APPENDIX 4

Treasury Management Strategy Statement
Annual Investment Strategy and Minimum Revenue Provision Policy Statement 2019/20

Contents

1. Introduction

1.1. Background

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

The second main function of the treasury management service is the funding of the Council's capital plans, which provide a guide to the borrowing need of the Council. Although the Council does not borrow to finance its capital spending plans, officers still plan and forecast the longer term cash flow position in order to ensure that the Council can meet its capital spending obligations and that it maintains balances (working capital) at a prudent and sustainable level.

CIPFA defines treasury management as:

"The management of the local authority'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."

1.2. Statutory and reporting requirements

The Local Government Act 2003 (the Act) and supporting regulations requires the Council to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

The Council is currently required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals. These reports are required to be adequately scrutinised by Members before being recommended to the Council. This role is undertaken by the Executive, Resources and Contracts Policy Development & Scrutiny Committee.

Prudential and Treasury Indicators and Treasury Strategy (this report) - This covers:

- the capital plans (including prudential indicators);
- a Minimum Revenue Provision Policy (how residual capital expenditure is charged to revenue over time);
- the Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

A Part-Year Treasury Management Report (approved by Council in December 2018) – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy is meeting the strategy or whether any policies require revision.

An Annual Treasury Report – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Capital Strategy

In December 2017, CIPFA issued revised Prudential and Treasury Management Codes. As from 2019-20, all local authorities will be required to prepare an additional report, a Capital Strategy report, which is intended to provide the following: -

- a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial sustainability

The aim of this report is to ensure that all elected members on the full council fully understand the overall strategy, governance procedures and risk appetite entailed by this Strategy.

The Capital Strategy will include capital expenditure, investments and liabilities and treasury management in sufficient detail to allow all members to understand how stewardship, value for money, prudence, sustainability and affordability will be secured.

1.3. Treasury Management Strategy for 2019/20

The proposed strategy for 2019/20 covers two main areas:

Capital Issues

- the capital plans and the prudential indicators;
- the MRP strategy.

Treasury management Issues

- the current treasury position;
- treasury indicators that limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, CLG MRP Guidance, the CIPFA Treasury Management Code and CLG Investment Guidance.

1.4. Treasury management consultants

The Council uses Link Asset Services, Treasury Solutions as its external treasury management advisors.

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

1.5. Elective professional client status

From 3rd January 2018 the Financial Conduct Authority is obligated to treat all Local Authorities as “retail clients” under European Union legislation, the Markets in Financial Instruments Directive II (MiFID II). The client status of the Local Authority relates to its knowledge and experience with regards to the use of regulated investment products and the decision-making processes it has in place for making such investments. The directive is focused on products such as Certificates of Deposit, Gilts, Corporate Bonds and investment funds, including Money Market Funds.

The Council will opt up to “elective professional” status in order to continue to have access to these funds as an investment option as they are not available to retail clients. The Council had opted up to elective professional status with all relevant counterparties, including its advisers and brokers, prior to the deadline. This will be kept under regular review and counterparties will be added or removed as necessary for the Council’s investment needs.

2. The Capital Prudential Indicators 2018/19 to 2021/22

The Council's capital expenditure plans are the key driver of treasury management activity. The outputs of the capital expenditure plans are reflected in prudential indicators, which are designed to assist members to overview and confirm capital expenditure plans.

2.1. Capital Expenditure

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts (as per the capital monitoring and review report to Executive on 13th February 2019):

Capital Expenditure	**2017/18 Actual**	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**	**2021/22 Estimate**
Latest estimate at time of writing	£m	£m	£m	£m	£m
Education, Children & Families	15.8	13.6	17.2	0.8	0.0
Adult Care & Health	4.4	0.3	1.4	1.0	1.3
Environment & Community	11.7	14.5	7.0	5.4	2.2
Renewal, Recreation & Housing	3.4	10.1	17.7	14.1	0.0
Resources, Commissioning & Contracts Management	5.0	0.9	34.7	1.7	0.4
Public Protection & Enforcement	0.0	0.0	0.0	0.0	0.0
Sub-Total	**40.3**	**39.4**	**78.0**	**23.0**	**3.8**
Add: Future new schemes	0.0	0.0	3.5	3.5	3.5
Less: Estimated slippage	0.0	-5.0	3.0	2.0	0.0
Grand Total	**40.3**	**34.4**	**84.5**	**28.5**	**7.4**

NB. The above financing need excludes other long term liabilities (finance lease arrangements), which already include borrowing instruments.

The table below shows how the above capital expenditure plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding need (borrowing).

Capital Expenditure	**2017/18 Actual**	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**	**2021/22 Estimate**
Latest estimate at time of writing	**£m**	**£m**	**£m**	**£m**	**£m**
Total Expenditure	**40.3**	**34.4**	**84.5**	**28.5**	**7.4**
Financed by:					
Capital receipts	7.2	7.7	41.2	24.2	3.8
Capital grants/contributions	24.7	23.2	26.3	4.2	3.5
General Fund	-	-	12.7	-	-
Revenue contributions *	8.4	3.5	4.3	0.1	0.1
Net financing need	**40.3**	**34.4**	**84.5**	**28.5**	**7.4**

* These are approved contributions from the revenue budget, earmarked to fund specific schemes.

2.2. The Council's Borrowing Need (the Capital Financing Requirement)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either

revenue or capital resources. It is essentially a measure of the Council's indebtedness and so its underlying borrowing need.
If the CFR is positive, the Council may borrow from the Public Works Loans Board (PWLB) or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The Council's CFR represents liabilities arising from finance leases entered into in recent years in respect of various items of plant and equipment (primarily equipment in schools and vehicles and plant built into highways and waste contracts). The Council currently has no external borrowing as such. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.
The Council is asked to approve the CFR projections below:

CFR	**2017/18 Actual**	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**	**2021/22 Estimate**
	£m	£m	£m	£m	£m
Total CFR	**2.3**	**1.6**	**1.1**	**0.6**	**0.1**
Movement in CFR	**-0.7**	**-0.7**	**-0.5**	**-0.5**	**-0.5**
Movement in CFR represented by					
Net financing need for the year (above)	0	0	0	0	0
Less MRP/VRP and other financing movements	-0.7	-0.7	-0.5	-0.5	-0.5
Movement in CFR	**-0.7**	**-0.7**	**-0.5**	**-0.5**	**-0.5**

2.3. MRP Policy Statement

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to make additional voluntary payments (voluntary revenue provision - VRP).
CLG Regulations require the full Council to approve **an MRP Statement** in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision.

The Council is recommended to approve the following MRP Statement:

MRP will be based on the estimated lives of the assets, in accordance with the regulations, and will follow standard depreciation accounting procedures. Estimated life periods will be determined under delegated powers. To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Council. However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

In practice, the Council's capital financing MRP is assessed as 4% of the outstanding balance on the finance leases the Council has entered into. A Voluntary Revenue Provision (VRP) may also be made in respect of additional repayments.

2.4. Core funds and expected investment balances

The application of resources (capital receipts, reserves, etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales, etc.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Year End Resources	**2017/18 Actual**	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**	**2021/22 Estimate**
	£m	£m	£m	£m	£m
General Fund balance	20.0	20.0	18.9	18.9	18.9
Capital receipts	25.7	32.2	0.9	0.6	0.0
Capital grants	33.1	10.2	14.5	0.4	0.4
Provisions	14.6	14.5	14.5	14.5	14.5
Other (earmarked reserves)	126.0	111.7	111.2	81.3	78.7
Total core funds	**219.4**	**188.6**	**145.5**	**115.7**	**112.5**
Working capital*	65.4	69.8	69.8	69.8	69.8
Under/over borrowing	0.0	0.0	0.0	0.0	0.0
Investments	**284.8**	**258.4**	**215.3**	**185.5**	**182.3**

*Working capital balances shown are estimated year end; these may be higher mid-year.

2.5. Affordability Prudential Indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. In practice, these indicators are virtually irrelevant for Bromley, as it has no external borrowing other than residual finance leases. The Council is asked to approve the following indicators:

2.5.1. Ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

%	**2017/18 Actual**	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**	**2021/22 Estimate**
	%	%	%	%	%
Non-HRA	-	-	-	-	-

3. Treasury Management Strategy

The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1. Current Portfolio Position

The Council's treasury portfolio position at 31 March 2018 is summarised below, together with forward projections. The table shows the actual external borrowing (the treasury management operations), against the capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
	£m	£m	£m	£m	£m
External borrowing					
Borrowing at 1 April	-	-	-	-	-
Expected change in borrowing	-	-	-	-	-
Other long-term liabilities (OLTL)	2.3	1.6	1.1	0.6	0.1
Expected change in OLTL	-0.7	-0.7	-0.5	-0.5	-0.5
Actual borrowing at 31 March	**-**	**-**	**-**	**-**	**-**
CFR – the borrowing need	2.3	1.6	1.1	0.6	0.1
Under / (over) borrowing	2.3	1.6	1.1	0.6	0.1
Investments	**257.3**	**268.8**	**294.8**	**246.9**	**214.2**
Net investments	**255.0**	**267.2**	**293.7**	**246.3**	**214.1**
Change in Net investments	-11.8	12.2	26.5	--47.4	-32.2

Within the prudential indicators, there are a number of key indicators to ensure that the Council operates its activities within defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2018/19 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes.
The Director of Finance reports that the Council complied with this prudential indicator in the current year and does not envisage non-compliance in the future. This view takes into account current commitments, existing plans, and the proposals in this year's budget report.

3.2. Treasury Indicators: Limits to Borrowing Activity

3.2.1. The Operational Boundary

This is the total figure that external borrowing is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual borrowing.

Operational boundary £m	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Borrowing	10.0	10.0	10.0	10.0
Other long term liabilities	20.0	20.0	20.0	20.0
Total Operational Boundary	30.0	30.0	30.0	30.0

3.2.2. The Authorised Limit for external borrowing

A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external borrowing is prohibited and this limit needs to be set or revised by the full Council. It reflects the level of external borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

1. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.
2. The Council is asked to approve the following Authorised Limit:

Authorised limit £m	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**	**2021/22 Estimate**
	£m	£m	£m	£m
Borrowing	30.0	30.0	30.0	30.0
Other long term liabilities	30.0	30.0	30.0	30.0
Total Authorised Limit	60.0	60.0	60.0	60.0

3.3. Prospects for Interest Rates

The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table and narrative gives Link Asset Services central view.

	Bank Rate	PWLB Borrowing Rates		
		5 year	25 year	50 year
Mar 2019	0.75	2.10	2.90	2.70
Jun 2019	1.00	2.20	3.00	2.80
Sep 2019	1.00	2.20	3.10	2.90
Dec 2019	1.00	2.30	3.10	2.90
Mar 2020	1.25	2.30	3.20	3.00
Jun 2020	1.25	2.40	3.30	3.10
Sep 2020	1.25	2.50	3.30	3.10
Dec 2020	1.50	2.50	3.40	3.20
Mar 2021	1.50	2.60	3.40	3.20
Jun 2021	1.75	2.60	3.50	3.30
Sep 2021	1.75	2.70	3.50	3.30
Dec 2021	1.75	2.80	3.60	3.40
Mar 2022	2.00	2.80	3.60	3.40

The flow of generally positive economic statistics after the quarter ended 30 June meant that it came as no surprise that the MPC came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, from 0.5% to 0.75%. Growth became increasingly strong during 2018 until slowing significantly during the last quarter. At their November quarterly Inflation Report meeting, the MPC left Bank Rate unchanged, but expressed some concern at the Chancellor's fiscal stimulus in his Budget, which could increase inflationary pressures. However, it is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. On a major assumption that Parliament and the EU agree a Brexit deal in the first quarter of 2019, then the next increase in Bank Rate is forecast to be in May 2019, followed by increases in February and November 2020, before ending up at 2.0% in February 2022.

The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. However, over about the last 25 years, we have been through a period of falling bond yields as inflation subsided to, and then stabilised at, much lower levels than before, and supported by central banks implementing substantial quantitative easing purchases of government and other debt after the financial crash of 2008. Quantitative easing, conversely, also caused a rise in equity values as investors searched for higher returns and purchased riskier assets. In 2016, we saw the start of a reversal of this

trend with a sharp rise in bond yields after the US Presidential election in November 2016, with yields then rising further as a result of the big increase in the US government deficit aimed at stimulating even stronger economic growth. That policy change also created concerns around a significant rise in inflationary pressures in an economy which was already running at remarkably low levels of unemployment. Unsurprisingly, the Fed has continued on its series of robust responses to combat its perception of rising inflationary pressures by repeatedly increasing the Fed rate to reach 2.25 – 2.50% in December 2018. It has also continued its policy of not fully reinvesting proceeds from bonds that it holds as a result of quantitative easing, when they mature. We therefore saw US 10 year bond Treasury yields rise above 3.2% during October 2018 and also investors causing a sharp fall in equity prices as they sold out of holding riskier assets. However, by early January 2019, US 10 year bond yields had fallen back considerably on fears that the Fed was being too aggressive in raising interest rates and was going to cause a recession. Equity prices have been very volatile on alternating good and bad news during this period.

From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.

Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

Investment and borrowing rates:

- Investment returns are likely to remain low during 2019/20 but to be on a gently rising trend over the next few years.
- Borrowing interest rates have been volatile so far in 2018-19 and while they were on a rising trend during the first half of the year, they have backtracked since then until early January. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt;
- There will remain a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

3.4. Borrowing Strategy

The Council currently does not borrow to finance capital expenditure and finances all expenditure from external grants and contributions, capital receipts or internal balances. The Council does, however, have a Capital Financing Requirement (CFR) of £2.3m (as at 31st March 2018), which is the outstanding liability on finance leases taken out in respect of plant, equipment and vehicles.

The uncertainty over future interest rates increases the risks associated with treasury activity. As a result the Council will take a cautious approach to its treasury strategy and will monitor interest rates in financial markets.

3.4.1. Treasury indicators for debt

There are three debt-related treasury activity limits. The purpose of these is to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse

movement in interest rates. However, if these are set to be too restrictive, they will impair the opportunities to reduce costs / improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments;
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

The Council is asked to approve the following treasury indicators and limits:

£m	**2018/19**	**2019/20**	**2020/21**
Interest rate Exposures			
	Upper	Upper	Upper
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	20%	20%	20%
Maturity Structure of fixed interest rate borrowing 2018/19			
		Lower	**Upper**
Under 12 months (temporary borrowing only)		100%	100%
12 months to 2 years		N/A	N/A
2 years to 5 years		N/A	N/A
5 years to 10 years		N/A	N/A
10 years and above		N/A	N/A

3.5. Policy on Borrowing in Advance of Need

The Council will not borrow more than or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds. Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

4. Annual Investment Strategy

4.1. Investment Policy

The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the CIPFA TM Code"). The Council's investment priorities will be security first, portfolio liquidity second, then return.

In accordance with the above guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

Investment instruments identified for use in the financial year are listed in appendix 5.3 under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the Council's treasury management practices – schedules.

The intention of the strategy is to provide security of investment and minimisation of risk.

4.2. Creditworthiness policy

Investment instruments identified for use in the financial year are listed in Annex 2 under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices – Schedules.

Investment Counterparty Selection Criteria - The primary principles governing the Council's investment criteria are the security and liquidity of its investments, although the yield or return on the investment is also a key consideration. After these main principles, the Council will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the Specified and Non-Specified investment sections below; and
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

The Director of Finance will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to those that determine which types of investment instrument are either Specified or Non-Specified as they provide an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.
The rating criteria require at least one of the ratings provided by the three ratings agencies (Fitch, Moody's and Standard & Poors) to meet the Council's minimum credit ratings criteria. This approach is supported by Link and is in compliance with a CIPFA Treasury Management Panel recommendation in March 2009 and the CIPFA Treasury Management Code of Practice.

Credit rating information is supplied by Link, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating watch applying to counterparty at the minimum Council criteria may be suspended from use, with all others being reviewed in light of market conditions.

In addition, the Council receives weekly credit lists as part of the creditworthiness service provided by Link. This service employs a sophisticated modelling approach utlilising credit ratings from the three main credit rating agencies - Fitch, Moodys and Standard and Poors. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- CDS (Credit Default Swap) spreads to give early warning of likely changes in credit ratings (these provide an indication of the likelihood of bank default);
- sovereign ratings to select counterparties from only the most creditworthy countries.

This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour code bands which indicate the relative creditworthiness of counterparties and a recommendation on the maximum duration for investments. The Council would not be able to replicate this level of detail using in-house resources, but uses this information, together with its own view on the acceptable level of counterparty risk, to inform its creditworthiness policy. The Council will also apply a minimum sovereign rating of A- to investment counterparties.

The criteria for providing a pool of high quality investment counterparties (both Specified and Non-specified investments) are:

- **Banks 1** - good credit quality **–** the Council will only use banks which:
  a) are UK banks;
  b) are non-UK and domiciled in a country with a minimum long-term sovereign rating of A- or equivalent;
  c) have, <u>as a minimum</u>, at least one of the following Fitch, Moody's and Standard and Poors credit ratings (where rated):

    - Short term – Fitch F3; Moody's P-3; S&P A-3
    - Long term – Fitch BBB+; Moody's Baa3; S&P BBB+

- **Banks 2** – Part nationalised UK bank – Royal Bank of Scotland (ring fenced). This bank can be included provided it continues to be part nationalised (Lloyds is also temporarily included until existing investments mature in 2018/19).

- **Bank subsidiary and treasury operation** - The Council will use these where the parent bank has provided an appropriate guarantee or has the necessary ratings in Banks 1 above.

- **Building societies** - The Council will use all societies that meet the ratings in Banks 1 above.

- **Money Market Funds** – The Council will use AAA-rated Money Market Funds, including VNAV funds.

- **UK Government** (including gilts and the DMADF)

- **Other Local Authorities, Parish Councils, etc.**

- **Housing Associations**

- **Collective (pooled) investment schemes**

- **Supranational institutions**
- **Corporate Bonds**
- **Certificates of Deposit, Commercial Paper and Floating Rate Notes**

The Council's detailed eligibility criteria for investments with counterparties are included in Annex 2.
All credit ratings will be continuously monitored. The Council is alerted to changes to ratings of all three agencies through its use of the Link creditworthiness service.

- if a downgrade results in the counterparty no longer meeting the Council's minimum criteria, its further use for new investments will be withdrawn immediately.
- in addition to the use of Credit Ratings, the Council will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

Sole reliance will not be placed on the external advisers. In addition, this Council will also use market data and market information, information on government support for banks and the credit ratings of that government support. The Council forms a view and determines its investment policy and actions after taking all these factors into account.

4.3. Country limits

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent from other agencies if Fitch does not provide). The list of countries that qualify using these credit criteria as at the date of this report is shown in Annex 2. This list will be amended by officers should ratings change in accordance with this policy.

4.4. Investment Strategy

In-house funds: The Council's core portfolio is around £300m although cashflow variations during the course of the year have the effect from time to time of increasing the total investment portfolio to a maximum of around £360m. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

Investment returns outlook:
On the assumption that the UK and EU agree a Brexit deal in spring 2019, then Bank Rate is forecast to increase steadily but slowly over the next few years to reach 2.00% by quarter 1 2022. Bank Rate forecasts for financial year ends (March) are:

- 2018/19 0.75%
- 2019/20 1.25%
- 2020/21 1.50%
- 2021/22 2.00%

Link Asset Services suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows:

2018/19	0.75%
2019/20	1.00%
2020/21	1.50%
2021/22	1.75%
2022/23	1.75%
2023/24	2.00%
Later years	2.50%

- The overall balance of risks to economic growth in the UK is probably neutral.

The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

Investment treasury indicator and limit - total principal funds invested for greater than 365 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

The Council is asked to approve the treasury indicator and limit: -

As at year end	2018/19	2019/20	2020/21	2021/232
	£m	£m	£m	£m
Principal sums invested > 365 days	170.0	170.0	170.0	170.0

For its cash flow generated balances, the Council will seek to utilise its short notice accounts, money market funds and short-dated deposits (overnight to three months) in order to benefit from the compounding of interest.

4.5. End of year investment report

After the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

4.6. Scheme of delegation

(i) Full board/council

- receiving and reviewing reports on treasury management policies, practices and activities
- approval of annual strategy.

(ii) Boards/committees/council/responsible body

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices
- budget consideration and approval
- approval of the division of responsibilities
- receiving and reviewing regular monitoring reports and acting on recommendations
- approving the selection of external service providers and agreeing terms of appointment.

(iii) Body/person(s) with responsibility for scrutiny

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

4.7. Role of the section 151 officer

The S151 (responsible) officer is responsible for:

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance
- submitting regular treasury management policy reports
- submitting budgets and budget variations
- receiving and reviewing management information reports
- reviewing the performance of the treasury management function
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- ensuring the adequacy of internal audit, and liaising with external audit
- recommending the appointment of external service providers.

5. ANNEXES

1. Economic background
2. Specified and non specified investments – Eligibility Criteria
3. Prudential Indicators – summary for approval by Council

ANNEX 1. Economic Background (Provided by Link Asset Services)

Detailed economic commentary on developments during quarter ended 31 December 2018

- **During the quarter ended 31 December 2018 *(quarter 4 of 2018):***
  - The economy lost some momentum after a strong quarter ended 30.9.18;
  - There was a further acceleration in wage growth;
  - Early signs that lower oil prices will soon depress inflation;
  - The Chancellor delivered a giveaway in the autumn Budget;
  - The MPC was stuck in a state of Brexit inertia;
  - Parliament was deadlocked over Brexit;
  - Equity markets worldwide were hit hard by global growth fears.

GDP growth in the quarter ended 30.9.18 was a solid 0.6% q/q, the strongest rise since late 2016. However, growth was boosted by some temporary factors - the unusually warm summer, the boost to consumer spending from the world cup and construction firms catching up on activity lost during the unusually poor weather earlier in the year. There were also signs of Brexit uncertainty weighing more heavily on growth. The 1.1% q/q fall in business investment in the quarter was the third in a row.

While **household spending** grew by a fairly strong 0.5% q/q, more recent data pointed to slower growth in the last quarter of 2018. GfK's measure of consumer confidence dropped from -9 in September, to a 5-year low of -14 in December. Although the 1.4% monthly rise in retail sales volumes in November looked impressive at first glance, the 3m/3m growth rate ticked down to a fairly subdued 0.3%. What's more, much of the monthly rise in November seems to have been due to consumers bringing forward Christmas purchases in order to take advantage of the price cuts on Black Friday. Indeed, the reported sales balance of the CBI's Distributive Trades Survey, which is a timelier indicator of retail trade, dropped sharply in December.

Production data and activity surveys for Q4 of 2018 also pointed to the economy having lost momentum. 3m/3m GDP growth eased from 0.6% in September to 0.4% in October, as the boost from temporary factors faded and the manufacturing sector continued to struggle. And while the rises in the Markit/CIPS manufacturing PMI in both November and December point to industry faring a little better more recently, the services PMI dropped to just 50.4 in November. The combined PMIs are consistent with quarterly GDP growth of just 0.1% in Q4. That said, the PMIs have overstated the economy's weakness in the past when Brexit uncertainty has been high, and other indicators point to growth coming in at around 0.3%.

However, the **labour market** remained a bright spot for the economy in Q4 of 2018. After a few months of weaker employment growth, 79,000 jobs were created in the three months to October. That pushed up the annual growth rate to 1.2%, which was the strongest rate in six months. Meanwhile, headline regular pay growth excluding bonuses picked up to a fresh post-crisis high of 3.3% during the same period. That was already well above the Bank of England's forecast for Q4 of 2.75%. What's more, surveys of pay settlements point to upward pressure on wage rates.

Inflation held steady at 2.4% in October, as pre-announced hikes in utilities prices were offset by falling food inflation. However, not only did inflation tick down to 2.3% in November, largely on the back of easing energy inflation, but the sharp drop in the oil price since the start of Q4 should soon feed through into larger falls in petrol prices. As such, falling energy costs should provide a large drag on the overall inflation rate in the coming months. A return to the Bank of England's 2% target in December looks quite likely. That should provide a further boost to consumers' real spending power.

Prior to October's autumn Budget, the Chancellor received a helping hand from the Office of Budget Responsibility (OBR). It revised down its forecasts for **public sector borrowing** in the current fiscal year by some £13bn, and carried that improvement forward into future years. That allowed Phillip Hammond

to maintain the £15bn of headroom that he has built up against his target of keeping the government's cyclically-adjusted budget deficit below 2% in 2020/21, to deliver the Prime Minister's pre-announced boost to healthcare spending, and to announce a handful of additional fiscal giveaways. In fact, the Chancellor was unusually spendthrift, with 2019/20 now set to see the first discretionary *loosening* of fiscal policy in a decade. The Bank of England judged in December that this should, all else being equal, boost GDP growth by 0.3% over 2019 and 2020. We agree.

Government borrowing data for October and November point to the budget deficit slightly overshooting the OBR's new forecast for 2018/19 of £25.5bn. But worse news for the Chancellor was the Office of National Statistics' recent announcement that from September, it will treat a portion of spending on student loans as grants, rather than lending, reflecting the fact that a large share will eventually not be paid back. That may push up the deficit by roughly 0.6% of GDP each fiscal year and wipe out almost all of the Chancellor's £15bn of 'fiscal headroom'. However, the change is essentially cosmetic. So while it will make the budget deficit look a bit worse, it seems unlikely to be a major influence on the direction of fiscal policy.

Brexit uncertainty kept the Bank of England in a state of inertia in Q4, with the **Monetary Policy Committee (MPC)** voting unanimously to keep policy unchanged in both November and December. After all, despite the recent strength of pay growth, the MPC would not have wanted to vote for a rate hike that may need to be quickly reversed if the UK left the EU without a deal in March. However, November's Inflation Report's projections were fairly hawkish and suggest that if a Brexit deal is secured, the MPC will not sit on its hands for long. In the projections, which were based on the assumption of rates rising twice in the next two years, inflation remains above the 2% target at the end of the Bank's two-year policy horizon. That suggests rates may need to rise more quickly in order to return inflation to target.

The MPC did restate in its December meeting's minutes that Bank Rate would rise "at a gradual pace and to a limited extent" if the economy continued to develop in line with November's projections. However, those projections were made prior to the announcement of looser fiscal policy in 2019 and the acceleration of wage growth to above the Bank's forecasts, which both strengthen the case for monetary tightening. If a Brexit deal is ratified we expect the Bank to raise interest rates three times in 2019 and twice in 2020. The MPC also stressed again in December's minutes that the response of monetary policy to a "no deal" Brexit would, "not be automatic, and could be in either direction". But neither we, nor the financial markets, believe that the Bank would actually raise rates in response. As the implied probability of "no deal" has grown, market-implied interest rate expectations have fallen.

After a few fraught final months of negotiation with the EU, and several ministerial resignations, in mid-November **the Prime Minister managed to agree a Brexit deal with the EU** that mustered the broad support of her Cabinet. But that counted for little when all opposition parties, and over 100 of Theresa May's own MPs, spoke out against the deal. With the deal looking all but certain to be rejected in Parliament, the Government cancelled the key vote scheduled in early December. **While a new vote is now due to take place in the week beginning January 14th**, the Prime Minister seems unlikely to receive the sort of concessions from the EU on the so-called "Irish Backstop", that could unite her party behind the deal. But while British politics has rarely looked more unpredictable, the odds of a "no deal" Brexit seem to have fallen for two reasons. First, Theresa May's survival of a leadership challenge has greatly reduced the chances of a Brexiteer taking the helm as Prime Minister. Second, the European Court of Justice's recent ruling that the UK can choose to remain in the EU by unilaterally revoking Article 50, has probably raised the odds that Parliament pushes for the UK to remain if Britain faces a "no deal" exit in March 2019.

Equity prices across the world fell sharply over the course of Q4, driven lower by fears of a US-led slowdown in global growth. In Amercia, the S&P 500 index finished the quarter down 14%. Meanwhile, US 10-year Treasury yields also fell by roughly 40bps over the quarter, as investors revised down their expectations for rises in the Fed funds rate. Closer to home, volatility in **sterling** continued as the currency traded up or down on the latest Brexit developments. The pound suffered some of its largest single-day falls since the EU referendum on news of Dominic Raab's resignation and that the Government would delay the vote on Theresa May's Brexit deal. At the same time, 10-year gilt yields have fallen some 30bps as investors have revised down their interest rate expectations on the back of growing fears of a "no deal" Brexit.

While **the US Federal Reserve** delivered a widely-expected **ninth rate hike** in its current tightening cycle in December, taking the Fed funds range to 2.25%-2.50%, Fed officials lowered their projections

for interest rates in 2019. They now expect only two hikes next year on average, rather than three. Although the US economy was confirmed to have grown at an annualised rate of 3.5% in Q3, down only a touch from Q2's 4.2%, the slowdown in business investment and further contraction in residential investment, suggest that higher interest rates are beginning to take their toll.

Meanwhile in the **eurozone**, supply-side disruptions to car production due to new EU emissions tests appeared responsible for half of the drop in eurozone growth to 0.2% q/q in Q3 from 0.4% in Q2. That pointed to a broader underlying slowdown. Although the ECB pressed ahead with plans to end its monthly net asset purchases in December, the central bank also stated that the balance of risks to the growth outlook was "moving to the downside".

Detailed commentary on interest rate forecasts

1. Quarterly Inflation Report and Monetary Policy Committee (MPC) meeting 1 November

- The biggest issue today when doing our forecasts, is what sort of Brexit will we have? We have to make an assumption one way or the other so our starting point is an assumption that the UK will muddle through to an eventual agreed exit being passed by the UK Parliament and also passed by the EU parliamentary processes.

- The next known unknown that will follow on from that is whether this will be the sort of 'agreement' which just kicks the can down the road until the end of the transition period at the end of 2020, and provides little solid certainty for entrepreneurs to enable them to release the investing decisions that have been pent up since the referendum, or whether it will be a more substantial agreement which will result in a significant boost to GDP in the form of a return to consumer and entrepreneur confidence that sends the economy up a gear. We have taken a cautious view on the ensuing rate of GDP growth.

- All our forecasts will be subject to review once this fog clears.

- The MPC and Inflation Report last week were more hawkish than expected in their words, due to the Chancellor's release of a significant fiscal stimulus which looks like it could add 0.3% to GDP growth, (after netting down for the effect of the economy operating near to full capacity), and consequently boost inflationary pressures. However, the Bank did not have time to undertake an impact analysis of the Chancellor's measures so this will have to wait until their next meeting on 14 December. The MPC are also assuming a reasonable agreed exit.

The flow of positive economic statistics since the end of the first quarter this year has shown that pessimism was overdone about the poor growth in quarter 1 when adverse weather caused a temporary downward blip. Quarter 1 at 0.1% growth in GDP was followed by a return to 0.4% in quarter 2; quarter 3 is expected to come in at around +0.6 to 0.7%, *(actual was +0.6%),* but quarter 4 is expected to weaken from that level.

The MPC repeated their well-worn phrase that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary of contractionary), than before the crash; indeed they gave a figure for this of around 2.5% in ten years' time but they declined to give a medium term forecast. However, with so much uncertainty around Brexit, they warned that the next move could be up or down, even if there was a disorderly Brexit. While it would be expected that Bank Rate could be cut if there was a significant fall in GDP growth as a result of a disorderly Brexit, so as to provide a stimulus to growth, they warned they could also raise Bank Rate in the same scenario if there was a boost to inflation from increases in import prices, depreciation of sterling, and more expensive goods produced in the UK replacing cheaper goods previously imported, and so on. In addition, the Chancellor has held back some spare capacity to provide a further fiscal stimulus.

Overall, the MPC was more hawkish than expected, i.e. this indicates the likelihood of a faster pace of increases than previously expected: -

- MPC voted 9-0 for no change in Bank Rate and quantitative easing.
- GDP growth 2018 cut to 1.3% from 1.4%; next three years @ 1.7% (2019 previously 1.8%).
- The economy will be operating at a small amount of excess demand in 2020, (previously 2021). This is likely to generate an increase in home grown inflationary pressures, (as opposed to imported due to a one off fall in the value of sterling).
- Unemployment rate to stay at 3.9% over the next three years; (equilibrium rate forecast 4.25%). N.B. the percentage of the population in employment is also at record highs. In addition, there has been much concern at how weak productivity increases have been in recent years.
- Build-up of wage inflation pressures as a result. Wage inflation actual 3.1% excluding bonuses in 3 months June to August; MPC forecast 3.25% 2019, 3.5% 2020, 3.75% 2021.
- CPI inflation up from 2.0% to 2.1% 2 years ahead, i.e. *above* their 2% target.
- Key message: the economy is heading into overheating and the fiscal position has changed direction to now be a slight tailwind, i.e. the MPC will be wanting to take action to counter building inflationary pressures as soon as Brexit uncertainty clears.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably neutral.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are broadly dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

One risk that is both an upside and downside risk, is that all central banks are now working in very different economic conditions than before the 2008 financial crash as there has been a major increase in consumer and other debt due to the exceptionally low levels of borrowing rates that have prevailed for ten years since 2008. This means that the neutral rate of interest in an economy, (i.e. the rate that is neither expansionary nor deflationary), is difficult to determine definitively in this new environment, although central banks have made statements that they expect it to be much lower than before 2008. Central banks could therefore over or under do increases in central interest rates.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- **Brexit** – if it were to cause significant economic disruption and a major downturn in the rate of growth.
- **Bank of England monetary policy** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the **eurozone sovereign debt crisis**, possibly **Italy**, due to its high level of government debt, low rate of economic growth and vulnerable banking system, and due to the election in March of a government which has made a lot of anti-austerity noise. At the time of writing, the EU has rejected the proposed Italian budget and has demanded cuts in government spending which the Italian government has refused. *(2.1.19 The Italian government has now agreed to eliminate its structural deficit in 2019-20, but only by delaying implementation of increases in expenditure plans to a later year!)* The rating agencies have started on downgrading Italian debt to one notch above junk level. If Italian debt were to fall below investment grade, many investors would be unable to hold Italian debt. Unsurprisingly, investors are becoming increasingly concerned by the actions of the Italian government and consequently, Italian bond yields have risen sharply – at a time when the government faces having to refinance large amounts of debt maturing in 2019.

- Weak capitalisation of some **European banks**. Italian banks are particularly vulnerable; one factor is that they hold a high level of Italian government debt - debt which is falling in value. This is therefore undermining their capital ratios and raises the question of whether they will need to raise fresh capital to plug the gap.
- **German minority government.** In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. Then in October 2018, the results of the Bavarian and Hesse state elections radically undermined the SPD party and showed a sharp fall in support for the CDU. As a result, the SPD is reviewing whether it can continue to support a coalition that is so damaging to its electoral popularity. After the result of the Hesse state election, Angela Merkel announced that she would not stand for re-election as CDU party leader at her party's convention in December 2018, *(a new leader has been appointed).* However, this makes little practical difference as she is still expected to aim to continue for now as the Chancellor. However, there are five more state elections coming up in 2019 and EU parliamentary elections in May/June; these could result in a further loss of electoral support for both the CDU and SPD which could also undermine her leadership.
- **Other minority EU governments.** Spain, Portugal, Netherlands, Ireland and Belgium all have vulnerable minority governments dependent on coalitions which could prove fragile. Sweden is also struggling to form a government due to the anti-immigration party holding the balance of power, and which no other party is willing to form a coalition with. *(2.1.19 The Belgian coalition collapsed in December but now has a minority government until the EU wide elections scheduled for May 2019.)*
- **Austria, the Czech Republic and Hungary** now form a strongly anti-immigration bloc within the EU while **Italy,** this year, has also elected a strongly anti-immigration government. Elections to the EU parliament are due in May/June 2019.
- Further increases in interest rates in the US could spark a **sudden flight of investment funds** from more risky assets e.g. shares, into bonds yielding a much improved yield. In October 2018, we have seen a sharp fall in equity markets but this has been limited, as yet. Emerging countries which have borrowed heavily in dollar denominated debt, could be particularly exposed to this risk of an investor flight to safe havens e.g. UK gilts.
- There are concerns around the level of **US corporate debt** which has swollen massively during the period of low borrowing rates in order to finance mergers and acquisitions. This has resulted in the debt of many large corporations being downgraded to a BBB credit rating, close to junk status. Indeed, 48% of total investment grade corporate debt is now rated at BBB. If such corporations fail to generate profits and cash flow to reduce their debt levels as expected, this could tip their debt into junk ratings which will increase their cost of financing and further negatively impact profits and cash flow.
- **Geopolitical risks,** especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

Upside risks to current forecasts for UK gilt yields and PWLB rates

- **Brexit** – if both sides were to agree a compromise that removed all threats of economic and political disruption.
- **The Fed causing a sudden shock in financial markets** through misjudging the pace and strength of increases in its Fed Funds Rate and in the pace and strength of reversal of QE, which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.
- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.

- **UK inflation,** whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

2. LINK ASSET SERVICES' FORECASTS

We do not currently think that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. It is likely that getting parliamentary approval on both sides of the Channel will take well into spring next year. However, in view of the hawkish stance of the MPC this time, we have moved forward our first increase in Bank Rate from August to May 2019. The next increases then occur in February and November 2020 before ending up at 2.0% in February 2022.

Financial markets are now expecting a first increase in February 2019 and then further increases only in February 2020 and then May 2021, to end 21/22 at only 1.50%.

PWLB rates, particularly 5 and 10 year rates, have increased slightly in response to the faster pace of Bank Rate increases.

Forecasts for average investment earnings beyond the three year time horizon will be heavily dependent on economic and political developments.

Gilt yields and PWLB rates

The general situation is for volatility in bond yields to endure as investor fears and confidence ebb and flow between favouring relatively more "risky" assets i.e. equities, or the "safe haven" of government bonds. The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently, although there are likely to also be periods of sharp volatility from time to time.

We have pointed out consistently that the Fed. Rate is likely to go up more quickly and more strongly than Bank Rate in the UK. The correlation between the two rates and bond yields in both countries has been weak over the last few years as the US and UK economies are at different points in both the business cycle and in tightening monetary policy.

Our forecasts are also predicated on an assumption that there is no break-up of the eurozone or EU, (apart from the departure of the UK), within our forecasting time period, despite the major challenges that are looming up, and that there are no major ructions in international relations, especially between the US and China / North Korea and Iran, which have a major impact on international trade and world GDP growth. However, the current round of increases in tariff rates sparked by President Trump, both actual and threatened, are causing increasing concern around the potential impact on world growth and also on inflationary pressures, e.g. in the US.

We would, as always, remind clients of the view that we have expressed in our previous interest rate revision newsflashes of just how unpredictable PWLB rates and bond yields are at present. Our revised forecasts are based on the Certainty Rate, (the Standard Rate minus 20 bps), which has been accessible to most authorities since 1st November 2012.

ANNEX 2. Specified and Non-Specified Investments

Eligibility Criteria for investment counterparties

SPECIFIED INVESTMENTS: All such investments will be sterling denominated, with **maturities up to a maximum of 1 year**, meeting the minimum 'high' quality criteria where applicable.

NON-SPECIFIED INVESTMENTS: These are any investments which do not meet the Specified Investment criteria (i.e. non-sterling and placed for periods greater than 1 year).

A variety of investment instruments will be used. Subject to the credit quality of the institution and depending on the type of investment made, investments will fall into one of the above categories.

The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

SPECIFIED INVESTMENTS
These investments are sterling investments of not more than one-year maturity or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These are relatively low risk investments where the possibility of loss of principal or investment income is small. These would include investments with:

1. The UK Government (such as the Debt Management Account deposit facility, a UK Treasury Bill or a Gilt with a maximum of 1 year to maturity).
2. A local authority, parish council or community council (maximum duration of 1 year).
3. Corporate or supranational bonds of no more than 1 year's duration.
4. Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency.
5. A bank or building society that has been awarded a high credit rating by a credit rating agency (only investments placed for a maximum of 1 year).
6. Certificates of deposit, commercial paper or floating rate notes (maximum duration of 1 year).

Minimum credit ratings (as rated by Fitch, Moody's and Standard & Poors) and monetary and time period limits for all of the above categories are set out below. The rating criteria require at least one of the ratings provided by the three ratings agencies (Fitch, Moody's and Standard & Poors) to meet the Council's minimum credit ratings criteria. The Council will take into account other factors in determining whether an investment should be placed with a particular counterparty, but all investment decisions will be based initially on these credit ratings criteria. The Council will also apply a minimum sovereign rating of A- (or equivalent) to investment counterparties.

NON-SPECIFIED INVESTMENTS
Non-specified investments are any other type of investment (i.e. not defined as Specified above) and can be for any period over 1 year. The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below.

	Non Specified Investment Category	Limit (£ or %)
	Bank Deposits with a maturity of more than one year and up to a maximum of 3 years. These can be placed in accordance with the limits of the Council's counterparty list criteria (i.e. subject to satisfaction of Fitch, Moody's and Standard & Poors credit ratings criteria shown below).	£80m and 3 years limits with RBS (ring-fenced) (Lloyds is also temporarily included until existing investments mature in 2019/20).
	Building Society Deposits with a maturity of more than one year. These can be placed in accordance with the limits of the Council's counterparty list criteria (i.e. subject to satisfaction of Fitch, Moody's and Standard & Poors credit ratings criteria shown below).	None permitted at present.
	Deposits with other local authorities with a maturity of greater than 1 year and up to a maximum of 3 years. Maximum	£15m limit with each local authority; maximum duration

	total investment of £15m with each local authority.	3 years.
	Gilt edged securities with a maturity of greater than one year. These are Government bonds and so provide the highest security of interest and the repayment of principal on maturity. The use of UK Government gilts is restricted to fixed date, fixed rate stock with a maximum maturity of five years. The total investment in gilts is limited to £25m and will normally be held to maturity, but the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity. The Director of Finance must personally approve gilt investments. The Council currently has no exposure to gilt investments.	£25m in total; maximum duration 5 years.
	Non-rated subsidiary of a credit-rated institution that satisfies the Council's counterparty list criteria. Investments with non-rated subsidiaries are permitted, but the credit-rated parent company and its subsidiaries will be set an overall group limit for the total of funds to be invested at any time.	Subject to group limit dependent on parent company's ratings.
	Corporate Bonds with a duration of greater than 1 year and up to a maximum of 5 years, subject to satisfaction of credit ratings criteria as set out below.	£25m in total; maximum duration 5 years.
	Collective (pooled) investment schemes with a duration of greater than 1 year. The total investment in collective (pooled) investment schemes is limited to £100m and can include property funds, diversified growth funds and other eligible funds.	£100m in total.
	Certificates of Deposit, Commercial Paper and Floating Rate Notes with a duration of greater than 1 year, subject to satisfaction of credit ratings criteria as set out below.	Subject to group banking limits dependent on bank / building society credit ratings.
	Housing Associations with a duration of between 1 and 2 years, subject to satisfaction of credit ratings criteria as set out below.	£50m in total; maximum duration 2 years.

CRITERIA FOR FUNDS MANAGED INTERNALLY AND EXTERNALLY

- **Banks General** - good credit quality **–** the Council may only use banks which:
  a) are UK banks;
  b) are non-UK and domiciled in a country with a minimum long-term sovereign rating of A- or equivalent;
  c) have, as a minimum, at least one of the following Fitch, Moody's and Standard and Poors credit ratings (where rated):

  - Short term – Fitch F3; Moody's P-3; S&P A-3
  - Long term – Fitch BBB+; Moody's Baa3; S&P BBB+

- **Banks 1A – UK and Overseas Banks (highest ratings)** - the Council may place investments up to a total of £30m for a maximum period of 1 year with UK banks (and up to a total of £15m for a maximum period of 1 year with Overseas banks) that have, as a minimum, at least at least one of the following Fitch, Moody's and Standard & Poors ratings (where rated).

	Short-Term	Long-Term
Fitch	F1+	AA-
Moody's	P-1	Aa3
S & P	A-1+	AA-

- **Banks 1B – UK and Overseas Banks (very high ratings)** - the Council may place investments up to a total of £20m for a maximum period of 1 year with UK banks (and up to a total of £10m for a maximum period of 6 months with Overseas banks) that have, as a minimum, at least one of the following Fitch, Moody's and Standard & Poors ratings (where rated).

	Short-Term	Long-Term
Fitch	F1	A
Moody's	P-1	A2
S & P	A-1	A

- **Banks 1C – UK and Overseas Banks (high ratings)** – the Council may place investments up to a total of £10m for a maximum period of 1 year with UK banks (and up to a total of £5m for a maximum period of 3 months with Overseas banks) that have, as a minimum, at least one of the following Fitch, Moody's and Standard & Poors ratings (where rated):

	Short-Term	Long-Term
Fitch	F3	BBB+
Moodys	P-3	Baa3
S & P	A-3	BBB+

- **Banks 2 - Part nationalised UK banks (Royal Bank of Scotland – ring fenced)** - the Council may place investments up to a total of £80m for up to 3 years with the part-nationalised UK Royal Bank of Scotland (ring-fenced) provided it remain part-nationalised (Lloyds is also temporarily included until existing investments mature in 2019/20).

- **Bank subsidiary and treasury operation** - The Council may use these where the parent bank has provided an appropriate guarantee and has the necessary ratings in Banks 1 above. The total investment limit and period will be determined by the parent company credit ratings.

- **Building societies** - The Council may use all societies that meet the ratings in Banks 1 above.

- **Money Market Funds** – The Council may invest in AAA rated Money Market Funds, including Constant Net Asset Value (CNAV) Funds, Low Volatility Net Asset Value (LVNAV) funds and Variable Net Asset value (VNAV) funds. The total invested in each of the CNAV and LVNAV Funds must not exceed £15m at any time and £10m for VNAV funds. This includes the Payden Sterling Reserve Fund for which a limit of £15m is also applied. No more than £25m in total may be invested in VNAV funds at any time."

- **UK Government (including gilts and the DMADF)** – The Council may invest in the government's DMO facility for a maximum of 1 year, but with no limit on total investment. The use of UK Government gilts is restricted to a total of £25m and to fixed date, fixed rate stock with a maximum maturity of 5 years. The Director of Finance must personally approve gilt investments.

- **Local Authorities, Parish Councils etc** – The Council may invest with any number of local authorities, subject to a maximum exposure of £15m for up to 3 years with each local authority.

- **Business Reserve Accounts** - Business reserve accounts may be used from time to time, but value and time limits will apply to counterparties as detailed above.

- **Corporate Bonds** – Investment in corporate bonds with a minimum credit rating of A- is permitted, subject to a maximum duration of 5 years and a maximum total exposure of £25m.

- **Collective (pooled) investment schemes** – these may comprise property funds, diversified growth funds and other eligible funds and are permitted up to a maximum (total) of £100m.

- **Certificates of Deposit, Commercial Paper and Floating Rate Notes** – These are permitted, subject to satisfaction of minimum credit ratings in Banks General above.

- **Housing Associations** – The Council may invest with Housing Associations with a minimum credit rating of A-, for a maximum duration of 2 years, and with a maximum deposit of £10m with any one Housing Association and £50m in total.

- **Sovereign Ratings** – The Council may only use counterparties in countries with sovereign ratings (all 3 agencies) of A- or higher.

  These currently include:

  AAA
  - Australia
  - Canada
  - Denmark
  - Germany
  - Luxembourg
  - Netherlands
  - Norway
  - Singapore
  - Sweden
  - Switzerland

  AA+
  - Finland
  - Hong Kong
  - U.S.A.

  AA
  - U.K
  - Abu Dhabi (UAE)
  - France

  AA-
  - Belgium
  - Qatar

ANNEX 3. Prudential and Treasury Indicators

Prudential and Treasury Indicators are relevant for the purposes of setting an integrated treasury management strategy and require the approval of the Council. They are included separately in Appendix 1 together with relevant narrative and are summarised here for submission to the Council meeting for approval.

The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. The revised Code (published in 2009 and updated in 2011 and 2017) was initially adopted by full Council on 15th February 2010 and has subsequently been re-adopted each year in February.

PRUDENTIAL INDICATORS	2017/18	2018/19	2019/20	2020/21	2021/22
	actual	estimate	estimate	estimate	estimate
Total Capital Expenditure	£40.3m	47.1m	£51.5m	£42.0m	£12.3m
Ratio of financing costs to net revenue stream	0.0%	0.0%	0.0%	0.0%	0.0%
Net borrowing requirement (net investments for Bromley)					
brought forward 1 April	£257.3m	£268.8m	£294.8m	£246.9m	£214.2m
carried forward 31 March	£268.8m	£294.8m	£246.9m	£214.2m	£207.0m
in year borrowing requirement (movement in net investments for Bromley)	+£11.5m	-£26.0m	-£47.9m	-£32.7m	-£7.2m
Capital Financing Requirement as at 31 March	£2.3m	£1.6m	£1.1m	£1.6m	£0.1m
Annual change in Cap. Financing Requirement	-£0.8m	-£0.7m	-£0.5m	-£0.5m	-£0.5m

TREASURY MANAGEMENT INDICATORS	2017/18	2018/19	2019/20	2020/21	2021/22
	actual	estimate	estimate	estimate	estimate
Authorised Limit for external debt -					
borrowing	£30.0m	£30.0m	£30.0m	£30.0m	£30.0m
other long term liabilities	£30.0m	£30.0m	£30.0m	£30.0m	£30.0m
TOTAL	£60.0m	£60.0m	£60.0m	£60.0m	£60.0m
Operational Boundary for external debt -					
borrowing	£10.0m	£10.0m	£10.0m	£10.0m	£10.0m
other long term liabilities	£20.0m	£20.0m	£20.0m	£20.0m	£20.0m
TOTAL	£30.0m	£30.0m	£30.0m	£30.0m	£30.0m
Upper limit for fixed interest rate exposure	100%	100%	100%	100%	100%
Upper limit for variable rate exposure	20%	20%	20%	20%	20%
Upper limit for total principal sums invested for more than 365 days beyond year-end dates	£170.0m	£170.0m	£170.0m	£170.0m	£170.0m