

TREASURY MANAGEMENT STRATEGY REPORT 2020/21

1. INTRODUCTION

- 1.1. Treasury management is the management of the Council's cash flows, borrowing and investments, and the associated risks. The Council has borrowed and invested 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.
- 1.2. Treasury risk management at the Council is conducted within the framework of the CIPFA Code which requires the Council to approve a Treasury Management Strategy Statement (TMSS) 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.
- 1.3. Investments held for service purposes or for commercial profit are considered in a different report, the Investment Strategy.

2. POLICIES AND APPROVALS REQUIRED

2.1. Treasury Management Strategy Statement

The Treasury Management Strategy Statement sets out how the Council's treasury service will support the capital expenditure and financing decisions taken over the three year period from 2020/21 to 2022/23. The day to day treasury management function and the limitations on activity through treasury indicators are also set out in the statement.

This report has been prepared prior to the finalisation of the Capital Programme for 2020/21 and subsequent years. Therefore, the target indicators may be subject to minor variation. These indicators are targets only and minor adjustments will not be reported.

Any adjustments to the treasury management limits will be reported.

2.2. Treasury Management Investment Strategy

Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in Public Services: Code of Practice 2017 Edition (the CIPFA Code). This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

The Treasury Management investment strategy sets out the Council's criteria for choosing investment counterparties and limiting exposure to the risk of loss.

This strategy is shown in Annex A in Section 5.

The above policies and parameters provide an approved framework within which officers undertake the day to day treasury activities.

This strategy aims to strike a balance between allowing for current investment levels to continue, whilst also considering the Council's intention to directly invest in both commercial and residential property.

3. ENVIRONMENTAL IMPLICATIONS

3.1. There are no environment implications arising from this report.

4. CRIME AND DISORDER IMPLICATIONS

4.1. There are no crime and disorder implications arising from this report.

5. RECOMMENDATIONS

The Audit Committee is recommended to request Council to approve the key element of this report:

5.1. The Treasury Management Strategy 2020/21 to 2022/23 including the Annual Treasury Management Investment Strategy for 2020/21 (and the remainder for 2019/20) and the Treasury Indicators contained within Annex A.

5.2. That authority is delegated to the Section 151 Officer, who in turn delegates to Hampshire County Council's Director of Corporate Resources, as agreed in the Service Level Agreement, to manage all Council investments (other than the high yield investment portfolio) and borrowing according Treasury Management Strategy Statement as appropriate.

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2. EXTERNAL CONTEXT

- 2.1. The following paragraphs explain the economic and financial background against which the TMSS is being set.

2.2. Economic background

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

GDP growth rose by 0.4% in the third quarter of 2019 from -0.2% in the previous three months with the annual rate falling further below its trend rate to 1.1%. Looking ahead, the Bank of England forecasts economic growth to pick up during 2020 as Brexit-related uncertainties dissipate and provide a boost to business investment helping GDP reach 1.6% in Q4 2020, 1.8% in Q4 2021 and 2.1% in Q4 2022.

The headline rate of UK Consumer Price Inflation remained the same in November 2019 at 1.5% year-on-year, although lower than highs of 2.1% in July and April 2019 and below the BOE target of 2%.

Labour market data continues to be positive with unemployment at 3.8%, the lowest level since 1975. The 3-month average annual growth rate for pay excluding bonuses rose to 3.5% in November 2019 providing some evidence that a shortage of labour is supporting wages. However, adjusting for inflation this means real wages were only up by 0.9% in October 2019 and only likely to have a moderate impact on household spending.

2.3. Credit outlook

The recent Bank of England stress tests assessed all seven UK banking groups, with all seven passing the test. Major banks have steadily increased their capital for many years now, however the tests do not cover all banks and the Bank of England will seek to address some of these issues in 2020, when Virgin Money/Clydesdale will be added to the testing group and separate tests will be included of ringfenced banks.

Looking forward, the potential for a “no-deal” Brexit and/or a global recession remain the major risks facing banks and building societies in 2020/21 and a cautious approach to bank deposits continues to be recommended by the Council’s treasury advisors.

2.4. Interest rate forecast

The Council’s treasury management adviser Arlingclose is forecasting that Bank Rate will remain at 0.75% until the end of 2022. The risks to this forecast are deemed to be significantly weighted to the downside, particularly given the need for greater clarity on Brexit and the continuing global economic slowdown.

The Bank of England, having previously indicated interest rates may need to rise if a Brexit agreement was reached, stated in its November Monetary Policy Report and its Bank Rate decision (7-2 vote to hold rates) that the MPC now believe this is less likely even in the event of a deal.

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

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

3. BALANCE SHEET SUMMARY AND FORECAST

- 3.1. On 30 November 2019, the Council held £135.5m of borrowing and £79.7m of investments. This is set out in further detail at Appendix B. Forecast changes in these sums are shown in the balance sheet analysis in Table 1 below.

Table 1: Balance Sheet Summary and Forecast	31/03/19 Actual £m	31/03/20 Estimate £m	31/03/21 Forecast £m	31/03/22 Forecast £m	31/03/23 Forecast £m
General Fund CFR	4.9	8.5	17.6	28.2	32.4
Housing Revenue Account CFR	134.5	130.4	129.8	131.9	135.5
HRA Settlement	1.9	1.9	1.9	1.9	1.9
Total CFR	141.3	140.8	149.3	162.0	169.8
Less: External borrowing *	(135.5)	(131.2)	(126.9)	(122.6)	(118.3)
Internal (over) borrowing	5.8	9.6	22.4	39.4	51.5
Less: GF Usable reserves	(31.2)	(28.1)	(23.1)	(18.6)	(18.1)
Less: HRA Usable reserves	(23.8)	(14.3)	(13.5)	(9.5)	(3.8)
Less: Working capital	(14.9)	(14.9)	(14.9)	(14.9)	(14.9)
Resources for investments	(69.9)	(57.3)	(51.5)	(43.0)	(36.8)
New borrowing (or investments)	(64.1)	(47.7)	(29.1)	(3.6)	14.7

* shows only loans to which the Council is committed and excludes optional refinancing

- 3.2. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment.
- 3.3. The General Fund CFR is showing an increase over the period as the Council looks to roll out its commercial and residential investment strategies. The HRA CFR is also increasing as the Council looks to deliver the accelerated housing programme as per the Housing Strategy to 2026. Table 1 demonstrates that the Council will be internally borrowed beyond the resources available for investment, at this point, an external borrowing position potentially sets in. At the appropriate time, the Council will consult with its treasury advisors on how best to service its borrowing requirements, including the possibility of renewing maturing loans on the HRA.
- 3.4. CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Council expects to comply with this recommendation during 2020/21.

4. BORROWING STRATEGY

- 4.1. The Council currently holds £135.5m of loans, a decrease of £4.3m on the previous year, as a result of the HRA refinancing in 2012. The balance sheet forecast in Table 1 shows that the Council does not expect to need to borrow in 2020/21. The Council may however

borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £201.6 million.

4.2. Objectives

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

4.3. Strategy

Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, if the Council does not need to borrow, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

By internally borrowing, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal and short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Council with this 'cost of carry' and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2020/21 with a view to keeping future costs low, even if this causes additional cost in the short-term.

The Council has previously raised the majority of its long-term borrowing from the Public Works Loan Board (PWLB) but the government increased the margin on PWLB rates by 100 basis points (1%) in October 2019 making it a relatively expensive way to meet borrowing needs.

Alternative options should the Council need to borrow any long-term amounts include banks, pension funds and local authorities as well as the potential to issue bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code.

The Council may also arrange forward starting loans during 2020/21, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

In addition, the Council may borrow short-term loans (normally for up to one month) to cover unplanned cash flow shortages.

4.4. 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 Hampshire Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

4.5. Other sources of debt finance

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

- leasing
- hire purchase
- Private Finance Initiative
- sale and leaseback

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

4.6. Short-term and variable rate loans

These loans leave the Council exposed to the risk of short-term interest rate rises, which is monitored through the indicator on interest rate exposure in the treasury management indicators below.

4.7. 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.

5. TREASURY MANAGEMENT INVESTMENT STRATEGY

5.1. The Council holds 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 £63.5m and £105.7m.

5.2. 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.

5.3. Negative interest rates

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

5.4. Strategy

Given the increasing risk and very low returns from short-term unsecured bank investments, the Council aims to continue to be diversified by holding more secure and/or higher yielding asset classes during 2020/21. This is especially the case for the estimated funds that are available for longer-term investment.

Approximately 76% of the Council's surplus cash is invested so that it is not subject to bail-in risk, as it is invested in local authorities, pooled property, equity and multi-asset funds, registered providers, corporate bonds and secured bank bonds. Whilst the remaining cash is subject to bail-in risk, 53% of this balance is held in overnight money market funds and cash plus funds which are subject to a reduced risk of bail-in, 16% is held in certificates of deposit which can be sold on the secondary market, and 31% is held in overnight call accounts with banks to allow for liquidity. This diversification will represent a continuation of the strategy adopted in 2015/16.

The Council has invested in further high yield investments by increasing its investments in pooled property and pooled equity funds, and by investing in pooled multi-asset funds.

The investments in pooled property, equity and multi-asset funds allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. The funds

which are operated on a variable net asset value (VNAV) basis offer diversification of investment risk, coupled with the services of a professional fund manager; they also offer enhanced returns over the longer term but are more volatile in the short-term. All of the Council's pooled fund investments are in the funds' distributing share classes which pay out the income generated.

Although money can be redeemed from the pooled funds at short notice, the Council's intention is to hold them for at least the medium term. Their performance and suitability in meeting the Council's investment objectives are monitored regularly and discussed with Arlingclose.

The Council's high yielding investments held at 30 November 2019 are shown in Table 2.

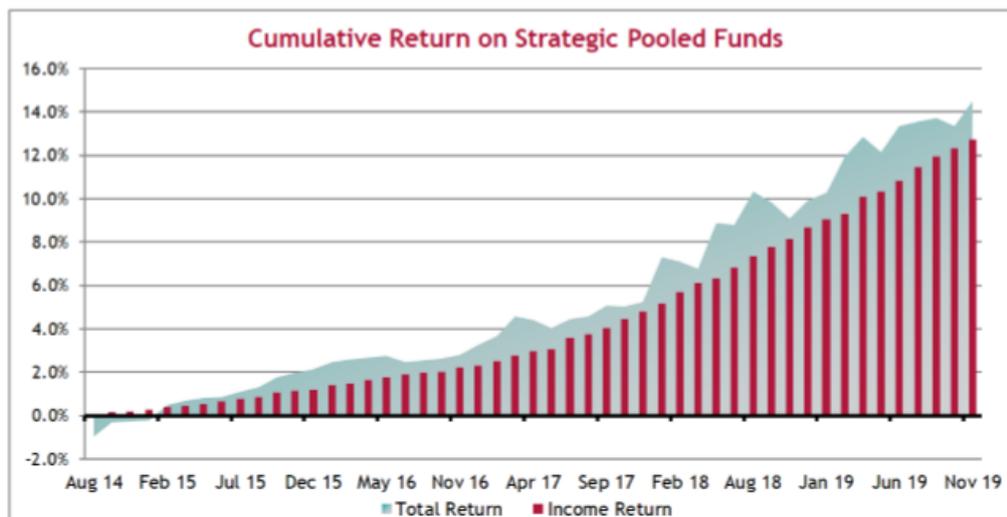
Table 2: High yield investments capital value	Principal invested £m	Market value 30/11/2019 £m	Capital yield (per annum) %
Pooled Property Funds	7.6	7.6	0.24
Pooled Equity Funds	3.0	3.0	0.58
Pooled Multi Asset Funds	3.0	3.1	(0.20)
Total	13.6	13.7	0.38

As shown in Appendix B, without this allocation the weighted average return of the Council's cash investments based on investments held on 30 November 2019 would have been 0.98%; whereas the allocation to higher yielding investments has a weighted average return of 4.51%, bringing the overall return for the portfolio to 1.58%.

The benefit to the revenue budget of these investments targeting higher yields is demonstrated in Table 3 below, using cash balances and average returns at 30 November 2019. It should be noted that balances and returns do not remain constant and the figures below are therefore indicative. The actual returns will form part of the outturn report at the conclusion of the financial year.

Table 3: Estimated annual income returns	Cash balance at 30/11/19	Weighted average return	Estimated annual income return
Short-term and long-term cash investments	£66.1m	0.98%	£0.65m
Investments targeting higher yields	£13.6m	4.51%	£0.61m
Total	£79.7m	1.58%	£1.26m

The cumulative total return from the Council's investments in pooled equity, property and multi-asset funds since purchase is shown in the graph below. This highlights that despite some volatility in the capital value of the funds over time, these pooled funds have delivered strong and steady income returns and a positive capital increase to date.



Non-cash pooled investments must be viewed as long-term investments in order that monies are not withdrawn in the event of a fall in capital values to avoid crystallising a capital loss. At the current time, given the medium to long term nature of the investments, it is unlikely that a capital loss would ever be realised, since the Council would avoid selling investments that realised a capital loss.

Going forward however, changes to International Financial Reporting Standards mean that capital gains and losses on investments need to be reflected in the revenue account on an annual basis. There is currently a statutory override in place for local authorities that exempts them from complying with this requirement for the next four years. The ongoing suitability of the Council's investments in pooled funds is monitored on a regular basis and based on advice from Arlingclose.

5.5. Investment limits

The maximum that will be lent/invested to/with any one organisation (other than the UK Government) will be £10 million, a reduction from the £12 million limit included in the 2019/20 strategy. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, and investments in pooled funds, as they would not count against a limit for any single foreign country, since the risk is diversified over many countries.

Table 4: Investment limits	Cash limit
Any single organisation, except the UK Central Government	£10m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£10m per group
Any group of pooled funds under the same management	£10m per manager
Registered providers and registered social landlords	£10m in total
Money Market Funds	£50% in total
Real estate investment trusts	£10m in total

5.6. Approved counterparties

The Council may invest its surplus funds with any of the counterparty types in Table 5 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 5: Approved investment counterparties and limits						
Credit rating	Banks		Government	Corporates	Registered Providers	
	Unsecured	Secured			Unsecured	Secured
UK Govt	n/a	n/a	£ Unlimited 30 years	n/a	n/a	n/a
AAA	£5m 5 years	£10m 20 years	£10m 50 years	£5m 20 years	£5m 20 years	£5m 20 years
AA+	£5m 5 years	£10m 10 years	£10m 25 years	£5m 10 years	£5m 10 years	£5m 10 years
AA	£5m 4 years	£10m 5 years	£10m 15 years	£5m 5 years	£5m 10 years	£5m 10 years
AA-	£5m 3 years	£10m 4 years	£10m 10 years	£5m 4 years	£5m 10 years	£5m 10 years
A+	£5m 2 years	£10m 3 years	£5m 5 years	£5m 3 years	£5m 5 years	£5m 5 years
A	£5m 13 months	£10m 2 years	£5m 5 years	£5m 2 years	£5m 5 years	£5m 5 years
A-	£5m 6 months	£10m 13 months	£5m 5 years	£5m 13 months	£5m 5 years	£5m 5 years
None	£1m 6 months	n/a	£10m 25 years	n/a	£5m 5 years	£5m 25 years
Pooled funds and real estate investment trusts	£10m per fund					

This table must be read in conjunction with the notes below

5.7. Credit rating

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

5.8. Banks unsecured

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

5.9. Banks secured

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

5.10. Government

Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 30 years.

5.11. Corporates

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

5.12. Registered providers

Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are tightly regulated by the Regulator of Social Housing (in England), the

Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

5.13. Pooled funds

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

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

5.14. Real estate investment trusts (REITs)

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, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.

5.15. Risk assessment and credit ratings

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

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

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating

criteria, then only investments that can be withdrawn [on the next working day] will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

5.16. Other information on the security of investments

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

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

5.17. Liquidity management

The Council has due regard for its future cash flows when determining the maximum period for which funds may prudently be committed. Historic cash flows are analysed in addition to significant future cash movements, such as payroll, grant income and council tax precept. Limits on long-term investments are set by reference to the Council's medium term financial position (summarised in Table 1) and forecast short-term balances.

6. TREASURY MANAGEMENT INDICATORS

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

6.2. Interest rate exposures

The following indicator shows the sensitivity of the Council's current investments and borrowing to a change in interest rates.

Table 6: Interest rate risk indicator	30 November 2019	Impact of +/-1% interest rate change
Sums subject to variable interest rates		
Investment	£53.6m	+/-£0.5m
Borrowing	(£0.0m)	+/-£0.0m

6.3. 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:

Table 7: Refinancing rate risk indicator	Upper	Lower
Under 12 months	25%	0%
12 months and within 24 months	25%	0%
24 months and within 5 years	25%	0%
5 years and within 10 years	25%	0%
10 years and above	100%	0%

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

6.4. 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:

Table 8: Price risk indicator	2020/21	2021/22	2022/23
Limit on principal invested beyond a year	£40m	£40m	£40m

7. RELATED MATTERS

7.1. The CIPFA Code requires the Council to include the following in its TMSS.

7.2. Financial derivatives

Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

In line with the CIPFA Code, the Council will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.

7.3. Housing Revenue Account

On 1st April 2012, the Council notionally split each of its existing long-term loans into General Fund and HRA pools. In the future, new long-term loans borrowed will be assigned in their entirety to one pool or the other. Interest payable and other costs/income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged/credited to the respective revenue account. Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. This balance will be measured each month and interest transferred between the General Fund and HRA at the average % Local Authority 7 day rate.

7.4. Markets in Financial Instruments Directive

The Council has opted up to professional client status with its providers of financial services, including advisers, 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 s151 Officer believes this is the most appropriate status.

Appendix A – Arlingclose Economic & Interest Rate Forecast January 2020

Underlying assumptions:

- The global economy has entered a period of weaker growth in response to political issues. The UK economy continues to experience slower growth due to both Brexit uncertainty and the downturn in global activity. In response, global and UK interest rate expectations are low.
- Some improvement in global economic data and a more positive outlook for US/China trade negotiations has prompted worst case economic scenarios to be pared back.
- The new Conservative UK government will progress with achieving Brexit on 31st January 2020. The more stable political environment will prompt a partial return in business and household confidence in the short term, but the subsequent limited Brexit transitional period, which the government is seeking to enforce, will create additional economic uncertainty.
- UK economic growth stalled in Q4 2019. Inflation is running below target at 1.5%. The inflationary consequences of the relatively tight labour market have yet to manifest, while slower global growth should reduce the prospect of externally driven pressure, although escalating geopolitical turmoil could continue to push up oil prices.
- The first few months of 2020 will indicate whether the economy benefits from restored confidence. The government will undertake substantial fiscal easing in 2020/21, which should help support growth in the event of a downturn in private sector activity.
- The weak outlook for the UK economy and current low inflation have placed pressure on the MPC to loosen monetary policy. Two MPC members voted for an immediate cut in the last two MPC meetings of 2019. The evolution of the economic data and political moves over the next few months will inform policy, but upside risks to Bank Rate are very limited.
- Central bank actions and escalating geopolitical risks will produce volatility in financial markets, including bond markets.

Forecast:

- We have maintained our Bank Rate forecast at 0.75% for the foreseeable future. Substantial risks to this forecast remain, arising primarily from the government's policy around Brexit and the transitional period.
- Arlingclose judges that the risks are weighted to the downside.
- Gilt yields remain low due to the soft UK and global economic outlooks. US monetary policy and UK government spending will be key influences alongside UK monetary policy.
- We expect gilt yields to remain at relatively low levels for the foreseeable future and judge the risks to be broadly balanced.

	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Official Bank Rate													
Upside risk	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Case	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Downside risk	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
3-month money market rate													
Upside risk	0.10	0.10	0.25	0.25	0.25	0.25	0.25	0.25	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Downside risk	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
1yr money market rate													
Upside risk	0.10	0.20	0.20	0.20	0.20	0.20	0.20	0.25	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85
Downside risk	0.30	0.50	0.55	0.65	0.65	0.65	0.65	0.65	0.65	0.65	0.65	0.65	0.65
5yr gilt yield													
Upside risk	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.45	0.45	0.45
Arlingclose Central Case	0.50	0.50	0.55	0.55	0.55	0.60	0.60	0.65	0.65	0.70	0.75	0.75	0.75
Downside risk	0.35	0.50	0.55	0.55	0.55	0.60	0.60	0.65	0.65	0.70	0.75	0.75	0.75
10yr gilt yield													
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45
Arlingclose Central Case	0.75	0.80	0.80	0.85	0.85	0.90	0.90	0.95	0.95	1.00	1.05	1.10	1.10
Downside risk	0.40	0.40	0.40	0.40	0.45	0.45	0.45	0.45	0.50	0.50	0.50	0.50	0.50
20yr gilt yield													
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45
Arlingclose Central Case	1.20	1.25	1.25	1.25	1.30	1.30	1.30	1.35	1.35	1.35	1.40	1.40	1.40
Downside risk	0.40	0.40	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.50	0.50
50yr gilt yield													
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45
Arlingclose Central Case	1.20	1.25	1.25	1.25	1.30	1.30	1.30	1.35	1.35	1.35	1.40	1.40	1.40
Downside risk	0.40	0.40	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.50	0.50

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 1.80%
 PWLB Local Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

Appendix B – Existing Investment & Debt Portfolio Position

Investment Position (Treasury Investments)

Investments	31/08/2019 Balance £m	Movement £m	30/11/2019 Balance £m	30/11/2019 Rate %	30/11/2019 WAM* years
Short term Investments					
Banks and Building Societies:					
- Unsecured	13.0	-4.0	9.0	0.88	0.17
- Secured	10.0	-	10.0	0.90	0.33
Treasury Bills	2.0	6.0	8.0	0.71	0.14
Money Market Funds	8.7	1.4	10.1	0.73	0.00
Local Authorities	12.0	3.0	15.0	0.90	0.34
Registered Providers	2.0	-	2.0	1.92	0.14
Cash Plus Funds	2.0	-	2.0	1.45	n/a
	49.7	6.4	56.1	0.89	0.20
Long term investments					
Banks and Building Societies:					
- Secured	3.0	-	3.0	0.96	3.20
Local Authorities	4.0	-1.0	3.0	1.33	1.53
Registered Providers	4.0	-	4.0	1.93	1.33
	11.0	-1.0	10.0	1.46	1.96
High yield investments					
Pooled Property Funds**	7.6	-	7.6	4.18	n/a
Pooled Equity Funds**	3.0	-	3.0	5.26	n/a
Pooled Multi-Asset Funds**	3.0	-	3.0	4.57	n/a
	13.6	-	13.6	4.51	n/a
TOTAL INVESTMENTS	74.3	5.4	79.7	1.58	0.49

* Weighted average maturity

** The rates provided for pooled fund investments are reflective of the average dividend return over the last 12 months.

Treasury Management Position

	30/11/2019 Balance £m	30/11/2019 Rate %
External Borrowing		
PWLB	(135.5)	(3.21)
Investments		
Total Investments	79.7	1.58
Net Debt	(55.7)	