st March 2024.

Table 2: Liability benchmark

	31.3.19 Actual £m	31.3.20 Estimate £m	31.3.21 Forecast £m	31.3.22 Forecast £m	31.3.23 Forecast £m	31.3.24 Forecast £m
Loans CFR	183.9	208.7	210.2	210.0	222.0	220.2
Less: Usable reserves	-17.3	-21.0	-26.8	-27.4	-27.2	-27.2
Less: Working capital	-8.7	-8.7	-8.7	-8.7	-8.7	-8.7
Plus: Forecast investments	20.4	15.0	15.0	15.0	15.0	15.0
Liability Benchmark **(Minimum level of gross borrowing needed)**	**178.3**	**194.0**	**189.6**	**188.8**	**201.1**	**199.3**

Following on from the medium-term forecasts in Table 2 above, the long-term liability benchmark, below assumes capital expenditure funded by borrowing is as the draft 2020/21 capital MTFP and thereafter £3.4m per year, minimum revenue provision on new capital expenditure is based on asset life as in the MTFP or 25 years and, income, expenditure and reserves held are not increasing or decreasing beyond the MTFP window. This is shown in the chart below:



Our underlying need to borrow is shown by the top blue line. However, due to the use of reserves and working capital, the Authority is expected to need total external borrowing between the full red lower line and the dotted line above it. As our existing loans portfolio will reduce as loans mature as shown by the grey areas, new loans will therefore be required to fill the gap between the grey area and the red lines over the long term. The Authority intends to maintain about a 50% level or £63m of short term loans which will partly fill this gap, but will still need to take out long term loans, mainly to fund the rest of the Commercial investment program and also the 21C schools band B program, both built into the Draft Capital MTFP.

Borrowing Strategy

As shown in Annex B, at the 31st December 2019, the Authority held £174.3 million of loans, a decrease of £4.0 million compared to 31st March 2019 as part of its strategy for funding previous years' capital programmes. The Liability Benchmark in table 2 shows that the Authority expects to borrow up to £189.6m by the end of 2020/21.

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.

Strategy: Given the significant cuts to public expenditure and in particular to local government funding, the Authority'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. 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.

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 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 2020/21 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

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

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

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

- Public Works Loan Board (PWLB) and any successor body
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- any other UK public sector body
- UK public and private sector pension funds (except the Greater Gwent Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

- CSC Foundry

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

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

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 2020/21, 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 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.

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.

Treasury Investment Strategy

The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. From the 1st April 2019 to 31st December 2019, the Authority's treasury investment balances ranged from £10 to £41 million, with an average of £25.1 million. The Authority is committed to holding a minimum of £10m as mentioned above due to the Mifid II regulation. 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.

Loans to organisations providing local public services and purchases of investment property are not normally considered to be treasury investments, and these are therefore covered separately in Annex D.

Objectives: Both the CIPFA Code and the WG Guidance require the Authority to invest its treasury 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.

Negative interest rates: If the UK enters into a recession in 2020/21, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

Strategy: Given the increasing risk and very low returns from short-term unsecured bank investments, the Authority aims to continue during 2020/21 with the diversification practiced in 2019/20 into higher yielding asset classes such as pooled funds. This continues to take advantage of the £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.

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 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 will go through Other Comprehensive Income (OCI) and be held in the Financial Instruments Revaluation Reserve (FIRR) until the investments are sold. Dividends from these funds will be credited to the SDPS.

Approved counterparties: The Authority may invest its surplus funds with any of the counterparty types in table 3 below, subject to the cash limits (per counterparty) and the time limits shown. Any formal recommendations received from the Authority's treasury advisors which reduces or increases the restrictions on certain counterparties in terms of eligibility, limits or duration of Investments will supersede the limits set below. . Any Investments with a credit rating of less than A-, or one which has a maturity of more than one year unless it is with another Local Authority, are classed in the 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. See Annex D for further information.

Table 3: Approved investment counterparties and limits

This table must be read in conjunction with the notes below

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 balances	£4m per foreign country with a credit rating of AA+ or above	Limit for negotiable instruments held in Brokers nominee accounts: the lower of 50% or £10m per Broker	6 months 13 months 2 years
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 with a credit rating of AA+ or above for all investme nt 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	£6m total investment at the time of	£2m per fund	N/A	N/A	N/A

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	deposit				
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

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

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

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

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

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

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

Pooled funds: Shares or units in diversified investment vehicles consisting of the any of the above investment types, plus equity shares, property & some minority holdings. 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 can 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.

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.

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. Investments in REIT shares cannot be withdrawn but can be sold on the stock market to another investor.

Operational bank accounts: The Authority may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, 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.

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.

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.

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.

Investment limits: The Authority's revenue reserves available to cover investment losses are forecast to be £13.5 million on 31st March 2020. In order that no more than 30% of available revenue 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 3). 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 & 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.

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 treasury team maintain an excel cashflow model which calculates the net cashflow movements expected per year based on the capital medium term financial plan and informs the timing and amount of any longer term investment and borrowing decisions. The team also uses a detailed excel cash flow forecasting spreadsheet for the current financial year to determine the optimum size and timing for new short term loans and investments to ensure sufficient liquid cash is available to make any payments required. The aim of short term liquidity management is to borrow only when the need arises and therefore to minimise net borrowing costs. 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.

Treasury Management Indicators

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

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

Interest rate exposures: This indicator is set to control the Authority's exposure to interest rate risk. The value of this indicator is the total of 'The 12 month impact of a 1% rise in interest rates on each loan' which will mature in the following 12 months offset by the 12 month impact of investments maturing in the next 12 months. The forecast levels and the Upper limit for the total impact is:

Interest rate risk (Forecasts / Limit)	**31st Dec 2019 £'000**	**31st Mar 2020 £'000**	**31st Mar 2021 £'000**	**31st Mar 2022 £'000**	**Limit £'000**
Forecasts / Upper limit on 12 month revenue impact	534	626	699	657	**825**

of a 1% rise in interest rates					
Forecast / Upper limit on one-year revenue impact of a 1% fall in interest rates	(534)	(626)	(699)	(657)	**0**
Rise as a % of Council Fund balance at 31st March 2019	7.5%	8.8%	9.8%	9.2%	**11.6%**

Note – This is a variation on the Interest rate exposure indicator from the 2019/20 strategy as 12 months of impact is included for each maturing loan irrespective of timing, so this indicator produces a higher figure but is less likely to vary due to small variations in maturity date which are not relevant for decision making. The impact is calculated assuming each maturing loan or investment will be replaced with a like for like instrument. In reality the type, counterparty and maturity might change, but it is however a good indicator of the interest rate risk of holding shorter maturity/variable rate instruments. The comparison to Council Fund balance is provided as any overspend resulting from an increase in interest rates would as a default be funded from the Council fund, £7.1m at 31st March 2019. As loan maturities are spread over the 12 months in question, the 12 month impact of all maturing loans being replaced by ones with higher rates would not be felt in the same financial year.

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 rate risk indicator	Forecast 31st March 2020 % / £m	Lower limit	Upper limit
Under 12 months – LOBO loans	8.0% / £13.6m		
Under 12 months – short term loans	36.9% / £62.7m		
Under 12 months – variable rate loans	8.0% / £13.5m		
Under 12 months – maturing LT loans	0.8% / £1.4m		
Total - Under 12 months	**53.7% / £91.2m**	**0.0%**	**60%**
12 months and within 24 months	**5.2% / £8.8m**	**0.0%**	**20%**
24 months and within 5 years	**7.7% / £13.1m**	**0.0%**	**30%**
5 years and within 10 years	**7.5% / £12.8m**	**0.0%**	**30%**
10 years and within 20 years	**7.5% / £12.7m**	**0.0%**	**100%**
20 years and above	**18.4% / £31.3m**	**0.0%**	**100%**
Total	**100% / £169.9m**		

The maturity periods in the table above are measured from the first day of the financial year for existing loans, loan start dates for new loans & with matured loans removed if relevant. The maturity date of borrowing is the earliest date on which the lender can demand repayment so LOBO loans are under 12 months despite not being expected to mature until 2041/3.

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 having to seek early repayment of long-term investments. The limits on the total of any long-term investments arranged before 31st March 2021, maturing in each of the following periods are:

Price risk indicator	2020/21	2021/22	2022/23
Limit on principal invested beyond year end	£6m	£6m	£2m

the limits are measured at invested amount if different to sum received at maturity

This indicator excludes Pooled funds, which, although intended to be held for 3 – 5 years, do not have a fixed maturity.

Prudential Indicators

Prudential indicators have traditionally been included in the Treasury Strategy but are now included with the 2020/21 budget papers as an Appendix. They are included in Annex C for information.

The Actual External Debt is reported against the Operational Boundary and Authorised Limit after the end of each year in the Treasury Outturn report.

Related Matters

The CIPFA Code requires the Authority to include 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.

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

Financial Implications

The budget for investment income in 2020/21 is £250,000, based on an average investment portfolio of £17 million at an interest rate of 0.7% plus £3m of strategic pooled funds at an average income return of 4.5%. The budget for debt interest paid in 2020/21 is £4.1 million excluding new debt required to fund the remainder of the Commercial Investment purchase program. This figure is based on an average debt portfolio of £174 million at an average interest rate of 2.4% made up of approximately half long and half short term and variable rate debt. If actual levels of investments and borrowing, or actual interest rates, differ from those forecast, performance against budget will be correspondingly different.

Other Options Considered

The WG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The S151 Officer and his team, having previously consulted the Audit Committee 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	Impact on risk management

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

Annex A – Arlingclose Economic & Interest Rate Forecast November 2019

Underlying assumptions:

- The global economy is entering a period of slower growth in response to political issues, primarily the trade policy stance of the US. The UK economy has displayed a marked slowdown in growth due to both Brexit uncertainty and the downturn in global activity. In response, global and UK interest rate expectations have eased.

- Some positivity on the trade negotiations between China and the US has prompted worst case economic scenarios to be pared back. However, information is limited, and upbeat expectations have been wrong before.

- Brexit has been delayed until 31 January 2020. While the General Election has maintained economic and political uncertainty, the opinion polls suggest the Conservative position in parliament may be strengthened, which reduces the chance of Brexit being further frustrated. A key concern is the limited transitionary period following a January 2020 exit date, which will maintain and create additional uncertainty over the next few years.

- UK economic growth has stalled despite Q3 2019 GDP of 0.3%. Monthly figures indicate growth waned as the quarter progressed and survey data suggest falling household and business confidence. Both main political parties have promised substantial fiscal easing, which should help support growth.

- While the potential for divergent paths for UK monetary policy remain in the event of the General Election result, the weaker external environment severely limits potential upside movement in Bank Rate, while the slowing UK economy will place pressure on the MPC to loosen monetary policy. Indeed, two MPC members voted for an immediate cut in November 2019.

- Inflation is running below target at 1.7%. While the tight labour market risks medium-term domestically-driven inflationary pressure, slower global growth should reduce the prospect of externally driven pressure, although political turmoil could push up oil prices.

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

Forecast:

- Although we have maintained our Bank Rate forecast at 0.75% for the foreseeable future, there are substantial risks to this forecast, dependant on General Election outcomes and the evolution of the global economy.

- Arlingclose judges that the risks are weighted to the downside.

- Gilt yields have risen but remain low due to the soft UK and global economic outlooks. US monetary policy and UK government spending will be key influences alongside UK monetary policy.

- We expect gilt yields to remain at relatively low levels for the foreseeable future and judge the risks to be broadly balanced.

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

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

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

Annex B - Existing Investment & Debt Portfolio Position

	31st Dec 2019 **Actual Portfolio £m**	**Average Rate %**
External borrowing:		
Public Works Loan Board – Fixed rate	75.7	**3.6**
Public Works Loan Board – Variable rate	13.5	**0.9**
LOBO loans from banks	13.6	**4.8**
Welsh Government Loans	4.6	**0.0**
Local authority & other LT loans	0.9	**0.95**
Local authority & other ST loans	66.0	**0.87**
Total external borrowing	**174.3**	**2.3**
Other long-term liabilities:		
Private Finance Initiative	0.7	
Leases	0.1	
Other	1.6	
Total other long-term liabilities	2.4	NA
Total gross external debt	176.7	NA
Treasury investments:		
Banks & building societies (unsecured)	5.8	}
Government (incl. local authorities)	5.5	0.7
Money Market Funds	6.8	}
Strategic pooled funds	3.0	4.5
Total treasury investments	21.1	1.2
Net debt	155.6	NA

Annex C - Prudential Indicators

Capital Expenditure £m	2018/19 actual	2019/20 forecast	2020/21 budget	2021/22 budget	2022/23 budget	2023/24 budget
General Fund services	39.6	27.6	27.9	20.3	19.6	5.9
Commercial investments (£50m total pool)	30.7	16.7	2.6	0.0	0.0	0.0
TOTAL	**70.3**	**44.3**	**30.5**	**20.3**	**19.6**	**5.9**

Proportion of Financing Costs to net revenue stream	2018/19 actual	2019/20 forecast	2020/21 budget	2021/22 budget	2022/23 budget	2023/24 budget
Interest £m	3.3	3.8	3.8	3.8	3.9	3.8
MRP £m	4.6	5.7	6.3	6.4	6.6	6.8
Total Financing costs £m	**7.9**	**9.5**	**10.1**	**10.2**	**10.5**	**10.6**
Net Revenue Stream (£m)	150.4	154.3	160.8	163.3	165.9	168.6
Proportion of net revenue stream %	**5.2%**	**6.1%**	**6.3%**	**6.2%**	**6.3%**	**6.3%**

Capital Financing Requirement	31.3.19 Actual £m	31.3.20 Estimate £m	31.3.21 Forecast £m	31.3.22 Forecast £m	31.3.23 Forecast £m	31.3.24 Forecast £m
Commercial Investments CFR (including solar farm)	35.1	50.7	51.4	49.3	47.2	44.3
Other Loans CFR	**148.8**	**158.0**	**158.8**	**160.7**	**174.8**	**175.9**
Total Loans CFR	**183.9**	**208.7**	**210.2**	**210.0**	**222.0**	**220.2**
Other Debt Liabilities CFR	2.4	2.4	3.4	3.4	3.4	3.4
Total CFR	**186.3**	**211.1**	**213.6**	**213.4**	**225.4**	**223.6**

A comparison of Net and Gross Debt to Capital Financing Requirement (Loans CFR)	31.3.2019 actual	31.3.2020 forecast	31.3.2021 budget	31.3.2022 budget	31.3.2023 budget	31.3.2024 budget
Net Debt	158.0	182.0	174.8	170.1	181.4	178.1
Gross Debt	178.3	197.0	189.8	185.1	196.4	193.1
Loans CFR	183.9	208.7	210.2	210.0	222.0	220.2

Authorised & Operational Borrowing Limits	2019/20 for comparison	2020/21 limit	2021/22 limit	2022/23 limit	2023/24 limit
Authorised limit - borrowing	248.2	230.0	225.3	236.6	233.3

Authorised limit - PFI, leases & Right of use assets	4.4	5.4	5.4	5.4	5.4
Authorised limit - total external debt	**252.6**	**235.5**	**230.7**	**242.0**	**238.7**
Operational boundary - borrowing	218.0	210.8	206.1	217.4	214.1
Operational boundary - PFI, leases & Right of use assets	2.9	3.9	3.9	3.9	3.9
Operational boundary - total external debt	**220.9**	**214.8**	**210.0**	**221.3**	**218.0**

nb - Authorised limit is higher than CFR as CFR is not a limit but an indicator of debt requirement