TREASURY MANAGEMENT STRATEGY 2018/19 – 2020/21

1. INTRODUCTION

1.1. In February 2012 the Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2011 Edition (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year. CIPFA consulted on changes to the Code in 2017, but has yet to publish a revised Code.

1.2. In addition, the Department for Communities and Local Government (CLG) issued revised Guidance on Local Authority Investments in March 2010 that requires the Council to approve an investment strategy before the start of each financial year.

1.3. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the CLG Guidance.

1.4. The Council has potentially large exposures to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Council's treasury management strategy.

2. EXTERNAL CONTEXT

1.5. The following paragraphs explain the economic and financial background against which the Treasury Management Strategy is being set.

1.6. Economic background

The major external influence on the Council's treasury management strategy for 2018/19 will be the UK's progress in negotiating its exit from the European Union and agreeing future trading arrangements. The domestic economy has remained relatively robust since the surprise outcome of the 2016 referendum, but there are indications that uncertainty over the future is now weighing on growth. Transitional arrangements may prevent a cliff-edge, but will also extend the period of uncertainty for several years. Economic growth is therefore forecast to remain sluggish throughout 2018/19.

Consumer price inflation (CPI) reached 3.0% in September 2017 as the post-referendum devaluation of sterling continued to feed through to imports. Unemployment continued to fall and the Bank of England's Monetary Policy Committee judged that the extent of spare capacity in the economy seemed limited and the pace at which the economy can grow without generating inflationary pressure had fallen over recent years. With its inflation-control mandate in mind, the Bank of England's Monetary Policy Committee raised official interest rates to 0.5% in November 2017. Since this point, CPI hit 3.1% in November 2017.

1.7. Credit outlook

High profile bank failures in Italy and Portugal have reinforced concerns over the health of the European banking sector. Sluggish economies and fines for pre-crisis behaviour continue to weigh on bank profits, and any future economic slowdown will exacerbate concerns in this regard.

Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the European Union, Switzerland and USA, while Australia and Canada are progressing with their own plans. In addition, the largest UK banks will ringfence their retail banking functions into separate legal entities during 2018. There remains some uncertainty over how these changes will impact upon the credit strength of the residual legal entities.

The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Council; returns from cash deposits however remain very low.

1.8. Interest rate forecast

The Council's treasury adviser Arlingclose's central case is for UK Bank Rate to remain at 0.50% during 2018/19, following the rise from the historic low of 0.25%. The Monetary Policy Committee re-emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.

Future expectations for higher short term interest rates are subdued and on-going decisions remain data dependant and negotiations on exiting the EU cast a shadow over monetary policy decisions. The risks to Arlingclose's forecast are broadly balanced on both sides. The Arlingclose central case is for gilt yields to remain broadly stable across the medium term. Upward movement will be limited, although the UK government's seemingly deteriorating fiscal stance is an upside risk.

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

3. LOCAL CONTEXT

1.9. On 31 December 2017, the Council held £144m of borrowing and £84.5m 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	**31/03/17 Actual £m**	**31/03/18 Estimate £m**	**31/03/19 Forecast £m**	**31/03/20 Forecast £m**	**31/03/21 Forecast £m**
General Fund CFR	3.3	5.7	15.5	26.7	35.7
Housing Revenue Account CFR	1.9	1.9	1.9	1.9	1.9
HRA Settlement	142.7	138.6	134.5	130.4	126.3
Total CFR	**147.9**	**146.2**	**151.9**	**159.0**	**163.9**
Less: External borrowing *	(144.1)	(139.8)	(135.5)	(131.2)	(126.9)
Internal (over) borrowing	**3.8**	**6.4**	**16.4**	**27.8**	**37.0**
Less: GF Usable reserves	(21.8)	(20.5)	(15.3)	(9.2)	(5.7)
Less: HRA Usable reserves	(29.2)	(25.6)	(20.1)	(18.9)	(17.7)
Less: Working capital	(11.6)	(7.4)	(7.4)	(7.4)	(7.4)
Resources for investments	**(62.6)**	**(53.5)**	**(42.8)**	**(35.5)**	**(30.8)**
New borrowing (or investments)	**(58.8)**	**(47.1)**	**(26.4)**	**(7.7)**	**6.2**

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

1.10. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

1.11. The CFR is showing a potential need for borrowing in the future as the Council looks to roll out its commercial and residential investment strategies, and at the appropriate time, the Council will consult with its treasury advisors on how best to service its borrowing, including the possibility of renewing maturing loans on the HRA. The level of usable HRA reserves is set to decrease over the period as the Council works towards achieving its latest acquisition and development strategy, as well as commencing with principal repayments on the settlement loan.

1.12. 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 2018/19.

4. BORROWING STRATEGY

1.13. The Council currently holds £144 million of loans, a decrease of £0.2 million 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 2018/19. The Council may however borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £206.4 million.

1.14. 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.

1.15. Limits

The Council is required to put in place the following Prudential Indicators to control its limits on borrowing; these are operational and authorised boundaries for external debt, and the maximum HRA debt limit.

Operational Boundary for External Debt

The operational boundary is based on the Council's estimate of most likely (i.e. prudent but not worst case) scenario for external debt. It links directly to the Council's estimates of capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring.

Table 2: Operational Boundary	2017/18 Revised £m	2018/19 Limit £m	2019/20 Limit £m	2020/21 Limit £m
Total Debt	**185.4**	**191.2**	**198.2**	**203.1**

Authorised Limit for External Debt

The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Council can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Table 3: Authorised Limit	2017/18 Limit £m	2018/19 Limit £m	2019/20 Limit £m	2020/21 Limit £m
Total Debt	**200.7**	**206.4**	**213.5**	**218.4**

Maximum HRA Debt Limit

The Council is also limited to a maximum HRA CFR through the HRA self-financing regime. The Council may not borrow more than this limit for HRA purposes. The 2017 Autumn statement lifted the borrowing cap by £1bn for Council's with the highest affordability pressures. Details are yet to be confirmed, and in any case, this Council is not currently planning to seek further approvals to increase

HRA borrowing beyond the previously set limit (based on the settlement payment plus the old Housing Subsidy Debt amount).

Table 4: HRA Debt Limit	2017/18 Revised £m	2018/19 Limit £m	2019/20 Limit £m	2020/21 Limit £m
Total	155.5	155.5	155.5	155.5

1.16. 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.

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

1.17. Sources of borrowing

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

- Public Works Loan Board (PWLB) and any successor body
- UK local authorities
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- 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

1.18. 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:

- operating and finance leases
- 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.

1.19. Municipal Bonds Agency

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

1.20. Short-term and variable rate loans

These loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators below.

1.21. 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. INVESTMENT STRATEGY

1.22. 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 £95.6 and £59.4 million.

1.23. Objectives

Both the CIPFA Code and the CLG Guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

1.24. Negative interest rates

If the UK enters into a recession in 2018/19, 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.

1.25. Strategy

Given the increasing risk and very low returns from short-term unsecured bank investments, the Council aims to continue to diversify into more secure and/or higher yielding asset classes during 2018/19. This is especially the case for the estimated £40m that is available for longer-term investment. Approximately 73% (increased from 59% last year) 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 and equity funds, and secured bank bonds. Whilst the remaining cash is subject to bail-in risk, 61% of this balance is held overnight money market funds which are subject to a reduced risk of bail-in, 28% is held in certificates of deposit which can be sold on the secondary market, and 3% is held in overnight call accounts with banks to allow for liquidity. This diversification will represent a continuation of the new 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.

Table 5: High yield investments capital value	Principal invested £m	Market value 31/12/2017 £m	Capital yield (per annum) %
Pooled Property Funds	6.05	6.13	-0.61
Pooled Equity Funds	3.00	3.18	4.61
Pooled Multi Asset Funds	2.00	1.99	-0.72
Total	**11.05**	**11.30**	**0.84**

As shown in Appendix B, without this allocation the weighted average return of the Council's cash investments would have been 0.57%; the allocation to high yielding investments has added 0.50% (£0.4m based on the cash balance at 31 December 2017) to the average interest rate earned by the remainder of the portfolio.

1.26. Investment limits

The maximum that will be lent/invested to/with any one organisation (other than the UK Government) will be £12 million. 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 the limit for any single foreign country, since the risk is diversified over many countries.

Table 6: Investment limits	**Cash limit**
Any single organisation, except the UK Central Government	£12m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£12m per group
Any group of pooled funds under the same management	£12m per manager
Registered providers	£10m in total
Money Market Funds	£50% in total

1.27. Approved counterparties

The Council may invest its surplus funds with any of the counterparty types in Table 7 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 7: Approved investment counterparties and limits						
Credit rating	**Banks unsecured**	**Banks secured**	**Government**	**Corporates**	**Registered Providers Unsecured**	**Registered Providers Secured**
UK Govt	n/a	n/a	£ Unlimited 30 years	n/a	n/a	n/a
AAA	£6m 5 years	£12m 20 years	£12m 50 years	£6m 20 years	£6m 20 years	£6m 20 years
AA+	£6m 5 years	£12m 10 years	£12m 25 years	£6m 10 years	£6m 10 years	£6m 10 years
AA	£6m 4 years	£12m 5 years	£12m 15 years	£6m 5 years	£6m 10 years	£6m 10 years
AA-	£6m 3 years	£12m 4 years	£12m 10 years	£6m 4 years	£6m 10 years	£6m 10 years
A+	£6m 2 years	£12m 3 years	£6m 5 years	£6m 3 years	£6m 5 years	£6m 5 years
A	£6m 13 months	£12m 2 years	£6m 5 years	£6m 2 years	£6m 5 years	£6m 5 years
A-	£6m 6 months	£12m 13 months	£6m 5 years	£6m 13 months	£6m 5 years	£6m 5 years
None	£1m 6 months	n/a	£12m 25 years	n/a	£6m 5 years	£6m 25 years
Pooled funds	£12m per fund					

This table must be read in conjunction with the notes below

1.28. Credit rating

Investment limits are set by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. 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.

1.29. 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.

1.30. 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.

1.31. 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 an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 30 years.

1.32. 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.

1.33. Registered providers

Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing, formerly known as housing associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services, they retain the likelihood of receiving government support if needed.

1.34. Pooled funds

Shares in diversified investment vehicles consisting of the 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.

1.35. 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.

1.36. 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. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating 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.

1.37. Specified investments

The CLG Guidance defines specified investments as those:

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

The Council defines "high credit quality" organisations and securities as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of A- or higher.

1.38. Non-specified investments

Any investment not meeting the definition of a specified investment is classed as non-specified. The Council does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement, and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown in Table 8 below.

Table 8: Non-specified investment limits	Cash limit
Total long-term investments	£40m
Total investments without credit ratings or rated below [A-] (except UK Government and local authorities)	£30m
Total non-Sterling investments	£0m
Total investments (except pooled funds) with institutions domiciled in foreign countries rated below AA+	£0m
Total non-specified investments	£45m*

* Total non-specified investments is a limit in its own right, and is not meant to equal the aggregate of the limits for total long-term investments, and total investments without credit ratings or rates below A-.

1.39. 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. NON-TREASURY INVESTMENTS

1.40. Although not classed as treasury management activities and therefore not covered by the CIPFA Code or the CLG Guidance, the Council is intending to purchase property for investment purposes and may also make loans and investments for service purposes, for example in equity investments and loans to the Council's subsidiaries.

1.41. Such loans and investments will be subject to the Council's normal approval processes for revenue and capital expenditure and need not comply with this treasury management strategy.

7. TREASURY MANAGEMENT INDICATORS

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

1.43. Interest rate exposures

This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the amount of principal borrowed or invested will be:

Table 9: Interest rate exposures	2018/19	2019/20	2020/21
Upper limit on fixed interest rate investment exposure	£40m	£40m	£40m
Upper limit on variable interest rate investment exposure	£120m	£120m	£120m
Upper limit on fixed interest rate borrowing exposure	£206.4	£213.5	£218.4
Upper limit on variable interest rate borrowing exposure	£206.4	£213.5	£218.4

Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate.

1.44. 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 fixed rate borrowing will be:

Table 10: Maturity structure of borrowing	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%

1.45. Principal sums invested for periods longer than 364 days

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 11	2018/19	2019/20	2020/21
Limit on principal invested beyond year end	£40m	£40m	£40m

8. OTHER ITEMS

1.46. There are a number of additional items that the Council is obliged by CIPFA or CLG to include in its Treasury Management Strategy.

1.47. Policy on the use of 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.

1.48. Policy on apportioning interest to the HRA

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.

1.49. Investment training

The needs of Hampshire County Council's treasury management staff delivering services, for training in investment management are assessed annually as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.

Staff regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA, and other appropriate organisations.

CIPFA's Code of Practice requires that the Council ensures that all members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities. All members were invited to a workshop presented by Arlingclose on 29 November 2017, which gave an update on treasury matters. A further Arlingclose workshop has been planned for November 2018.

1.50. Investment advisers

The Council has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues. The quality of this service is controlled through quarterly review meetings with Arlingclose.

1.51. Investment of money borrowed in advance of need

The Council may, from time to time, borrow in advance of need, where this is expected to provide the best long-term value for money. Since amounts borrowed will be invested until spent, the Council is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Council's overall management of its treasury risks. The total amount borrowed will not exceed the authorised borrowing limit of £206.4 million.

Appendix A – Arlingclose Economic & Interest Rate Forecast November 2017

Underlying assumptions:

- In a 7-2 vote, the MPC increased Bank Rate in line with market expectations to 0.5%. Dovish accompanying rhetoric prompted investors to lower the expected future path for interest rates. The minutes re-emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.

- Further potential movement in Bank Rate is reliant on economic data and the likely outcome of the EU negotiations. Policymakers have downwardly assessed the supply capacity of the UK economy, suggesting inflationary growth is more likely. However, the MPC will be wary of raising rates much further amid low business and household confidence.

- The UK economy faces a challenging outlook as the minority government continues to negotiate the country's exit from the European Union. While recent economic data has improved, it has done so from a low base: UK Q3 2017 GDP growth was 0.4%, after a 0.3% expansion in Q2.

- Household consumption growth, the driver of recent UK GDP growth, has softened following a contraction in real wages, despite both saving rates and consumer credit volumes indicating that some households continue to spend in the absence of wage growth. Policymakers have expressed concern about the continued expansion of consumer credit; any action taken will further dampen household spending.

- Some data has held up better than expected, with unemployment continuing to decline and house prices remaining relatively resilient. However, both of these factors can also be seen in a negative light, displaying the structural lack of investment in the UK economy post financial crisis. Weaker long term growth may prompt deterioration in the UK's fiscal position.

- The depreciation in sterling may assist the economy to rebalance away from spending. Export volumes will increase, helped by a stronger Eurozone economic expansion.

- Near-term global growth prospects have continued to improve and broaden, and expectations of inflation are subdued. Central banks are moving to reduce the level of monetary stimulus.

- Geo-political risks remains elevated and helps to anchor safe-haven flows into the UK government bond (gilt) market.

Forecast:

- The MPC has increased Bank Rate, largely to meet expectations they themselves created. Future expectations for higher short term interest rates are subdued. On-going decisions remain data dependant and negotiations on exiting the EU cast a shadow over monetary policy decisions.

- Our central case for Bank Rate is 0.5% over the medium term. The risks to the forecast are broadly balanced on both sides.

- The Arlingclose central case is for gilt yields to remain broadly stable across the medium term. Upward movement will be limited, although the UK government's seemingly deteriorating fiscal stance is an upside risk.

	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.19**
Arlingclose Central Case	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**
Downside risk	0.00	0.00	0.00	0.00	0.00	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	**-0.15**
3-month LIBID rate														
Upside risk	0.10	0.10	0.10	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.22**
Arlingclose Central Case	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**
Downside risk	-0.10	-0.10	-0.15	-0.15	-0.15	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	**-0.20**
1-yr LIBID rate														
Upside risk	0.15	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	**0.27**
Arlingclose Central Case	**0.70**	**0.70**	**0.70**	**0.70**	**0.80**	**0.80**	**0.80**	**0.80**	**0.80**	**0.80**	**0.80**	**0.80**	**0.80**	**0.77**
Downside risk	-0.15	-0.20	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.15	-0.15	**-0.26**
5-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	**0.32**
Arlingclose Central Case	**0.75**	**0.75**	**0.80**	**0.80**	**0.80**	**0.85**	**0.90**	**0.90**	**0.95**	**0.95**	**1.00**	**1.05**	**1.10**	**0.89**
Downside risk	-0.20	-0.20	-0.25	-0.25	-0.25	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	**-0.33**
10-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	**0.32**
Arlingclose Central Case	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.30**	**1.30**	**1.35**	**1.40**	**1.45**	**1.50**	**1.55**	**1.55**	**1.36**
Downside risk	-0.20	-0.25	-0.25	-0.25	-0.25	-0.30	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	**-0.33**
20-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	**0.32**
Arlingclose Central Case	**1.85**	**1.85**	**1.85**	**1.85**	**1.85**	**1.90**	**1.90**	**1.95**	**1.95**	**2.00**	**2.05**	**2.05**	**2.05**	**1.93**
Downside risk	-0.20	-0.30	-0.25	-0.25	-0.30	-0.35	-0.40	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	**-0.38**
50-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	**0.32**
Arlingclose Central Case	**1.70**	**1.70**	**1.70**	**1.70**	**1.70**	**1.75**	**1.80**	**1.85**	**1.90**	**1.95**	**1.95**	**1.95**	**1.95**	**1.82**
Downside risk	-0.30	-0.30	-0.25	-0.25	-0.30	-0.35	-0.40	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	**-0.39**

Appendix B – Existing Investment & Debt Portfolio Position

Investments	Asset value on 31/07/2017 £m	Asset value on 31/12/2017 £m	Average Rate/Yield on 31/12/17 %	Average Life on 31/12/17 years
Short term Investments				
- Banks and Building Societies:				
- Unsecured	15.6	9.1	0.41	0.17
- Secured	10.9	7.1	0.76	0.33
- Money Market Funds	5.5	14.0	0.34	0.01
- Local Authorities	18.0	30.5	0.58	0.44
- Corporate Bonds	1.5	0.0	n/a	n/a
	51.5	**60.7**	**0.52**	**0.29**
Long term investments				
- Banks and Building Societies:				
- Secured	10.5	10.5	0.76	1.68
- Local Authorities	3.0	2.0	1.00	2.14
	13.5	**12.5**	**0.80**	**1.76**
High yield investments				
- Pooled Property Funds*	4.1	6.1	4.43	n/a
- Pooled Equity Funds*	2.1	3.2	4.82	n/a
- Pooled Multi Asset Funds*	2.0	2.0	3.13	n/a
	8.2	**11.3**	**4.31**	**n/a**
TOTAL INVESTMENTS	**73.2**	**84.5**	**1.07**	**0.54**
Increase/ (Decrease) in Investments £m		11.3		

	£m	%
External Borrowing		
PWLB	(144.0)	(3.12)
Investments		
Total Investments	84.5	1.07
Net Debt	**(59.5)**	**(6.03)**

* Yield represents the average of each investment’s most recent dividend payment as a percentage of the asset value.