

**Treasury
Management
Strategy
2019-20**

INTRODUCTION

1. Treasury management is the management of Kent County Council's cash flows, borrowing and investments, and the associated risks. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Council's prudent financial management.
2. Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.
3. Investments held for service purposes or for commercial profit are considered in a different report, the Investment Strategy.

GOVERNANCE

4. The Corporate Director of Finance is responsible for the Council's treasury management operations and day to day responsibility is delegated to the Head of Finance (Policy, Planning & Strategy) / Head of Finance (Operations) and Treasury and Investments Manager. The detailed responsibilities are set out in the Council's Treasury Management Practices.
5. The Treasury Management Advisory Group (TMAG) which is a sub-committee of Cabinet has been established to work with the Officers on treasury management. The group consists of the Cabinet Member for Finance and Traded Services, Deputy Cabinet Member for Finance and Traded Services, Chairman Policy and Resources Cabinet Committee, Chairman Superannuation Fund Committee, Liberal Democrat Finance spokesman and a Labour Group Representative. The agreed terms of reference are "The Treasury Management Advisory Group will be responsible for advising the Cabinet and Corporate Director of Finance on treasury management policy within KCC's overarching Treasury Management Strategy". TMAG meets the requirement in the CIPFA Code for a member body focussing specifically on treasury management. TMAG meets half yearly and members of the group receive detailed information on a weekly and monthly basis.
6. Council will agree the Treasury Management Strategy and receives annual and half yearly reports on treasury management activity. Governance and Audit Committee

receives annual and half-yearly reports and makes recommendations to County Council. It also receives quarterly updates.

7. The Council's Treasury Management Policy Statement is attached in Appendix A to reflect the requirements of the CIPFA Code.

EXTERNAL CONTEXT

Economic background

8. 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 Council's treasury management strategy for 2019-20.
9. UK Consumer Price Inflation (CPI) for November was up 2.3% year/year, in line with the consensus forecast and broadly in line with the Bank of England's November Inflation Report. The most recent labour market data for the three months to October 2018 showed the unemployment rate remained at 4.1% while the employment rate of 75.7% was the joint-highest estimate since comparable estimates began in 1971. 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 likely to only have a modest impact on consumer spending.
10. 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. 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.
11. Following the Bank of England's decision to increase Bank Rate to 0.75% in August, no changes to monetary policy have been made since. However, the Bank expects that should the economy continue to evolve in line with its December 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.
12. While US growth has slowed over 2018, the economy has continued to perform robustly. The US Federal Reserve continued its tightening bias throughout 2018, pushing rates to the 2.25%-2.50% range in November while lowering its forecast of rate rises in 2019 to two from the three previously projected.

13. A temporary truce in the ongoing trade war between the US and China was announced as the leaders of both countries agreed to halt new trade tariffs for 90 days to allow talks to continue. Tariffs already imposed will remain in place. The fallout continues to impact on economic growth and stock market volatility.

Credit outlook

14. 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.
15. 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.

Interest rate forecast

16. Following the increase in Bank Rate to 0.75% in August 2018, the Authority's treasury management adviser Arlingclose is forecasting one more 0.25% hike during 2019 to take official UK interest rates to 1.00%. 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.
17. 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. While assumptions are that a Brexit deal is agreed and some agreement reached on transition and future trading arrangements before the UK leaves the EU, the possibility of a "no deal" Brexit hangs over economic activity. As such, the risks to the interest rate forecast are considered firmly to the downside.

18. 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. The projected weak economic outlook and volatility arising from both economic and political events are likely to continue to offer borrowing opportunities.
19. A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix B.
18. For the purpose of setting the budget, it has been assumed that new internally managed investments will be made at an average rate of LIBOR presently 0.90% and that new long-term loans will be borrowed at an average rate of 2.5%.

LOCAL CONTEXT

20. At 31 December 2018 the Council held £911m of borrowing and £333m of investments. This is set out in further detail in Appendix C.
21. 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. KCC's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.
22. CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years and the Council expects to comply with this recommendation.

BORROWING STRATEGY

23. On 31 December 2018, the Council held £911m of borrowing including £35m attributable to Medway Council, as part of its strategy for funding previous years' capital programmes. This represents a decrease of £37m on 31 March 2018 and reflects the Council's strategy of maintaining borrowing below their underlying levels.
24. The Council may borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £1,013m.

Objective

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

Strategy

26. The Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability or sustainability of the debt portfolio.
27. 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. By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. At the end of March 2018 the Council was internally borrowed by £106m.
28. The benefits of internal and short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. The Council will use the services of its treasury advisor to develop this 'cost of carry' and breakeven analysis and based on the results the Council will determine whether to 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.
29. Alternatively, the Council 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.
30. In addition, the Council may borrow short-term loans to cover unplanned cash flow shortages.
31. **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 Kent County Council Superannuation Fund)

- capital market bond investors
 - UK Municipal Bonds Agency plc and other special purpose companies created to enable local Council bond issues
 - UK Government backed funding initiatives
32. **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
33. The Council has previously borrowed from the PWLB and UK banks. It continues to investigate other sources of finance, such as loans from other local authorities and bank loans that may be available at more favourable rates.
34. **LOBO (Lender's Option Borrower's Option) loans:** In October 2018 the Council prepaid £60m RBS LOBO loans at a total cost of £73m funding this by using a mix of cash balances and a £40m 15-year Equal instalment of Principal (EIP) loan. It now holds £90m of LOBO loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. £50m of these LOBOs have options during 2019-20, and although the Council understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The Council will take the option to repay LOBO loans at no cost if it has the opportunity to do so; and has no plans to borrow via LOBO loans in future.
35. **Short-term and variable rate loans:** These loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below.
36. **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 Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

INVESTMENT STRATEGY

37. The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council's investment balance has ranged between £274m and £433m. The average balance is expected to reduce in 2019-20 reflecting KCC's policy of using cash balances to repay maturing loans and internally funding capital expenditure.
38. **Objectives:** The CIPFA Code requires the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.
39. **Strategy:** Given the increasing risk and very low returns from short-term unsecured bank investments the Council has continued its strategy of investing in pooled investment funds during 2018-19 adding a further £30m to its existing pooled fund portfolio. It will consider investing more in these higher yielding asset classes during 2019-20 which invest in a diversified range of assets primarily focussed on an income return rather than capital growth. It will however continue to invest in money market funds and Government including local authority deposits to meet its liquidity requirements.
40. **Business models:** Under the new IFRS 9 standard, the accounting for certain investments depends on the Council's "business model" for managing them. The Council aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

Approved Investment Counterparties

41. The Council may invest its surplus funds with any of the counterparty types listed below:
42. **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.

43. **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. Unsecured investments with banks rated below the agreed minimum rating of A- are restricted to overnight deposits with the Council's current banking services provider.
44. **Money Market Funds:** 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.
45. **Cash plus / Short Bond Funds:** Pooled investment funds whose value change with market prices and have a notice period, will be used as alternatives to unsecured bank deposits for longer investment periods.
46. **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.
47. **Corporates:** 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.
48. **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. As providers of public services, they retain the likelihood of receiving government support if needed.
49. **Loans:** Loans to entities set up on an arms-length basis from the Council, and other suitable opportunities. The Council will take advice from Arlingclose on the appropriate structure of the loans and applicable rate of interest.

50. **Pooled investment funds:** Shares or units in diversified investment vehicles consisting of any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.
51. Pooled funds offer enhanced returns over the longer term but are more volatile in the short term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.
52. **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.
53. **Operational bank accounts:** KCC 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.

Credit ratings

54. Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:
 - no new investments will be made,
 - any existing investments that can be recalled or sold at no cost will be, and
 - full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.
55. 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 Council 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

56. The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the Councils 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 Arlingclose, the Council's treasury management adviser. No investments will be made with an Council if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.
57. When deteriorating financial market conditions affect the creditworthiness of all Councils, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those Councils 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 Councils of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned but will protect the principal sum invested.

Investment limits

58. The Council's cash reserves available to cover investment losses are forecast to be £305m on 31 March 2019. In order that no more than 10% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one Council (other than the UK Government) will be £25m.
59. The Council may invest its surplus funds with any of the counterparty types listed above subject to the cash limits per counterparty and the durations shown in the table below:

Approved Investment Counterparties and limits

	Minimum Credit rating	Maximum Cash Limit		Maximum Duration
		Individual	Total	
Government				
- UK Government		unlimited		50 years
- UK Local Authorities		£25m		10 years
- Supranational banks	AAA	£20m	£30m	25 years
- Non - UK Government	AA+	£20m	£30m	25 years
UK banks and building societies – unsecured	A-	£15m		13 months
Council's banking services provider		£20m		Overnight
Overseas banks - unsecured	Country limit AA+, Individual limit A-	£20m	£30m country limit	13 months
Short-term Money Market Funds	A+	£20m per fund or 0.5% of the fund size if lower		
Cashplus / short bond funds		£20m per fund		
Banks secured				
- Covered bonds	AAA	£20m	£100m	5 years
- Reverse repurchase agreements	collateral of AA or better	£20m each		5 years
Corporates (non- financials)	A	£2m per issuer	£20m	2 years
Registered Providers		£10m	£25m	5 years
Loans			£20m	
Pooled funds and real estate investment trusts			£200m	
- Absolute Return funds		£25m per fund		
- Multi Asset Income funds		£25m per fund		
- Property funds		£75m or 5% of total fund value if greater		
- Bond funds		£25m per fund		
- Equity Income Funds		£25m per fund		
- Real Estate Investment Trusts		£25m per fund		

60. Liquidity management: The Council forecasts its cash flow requirements to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being

forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium-term financial plan and cash flow forecast.

TREASURY MANAGEMENT INDICATORS

- 61. The Council measures and manages its exposures to treasury management risks using the following indicators.
- 62. **Security:** The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its internally managed 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	AA

- 63. **Liquidity:** The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period, without additional borrowing.

Liquidity risk indicator	Target
Total cash available within 3 months	£110m

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

Interest rate risk indicator	Limit
Upper limit on one-year revenue impact of a 1% <u>rise</u> in interest rates	£10m
Upper limit on one-year revenue impact of a 1% <u>fall</u> in interest rates	£10m

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

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

Refinancing rate risk indicator	Upper limit	Lower limit
Under 12 months	100%	0%
12 months and within 5 years	50%	0%
5 years and within 10 years	50%	0%
10 years and within 20 years	50%	0%
20 years and within 40 years	50%	0%
40 years and longer	50%	0%

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

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

Price risk indicator	2019-20	2020-21	2021-22
Limit on principal invested beyond year end	£300m	£300m	£300m

RELATED MATTERS

67. The CIPFA Code requires the Council to include the following in its treasury management strategy.
68. **Financial Derivatives:** Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities’ use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).
69. KCC will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

70. Financial derivative transactions may be arranged with any Council that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.
71. **Markets in Financial Instruments Directive:** The Council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the Corporate Director of Finance believes this to be the most appropriate status.

FINANCIAL IMPLICATIONS

72. The budget for investment income in 2019-20 is £6.2m, based on an average investment portfolio of £300m at an interest rate of 2.05%. The budget for debt interest paid in 2019-20 is £39.8m, based on an average debt portfolio of £930m at an average interest rate of 4.5%. If actual levels of investments and borrowing, or actual interest rates, differ from forecast, performance against budget will be correspondingly different.

OTHER OPTIONS CONSIDERED

73. The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Corporate Director of Finance, having consulted the Deputy Leader and Cabinet Member for Finance and Traded Services, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller

Alternative	Impact on income and expenditure	Impact on risk management
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

Appendix A - Treasury Management Policy Statement

INTRODUCTION AND BACKGROUND

1. The Council adopts CIPFA's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) as described in Section 5 of the Code.
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.
3. This Council will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in its TMPs.
4. This Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Corporate Director of Finance and for the execution and administration of treasury management decisions to the Head of Finance (Policy, Planning & Strategy) / Head of Finance (Operations) and Treasury and Investments Manager who will act in accordance with the Council's policy statement and TMPs and, if they are a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.
5. This Council nominates the Treasury Management Advisory Group and Governance and Audit Committee to be responsible for ensuring effective scrutiny of its treasury management strategy and policies.

POLICIES AND OBJECTIVES OF TREASURY MANAGEMENT ACTIVITIES

6. The Council defines its treasury management activities as:

The management of the Council's investments 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.

Appendix 11

7. 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 Council, and any financial instruments entered into to manage these risks.
8. 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.
9. The Council's borrowing will be affordable, sustainable and prudent and consideration will be given to the management of interest rate risk and refinancing risk. The source from which the borrowing is taken and the type of borrowing should allow the Council transparency and control over its debt.
10. The Council's primary objective in relation to investments is 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.

Appendix B – Arlingclose Economic & Interest Rate Forecast January 2019

- The uncertain political situation surrounding Brexit has produced the prospect of divergent paths for UK monetary policy.
- Due to the short time for a Brexit withdrawal deal to be agreed and the possibility of an extended period of uncertainty over the possible outcome, we have altered the assumption underlying the central forecast, prompting us to push back forecast rises in Bank Rate.
- The MPC bias towards tighter monetary policy remains, but policymakers are unlikely to raise Bank Rate unless there is a withdrawal arrangement and the prospect of a transitional period.
- 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 stronger growth following an extension to Article 50 or a withdrawal agreement as business investment/general confidence recovers. The potential for severe economic outcomes in the short term has increased. We expect the Bank of England to hold at or reduce interest rates from current levels if Brexit risks materialise.
- The UK economic environment appears relatively soft, despite seemingly strong labour market data. Uncertainty surrounding Brexit and global growth is damaging consumer and business sentiment. While GDP growth recovered in the middle quarters of 2018, more recent data suggests the economy slowed markedly in Q4 2018/Q1 2019. Our view is that the UK economy faces a challenging outlook as the country exits the European Union and Eurozone/global economic growth softens.
- Cost pressures have eased due to a fall in oil prices. The apparent tight labour market risks longer term domestically-driven inflationary pressure whatever the external inflation effects. Wage growth has picked up in recent months.
- Global economic growth has eased and the economic/political outlook has prompted central banks to reduce expectations for on-going monetary tightening. Both the Federal Reserve and the ECB have backed away from/or diluted previous forward guidance on monetary tightening. Central bank actions and geopolitical risks 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. Our central case incorporates the likelihood of the MPC raising rates in the last quarter of 2019 after an extended period of uncertainty or a delay to Brexit.
- The forecast range encompasses the interest rate responses for various Brexit outcomes, from an immediate no-deal Brexit to remaining in the EU.
- Gilt yields have remained at low levels. We expect some upward movement from current levels based on a Brexit transitional period. However, our projected weak

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economic outlook and volatility arising from both economic and political events will continue to offer borrowing opportunities.

	Jan-19	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	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.33
Arlingclose Central	0.75	0.75	0.75	0.75	1.00	1.00	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.06
Downside risk	0.00	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00	1.00	0.77
3-mth money market rate														
Upside risk	0.00	0.10	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.33
Arlingclose Central	0.92	0.90	0.90	0.95	1.20	1.25	1.35	1.40	1.40	1.40	1.40	1.40	1.40	1.22
Downside risk	0.00	0.50	0.55	0.60	0.85	0.90	0.95	1.00	1.00	1.00	1.00	1.00	1.00	0.80
1-yr money market rate														
Upside risk	0.00	0.10	0.30	0.35	0.35	0.35	0.35	0.50	0.50	0.50	0.50	0.50	0.50	0.37
Arlingclose Central	1.16	1.20	1.20	1.25	1.50	1.60	1.75	1.75	1.70	1.70	1.70	1.70	1.70	1.53
Downside risk	0.00	0.50	0.60	0.60	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	0.80
5-yr gilt yield														
Upside risk	0.00	0.30	0.30	0.35	0.35	0.40	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.39
Arlingclose Central	0.90	0.95	0.95	1.00	1.25	1.30	1.45	1.45	1.40	1.40	1.40	1.40	1.40	1.25
Downside risk	0.00	0.45	0.45	0.50	0.75	0.80	0.95	0.95	0.90	0.90	0.90	0.90	0.90	0.72
10-yr gilt yield														
Upside risk	0.00	0.30	0.30	0.35	0.35	0.40	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.39
Arlingclose Central	1.26	1.30	1.35	1.40	1.65	1.75	1.90	1.85	1.85	1.85	1.85	1.85	1.85	1.67
Downside risk	0.00	0.60	0.65	0.70	0.95	1.00	1.10	1.00	1.00	1.00	1.00	1.00	1.00	0.85
20-yr gilt yield														
Upside risk	0.00	0.30	0.30	0.35	0.35	0.40	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.39
Arlingclose Central	1.66	1.70	1.75	1.80	2.00	2.05	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.03
Downside risk	0.00	0.60	0.65	0.70	0.95	1.00	1.10	1.00	1.00	1.00	1.00	1.00	1.00	0.85
50-yr gilt yield														
Upside risk	0.00	0.30	0.30	0.35	0.35	0.40	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.39
Arlingclose Central	1.62	1.65	1.70	1.75	1.95	2.00	2.15	2.15	2.15	2.15	2.15	2.15	2.15	1.98
Downside risk	0.00	0.60	0.65	0.70	0.95	1.00	1.10	1.00	1.00	1.00	1.00	1.00	1.00	0.85

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

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

Appendix C – Existing Investment & Debt Portfolio Position

	31-Dec-18 Actual Portfolio £m	31-Dec-18 Average Rate %
External borrowing		
Public Works Loan Board	493.3	5.03
LOBO loans from banks	90.0	4.15
Banks and other lenders (Fixed term)	328.0	4.04
Total external borrowing	911.3	4.59
Treasury investments		
Banks and building societies (unsecured)	0.4	
Covered bonds (secured)	70.2	1.02
Government (incl. local authorities)	39.9	0.83
Money Market Funds	76.2	0.62
Equity	2.1	
Total internally managed investments	188.8	0.83
Pooled investments funds		
- Property	50.5	3.55
- Multi Asset	38.9	2.38
- Absolute Return	4.8	2.30
- Equity UK	31.4	5.58
- Equity Global	18.9	2.85
Total externally managed investments	144.5	3.57
Total treasury investments	333.3	2.20
Net debt	573.0	