AGENDA ITEM 13

REPORT TO THE TEES VALLEY COMBINED AUTHORITY CABINET

28 MARCH 2018

REPORT OF THE FINANCE DIRECTOR

TREASURY MANAGEMENT STRATEGY 2018/19

SUMMARY

This report informs Members of the proposed 2018/19 Treasury Management Strategy (TMS) and Treasury Management Practices (TMP's) for Tees Valley Combined Authority.

RECOMMENDATIONS

It is recommended that the Combined Authority Cabinet approve the Treasury Management Strategy and Treasury Management Practices as presented in the report.

DETAIL

Introduction

The Authority has 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 Authority to approve a treasury management strategy before the start of each financial year. CIPFA consulted on changes to the Code in February and August last year and published its new 2017 editions in early 2018.

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

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

The Authority has invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy.

Revised strategy: In accordance with the CLG Guidance, the Authority will be asked to approve a revised Treasury Management Strategy Statement should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates, in the Authority's capital programme or in the level of its investment balance.

The CIPFA Code requires the setting out of the responsibilities and duties of members and officers, allowing a framework for reporting and decision making on all aspects of treasury management. The Code identifies twelve areas where statements of Treasury Management Practices (TMP's) should be developed to implement the full requirements of the Code. These TMP's are included in Appendix D for approval.

External Context

Economic background: The major external influence on the Authority'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 remains 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 reached 3.0% in September 2017 as the post-referendum devaluation of sterling continued to feed through to imports. However, this effect is expected to fall out of year-on-year inflation measures during 2018, removing pressure on the Bank of England to raise interest rates.

In contrast, the US economy is performing well and the Federal Reserve is raising interest rates in regular steps to remove some of the emergency monetary stimulus it has provided for the past decade. The European Central Bank is yet to raise rates, but has started to taper its quantitative easing programme, signalling some confidence in the Eurozone economy.

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 Authority; returns from cash deposits however remain very low.

Interest rate forecast: The Authority's treasury adviser Arlingclose's central case is for UK Bank Rate to increase to 1.25% during 2018/19**,** following the rise from the historic low of

0.25%. The Monetary Policy Committee noted that any prospective increases in Bank Rate would be to a higher level and sooner than originally anticipated..

A more detailed economic and interest rate forecast provided by Arlingclose is attached at ***Schedule 1***

Local Context

On 31st December 2017, the Authority had £97m 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

	31.3.17 Actual £m	**31.3.18 Estimate £m**	**31.3.19 Forecast £m**	**31.3.20 Forecast £m**	**31.3.21 Forecast £m**
General Fund CFR	0	0	0	0	0
Total CFR	**0**	**0**	**0**	**0**	**0**
Less: Other debt liabilities	0	0	0	0	0
Borrowing CFR	**0**	**0**	**0**	**0**	**0**
Less: Usable reserves	87,316	94,465	72,369	79,191	102,203
Less: Working capital	-9,258	-7,107	-5,829	-4,361	-4,245
Investments	**78,058**	**87,358**	**66,540**	**74,830**	**97,958**

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

The Authority is currently debt free and its capital expenditure plans do not currently imply any need to borrow over the forecast period. If there are any changes to this position then further reports will be presented to Cabinet.

CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Authority expects to comply with this recommendation during 2018/19.

Borrowing Strategy

The primary legislation which established Combined Authorities made provision for them to receive borrowing powers, akin to those already in place for other local authorities. In the 2016 Budget, the Chancellor of the Exchequer confirmed his intention to enact this provision using secondary legislation. A draft of the 'The Tees Valley Combined Authority (Borrowing) Regulations 2018' Statutory Instrument was laid before **and approved** by a resolution of each House of Parliament at the end of 2017.

The balance sheet forecast in table 1 shows that the Authority does not expected to borrow in 2018/19 but has approved a borrowing commitment of £6.5m in relation to the TAMP scheme. As noted on the Investment Update report presented to Cabinet on the 21st December borrowing is not required until 2021.

The authority currently has an active pipeline of 31 investment proposals amounting to £152m which are currently under review. If borrowing is required for any of these schemes further reports will be presented to Cabinet for consideration.

The Authority may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £100 million.

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

Strategy: The Authority's borrowing strategy will address the key issue of affordability without compromising the longer-term stability of any future debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal / short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Authority with this 'cost of carry' and breakeven analysis. Its output may determine whether the Authority borrows additional sums at long-term fixed rates in 2018/19 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

Alternatively, the Authority may arrange forward starting loans during 2018/19, 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 Authority may borrow short-term loans to cover unplanned cash flow shortages.

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

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

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 Authority when borrowing will investigate all available sources of finance, such as local authority loans and bank loans, to achieve the most favourable rates.

Investment Strategy

The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 7 months, the Authority's investment balance has ranged between £78m and £131 million, and levels are expected to increase in the forthcoming year as spending plans are developed.

Objectives: Both the CIPFA Code and the CLG Guidance require the Authority 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 Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Authority will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

Negative interest rates: If the UK enters into a recession in 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.

Strategy: Given the increasing risk and low returns from short-term unsecured bank investments, the **Authority aims to diversify into more secure and/or higher yielding asset classes during 2018/19**. All of the Authority's surplus cash is currently invested in short-term unsecured bank deposits, with local authorities and money market funds. This diversification will represent a **substantial change in strategy** over the coming year.

Approved counterparties: If the strategy is approved the Authority may invest its surplus funds with any of the counterparty types in table 2 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 2: Approved investment counterparties and limits

Credit rating	Banks unsecured	Banks secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 10 years	n/a	n/a
AAA	£7,500,000 5 years	£15,000,000 10 years	£15,000,000 10 years	£7,500,000 10 years	£7,500,000 10 years

AA+	£7,500,000 5 years	£15,000,000 10 years	£15,000,000 10 years	£7,500,000 10 years	£7,500,000 10 years
AA	£7,500,000 4 years	£15,000,000 5 years	£15,000,000 10 years	£7,500,000 5 years	£7,500,000 10 years
AA-	£7,500,000 3 years	£15,000,000 4 years	£15,000,000 10 years	£7,500,000 4 years	£7,500,000 10 years
A+	£7,500,000 2 years	£15,000,000 3 years	£7,500,000 5 years	£7,500,000 3 years	£7,500,000 5 years
A	£7,500,000 13 months	£15,000,000 2 years	£7,500,000 5 years	£7,500,000 2 years	£7,500,000 5 years
A-	£7,500,000 6 months	£15,000,000 13 months	£7,500,000 5 years	£7,500,000 13 months	£7,500,000 5 years
None	n/a	n/a	£15,000,000 10 years	£5,000,000 5 years	£7,500,000 5 years
Pooled funds	£15m per fund				

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.

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

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

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

Corporates: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made either following an external credit assessment or to a maximum of £5m per company as part of a diversified pool in order to spread the risk widely.

Registered providers: Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing, 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.

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 Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.

Operational bank accounts: The Authority may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £15m per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Authority maintaining operational continuity.

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

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

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

Other information on the security of investments: The Authority understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support 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 Authority will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Authority's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

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, Combined Authority, Police and Crime Commissioner, Fire Authority, parish council or community council, or
  - a body or investment scheme of "high credit quality".

The Authority 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.

Non-specified investments: Any investment not meeting the definition of a specified investment is classed as non-specified. The Authority 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 3 below.

<u>Table 3: Non-specified investment limits</u>

	Cash limit
Total long-term investments	£60m
Total investments without credit ratings or rated below A- (except UK Government and local authorities)	£40m

Total investments (except pooled funds) with institutions domiciled in foreign countries rated below AA+	£0m
Total non-specified investments	£100m

Investment limits: The Authority's revenue reserves available to cover investment losses will be set at £692,000 on 31st March 2018. The maximum that will be lent to any one organisation (other than the UK Government) will be £15 million Based on table 4 below. 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, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table 4: Investment limits

	Cash limit
Any single organisation, except the UK Central Government	£15,000,000
UK Central Government	unlimited
Any group of organisations under the same ownership	£15,000,000
Any group of pooled funds under the same management	£37,500,000
Negotiable instruments held in a broker's nominee account	£37,500,000
Foreign countries	£15,000,000
Registered providers	£37,500,000
Unsecured investments with building societies	£15,000,000
Loans to unrated corporates	£15,000,000
Money Market Funds	£75,000,000

Liquidity management: The Authority uses cash flow forecasting to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Authority's medium term financial plan and cash flow forecast.

Non-Treasury Investments

Although not classed as treasury management activities and therefore not covered by the CIPFA Code or the CLG Guidance, the Authority may also purchase property for investment purposes and may also make loans and investments for service purposes, for example in shared ownership housing, as loans to local businesses through the **new business finance facility**, or as equity investments.

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

Investments that are not part of Treasury Management Activity

Where, in addition to treasury management investment activity, organisations invest in other financial assets and property primarily for financial return, these investments should be proportional to the level of resources available to the organisation and the organisation should ensure that the same robust procedures for the consideration of risk and return are applied to these decisions.

The Authority recognises that investment in other financial assets and property primarily for financial return, taken for non-treasury management purposes, requires careful investment management. Such activity includes loans supporting service outcomes, investments in subsidiaries, and investment property portfolios.

The Authority will ensure that all the organisation's investments are covered in the capital strategy, investment strategy or equivalent, and will set out, where relevant, the organisation's risk appetite and specific policies and arrangements for non-treasury investments. It will be recognised that the risk appetite for these activities may differ from that for treasury management.

Treasury Management Indicators

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

Interest rate exposures: This indicator is set to control the Authority's exposure to interest rate risk:

	2018/19	2019/20	2020/21
Upper limit on fixed interest rate exposure	£20m	£20m	£20m
Upper limit on variable interest rate exposure	£20m	£20m	£20m

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.

Maturity structure of borrowing: This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	Upper	Lower
Under 12 months	25%	0%
12 months and within 24 months	40%	0%
24 months and within 5 years	60%	0%
5 years and within 10 years	80%	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.

Principal sums invested for periods longer than 364 days: The purpose of this indicator is to control the Authority'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:

	2018/19	**2019/20**	**2020/21**
Limit on principal invested beyond year end	£60m	£40m	£20m

Other Items

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

Policy on the use of financial derivatives: In the absence of any explicit legal power to do so, the Authority will not use standalone financial derivatives (such as swaps, forwards, futures and options). Derivatives embedded into loans and investments, including pooled funds and forward starting transactions, may be used, and the risks that they present will be managed in line with the overall treasury risk management strategy.

Investment training: The needs of the Authority's treasury management staff for training in investment management are assessed 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, or other appropriate organisations.

Investment advisers: The Authority has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues.

Investment of money borrowed in advance of need: The Authority 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 Authority 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 Authority's overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit of £100 million. The maximum period between borrowing and expenditure is expected to be two years, although the Authority is not required to link particular loans with particular items of expenditure.

Financial Implications

The budget for investment income in 2018/19 is £200,000 based on an average investment portfolio of £90 million. As the Authority is not expected to enter into any borrowing arrangements in 2018/19 the budget for debt interest is £0 million. If actual levels of investments and borrowing differ from those forecast, performance against budget will be correspondingly different.

Prudential Indicators and Minimum Revenue Provision (MRP)

The Authority has also regulatory requirements with regards to the publishing of prudential indicators and the MRP Statement. These are attached at ***Appendix C***.

Other Options Considered

The CLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Finance Director believes that the above strategy represents an appropriate balance between risk management and cost effectiveness.

Schedule 1 – Arlingclose Economic & Interest Rate Forecast February 2018

Underlying assumptions:

- The MPC has raised expectations for further rises in Bank Rate, both sooner and to a higher level than previously anticipated by markets. Reiterating the view of the UK economy's impaired supply capacity and survey data of higher private sector earnings growth, meaning inflationary outcomes are more likely, the MPC also revised the UK's economic growth prospects slightly higher due to the pull of global economic momentum.

- Significantly, the MPC also decided to shorten the forecast horizon over which inflation will be brought back to the CPI target.

- The MPC believes that soft domestic consumption will recover as the inflationary impact of weaker sterling fades. Their projections assume that households and companies base their decisions on a smooth adjustment to the new trading relationship with the EU.

- However, the additional moves made by the Bank to intentionally raise interest rate expectations suggests a wider strategy. By moving quickly and creating the conditions for monetary tightening, monetary policy will be a more effective weapon should downside Brexit risks crystallise.

- Our view is that the UK economy still 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 Q4 2017 GDP growth was 0.5%, after a 0.4% expansion in Q2. Household consumption growth has softened, despite high employment and low saving rates. Housing markets are soft. Nevertheless, we cannot disregard the MPC's forceful intent and signal in the February Inflation Report and accompanying commentary.

- The depreciation in sterling is assisting the economy to rebalance away from spending. Export volumes have increased, helped by a stronger global and Eurozone economic expansions.

- 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.

Forecast:

- Over the near term, Arlingclose must forecast the MPC's actions rather than the expected level of monetary policy given our assessment of the UK economy. There is clear momentum on the MPC for higher Bank Rate and this is likely to crystallise from May 2018.

- The MPC has heightened expectations of more increases in Bank Rate and at a quicker pace despite only modest changes in inflation and growth forecasts, based on the Bank's perceptions of impaired supply capacity and a desire to bring inflation back to target more quickly.

- Our central case is for Bank Rate is to rise twice in 2018 and once more in the first half of 2019. The risks are weighted to the downside.

- Gilt yields have risen but remain historically low; current yields already incorporate higher Bank Rate expectations, so we expect little further upward movement.

	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Average
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	**0.17**
Arlingclose Central Case	**0.50**	**0.75**	**0.75**	**1.00**	**1.00**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.08**
Downside risk	0.00	-0.25	-0.25	-0.50	-0.50	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	**-0.58**
3-month LIBID rate														
Upside risk	0.00	0.05	0.10	0.10	0.20	0.20	0.25	0.25	0.30	0.35	0.35	0.35	0.35	**0.22**
Arlingclose Central Case	**0.50**	**0.75**	**0.85**	**1.00**	**1.10**	**1.35**	**1.35**	**1.35**	**1.35**	**1.30**	**1.30**	**1.30**	**1.30**	**1.14**
Downside risk	0.00	-0.25	-0.30	-0.40	-0.50	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	**-0.57**
1-yr LIBID rate														
Upside risk	0.05	0.10	0.20	0.20	0.30	0.30	0.35	0.35	0.40	0.50	0.50	0.50	0.50	**0.33**
Arlingclose Central Case	**0.70**	**0.95**	**1.10**	**1.30**	**1.40**	**1.65**	**1.65**	**1.60**	**1.55**	**1.50**	**1.50**	**1.50**	**1.50**	**1.38**
Downside risk	0.00	-0.25	-0.30	-0.40	-0.50	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	**-0.57**
5-yr gilt yield														
Upside risk	0.20	0.20	0.20	0.20	0.20	0.25	0.35	0.40	0.40	0.40	0.40	0.40	0.40	**0.31**
Arlingclose Central Case	**1.15**	**1.35**	**1.40**	**1.50**	**1.55**	**1.60**	**1.65**	**1.70**	**1.70**	**1.70**	**1.65**	**1.65**	**1.65**	**1.56**
Downside risk	-0.10	-0.30	-0.35	-0.45	-0.50	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	**-0.50**
10-yr gilt yield														
Upside risk	0.15	0.20	0.20	0.20	0.25	0.25	0.35	0.35	0.40	0.40	0.40	0.40	0.40	**0.30**
Arlingclose Central Case	**1.65**	**1.80**	**1.85**	**1.90**	**2.00**	**2.05**	**2.10**	**2.15**	**2.15**	**2.15**	**2.05**	**2.05**	**2.05**	**2.00**
Downside risk	-0.10	-0.30	-0.35	-0.45	-0.50	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	**-0.50**
20-yr gilt yield														
Upside risk	0.15	0.20	0.20	0.20	0.25	0.25	0.35	0.35	0.40	0.40	0.40	0.40	0.40	**0.30**
Arlingclose Central Case	**2.00**	**2.10**	**2.15**	**2.15**	**2.20**	**2.25**	**2.25**	**2.20**	**2.15**	**2.20**	**2.20**	**2.20**	**2.20**	**2.17**
Downside risk	-0.10	-0.30	-0.35	-0.45	-0.50	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	**-0.50**
50-yr gilt yield														
Upside risk	0.15	0.20	0.20	0.20	0.25	0.25	0.35	0.35	0.40	0.40	0.40	0.40	0.40	**0.30**
Arlingclose Central Case	**1.80**	**1.95**	**2.00**	**2.00**	**2.05**	**2.10**	**2.10**	**2.05**	**2.00**	**2.05**	**2.05**	**2.05**	**2.05**	**2.02**
Downside risk	-0.10	-0.30	-0.35	-0.45	-0.50	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	**-0.50**

Appendix B – Existing Investment Portfolio Position

Counterparty	Amount £	Rate %	Start Date	Maturity Date
Bank Of Scotland	5,000,000	0.50%	06-Dec-17	06-Mar-18
Bank of Scotland	5,000,000	0.36%	06-Oct-17	06-Apr-18
Coventry BS	5,000,000	0.44%	11-Oct-17	11-Apr-18
Goldman Sachs	5,000,000	0.38%	29-Dec-17	06-Apr-18
Santander	10,000,000	0.40%	12-Oct-16	95 Day Notice
Standard Life	10,000,000	Variable	06-Oct-16	Money Market Fund
Federated	10,000,000	Variable	06-Oct-16	Money Market Fund
Blackrock	4,000,000	Variable	07-Dec-16	Money Market Fund
Blackpool BC	3,000,000	0.27%	11-Sep-17	11-Jan-18
Leeds	5,000,000	0.40%	19-Oct-17	19-Apr-18
Newham	5,000,000	0.30%	30-Oct-17	29-Mar-18
Northamptonshire	5,000,000	0.55%	05-Oct-17	05-Jul-18
Slough	5,000,000	0.38%	28-Sep-17	28-Feb-18
Stirling	3,000,000	0.50%	23-Nov-17	23-May-18
Suffolk County	5,000,000	0.45%	05-Dec-17	05-Mar-18
Surrey Heath	2,000,000	0.50%	22-Nov-17	22-May-18
Merthyr Tidfil	5,000,000	0.50%	22-Dec-17	23-Apr-18
Telford & Wrekin	5,000,000	0.27%	07-Sep-17	08-Jan-18
	97,000,000	**0.41%**		

Appendix C - Prudential Indicators 2018/19

The Local Government Act 2003 requires the Authority to have regard to the Chartered Institute of Public Finance and Accountancy's *Prudential Code for Capital Finance in Local Authorities* (the Prudential Code) when determining how much money it can afford to borrow.

The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Authority has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

Estimates of Capital Expenditure: The Authority's planned capital expenditure and financing may be summarised as follows.

Capital Expenditure and Financing	**2017/18 Revised £m**	**2018/19 Estimate £m**	**2019/20 Estimate £m**	**2020/21 Estimate £m**
Business Growth	6,989	1,500	1,750	1,750
Research, Development, Innovation & Energy	6,600	13,400	9,000	0
Education, Employment & Skills	4,288	5,332	0	0
Transport	19,866	18,877	16,352	13,952
Infrastructure	4,883	0	0	0
Development & Evaluation	6,883	0	0	0
Total Expenditure	**49,509**	**39,109**	**27,102**	**15,702**
Government Grants	49,509	39,109	27,102	15,702
Reserves	0	0	0	0
Revenue	0	0	0	0
Borrowing	0	0	0	0
Total Financing	**49,509**	**39,109**	**27,102**	**15,702**

Estimates of Capital Financing Requirement: The Capital Financing Requirement (CFR) measures the Authority's underlying need to borrow for a capital purpose.

Capital Financing Requirement	**31.03.18 Revised £m**	**31.03.19 Estimate £m**	**31.03.20 Estimate £m**	**31.03.21 Estimate £m**

General Fund	0	0	0	0
Total CFR	**0**	**0**	**0**	**0**

The CFR is forecast to remain at £0 over the next three years as capital expenditure is fully financed through grants.

Gross Debt and the Capital Financing Requirement: In order to ensure that over the medium term debt will only be for a capital purpose, the Authority should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.

Debt	**31.03.18 Revised £m**	**31.03.19 Estimate £m**	**31.03.20 Estimate £m**	**31.03.21 Estimate £m**
Borrowing	0	0	0	0
Finance leases	0	0	0	0
PFI liabilities	0	0	0	0
Transferred debt	0	0	0	0
Total Debt	**0**	**0**	**0**	**0**

As all current planned capital expenditure is fully financed total debt is expected to remain below the CFR during the forecast period.

Operational Boundary for External Debt: The operational boundary is based on the Authority's estimate of most likely (i.e. prudent but not worst case) scenario for external debt. It links directly to the Authority's estimates of capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring. Other long-term liabilities comprise finance lease, Private Finance Initiative and other liabilities that are not borrowing but form part of the Authority's debt.

Operational Boundary	**2017/18 Revised £m**	**2018/19 Estimate £m**	**2019/20 Estimate £m**	**2020/21 Estimate £m**
Borrowing	0	75	75	75
Other long-term liabilities	0	0	0	0
Total Debt	**0**	**75**	**75**	**75**

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 Authority can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Authorised Limit	**2017/18 Limit £m**	**2018/19 Limit £m**	**2019/20 Limit £m**	**2020/21 Limit £m**
Borrowing	10	100	100	100
Other long-term liabilities	0	**0**	0	0
Total Debt	**10**	**100**	**100**	**100**

Ratio of Financing Costs to Net Revenue Stream: This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Ratio of Financing Costs to Net Revenue Stream	**2017/18 Revised %**	**2018/19 Estimate %**	**2019/20 Estimate %**	**2020/21 Estimate %**
General Fund	0	0	0	0

Adoption of the CIPFA Treasury Management Code: The Authority adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition*. It fully complies with the Codes recommendations.

FINANCIAL IMPLICATIONS

Treasury Management Investment activity during 2018/19 is budgeted to generated income of £200k.

LEGAL IMPLICATIONS

None.

RISK ASSESSMENT

This Treasury Management Strategy annual report is categorised as low to medium risk. Existing management systems and daily routine activities are sufficient to control and reduce risk.

CONSULTATION

Not applicable.

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