

# North Norfolk District Council Treasury Management Strategy Statement 2020/21

- Summary: This report sets out details of the Council’s treasury management activities and presents a strategy for the prudent investment of the Council’s surplus funds, as well as external borrowing.
- Options Considered: Alternative investment and debt options are continuously appraised by the Council’s treasury advisors, Arlingclose and all appropriate options are included within this Strategy.
- Conclusions: The preparation of this Strategy Statement is necessary to comply with the Chartered Institute of Public Finance and Accountancy’s Code of Practice for Treasury Management in Public Services.
- Recommendations: That the Council be asked to RESOLVE that The Treasury Management Strategy Statement is approved.
- Reasons for Recommendation: The Strategy provides the Council with a flexible treasury strategy enabling it to respond to changing market conditions and ensure the security of its funds, as well as secure borrowing at the best value.

|  |                       |
|--|-----------------------|
| Cabinet Member(s)<br>Cllr E Seward                                   | Ward(s) affected: All |
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## **Introduction**

Treasury management is the management of the Authority’s cash flows, borrowing and investments, and the associated risks. The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Authority’s prudent financial management.

Treasury risk management at the Authority is conducted within the framework of the Chartered Institute of Public Finance and Accountancy’s *Treasury Management in the Public Services: Code of Practice 2017 Edition* (the CIPFA Code) which requires the Authority to approve a treasury management 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 the CIPFA Code.

Investments held for service purposes or for commercial profit are considered in a different report, the Investment Strategy.

## **External Context**

**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 Authority's treasury management strategy for 2020/21.

UK Consumer Price Inflation (CPI) for September registered 1.7% year on year, unchanged from the previous month. Core inflation, which excludes the more volatile components, rose to 1.7% from 1.5% in August.

GDP growth rose by 0.3% 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 1.0% from 1.2%. Looking ahead, the Bank of England's Monetary Policy Report (formerly the Quarterly Inflation Report) 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 Bank of England maintained Bank Rate to 0.75% in November following a 7-2 vote by the Monetary Policy Committee. Despite keeping rates on hold, MPC members did confirm that if Brexit uncertainty drags on or global growth fails to recover, they are prepared to cut interest rates as required. Moreover, the downward revisions to some of the growth projections in the Monetary Policy Report suggest the Committee may now be less convinced of the need to increase rates even if there is a Brexit deal.

**Credit outlook:** Credit conditions for larger UK banks have remained relatively benign over the past year. The UK's departure from the European Union was delayed three times in 2019 and while there remains some concern over a global economic slowdown, this has yet to manifest in any credit issues for banks. Meanwhile, the post financial crisis banking reform is now largely complete, with the new ringfenced banks embedded in the market.

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 remains advisable.

**Interest rate forecast:** The Authority'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 upcoming general election, 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.

For the purpose of setting the budget, it has been assumed that new treasury management investments will be made at an average rate of 3.3%, and that new long-term loans will be borrowed at an average rate of 2.74%.

### **Local Context**

On 31<sup>st</sup> December 2019, the Authority held £7.5m of borrowing and £37.7m of treasury 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*

|                             | <b>31.3.19<br/>Actual<br/>£m</b> | <b>31.3.20<br/>Estimate<br/>£m</b> | <b>31.3.21<br/>Forecast<br/>£m</b> | <b>31.3.22<br/>Forecast<br/>£m</b> | <b>31.3.23<br/>Forecast<br/>£m</b> |
|-----------------------------|----------------------------------|------------------------------------|------------------------------------|------------------------------------|------------------------------------|
| General Fund CFR            | 3.110                            | 2.841                              | 14.467                             | 15.130                             | 14.110                             |
| Less: External borrowing ** | 0.000                            | 0.000                              | -11.198                            | -12.077                            | -11.326                            |
| <b>Internal borrowing</b>   | <b>3.110</b>                     | <b>2.841</b>                       | <b>3.269</b>                       | <b>3.053</b>                       | <b>2.784</b>                       |
| Less: Usable reserves       | -29.909                          | -24.581                            | -19.029                            | -17.617                            | -16.649                            |
| Less: Working capital       | -14.358                          | -14.358                            | -14.358                            | -14.358                            | -14.358                            |
| <b>Treasury investments</b> | <b>41.156</b>                    | <b>36.098</b>                      | <b>30.118</b>                      | <b>28.922</b>                      | <b>28.222</b>                      |

\* leases and PFI liabilities that form part of the Authority's total debt

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

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 is currently debt free although its capital expenditure plans do currently imply a need to borrow over the forecast period. Investments are forecast to fall as capital receipts are used to finance capital expenditure.

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 2020/21.

### **Borrowing Strategy**

The Authority currently holds £7.5m of short-term loans, an increase of £4.5 million on the previous year, as part of its strategy for funding temporary shortfalls in cash flow.

The balance sheet forecast in table 1 shows that the Authority expects to borrow up to £11.198m in 2020/21. The Authority may also borrow additional sums to pre-fund future capital years' requirements, providing this does not exceed the authorised limit for borrowing.

**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:** Given the significant cuts to public expenditure and in particular to local government funding, the Authority'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, 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 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 2020/21 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

The Authority has previously raised long-term borrowing from the PWLB but the government increased PWLB rates by 1% in October 2019 making it now a relatively expensive options. The Authority will now look to borrow any long-term loans from other sources including banks, pensions and local authorities, and will investigate the possibility

of issuing 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.

Alternatively, the Authority may arrange forward starting loans, 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 further 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
- any other UK public sector body
- UK public and private sector pension funds (except Norfolk 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:

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

**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 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.

**Short-term and variable rate loans:** These loans leave the Authority exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below. Financial derivatives may be used to manage this interest rate risk (see section below).

**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 Authority may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

### **Investment Strategy**

The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Authority's investment balance has ranged between £32.030 and £46.985 million, and similar levels are expected to be maintained in the forthcoming year.

**Objectives:** The CIPFA Code requires 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 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.

**Strategy:** Given the increasing risk and very low returns from short-term unsecured bank investments, the Authority aims to further diversify into more secure and/or higher yielding asset classes during 2020/21. A dwindling proportion of the Authority's surplus cash remains invested in short-term unsecured bank deposits, and money market funds. This diversification will represent a continuation of the current strategy.

**Business models:** Under the new IFRS 9 standard, the accounting for certain investments depends on the Authority's "business model" for managing them. The Authority aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

**Approved counterparties:** The Authority may invest its surplus funds with any of the counterparty types in table 3 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 3: Approved investment counterparties and limits

| Credit rating   | Banks unsecured  | Banks secured          | Government              | Corporates          | Registered Providers |
|---|------------------|------------------------|-------------------------|---------------------|----------------------|
| UK Govt   | n/a              | n/a                    | £ Unlimited<br>50 years | n/a                 | n/a                  |
| AAA   | £2m<br>5 years   | £4m<br>20 years        | £4m<br>50 years         | £2m<br>20 years     | £2m<br>20 years      |
| AA+   | £2m<br>5 years   | £4m<br>10 years        | £4m<br>25 years         | £2m<br>10 years     | £2m<br>10 years      |
| AA  | £2m<br>4 years   | £4m<br>5 years         | £4m<br>15 years         | £2m<br>5 years      | £2m<br>10 years      |
| AA-   | £2m<br>3 years   | £4m<br>4 years         | £4m<br>10 years         | £2m<br>4 years      | £2m<br>10 years      |
| A+  | £2m<br>2 years   | £4m<br>3 years         | £4m<br>5 years          | £2m<br>3 years      | £2m<br>5 years       |
| A   | £2m<br>13 months | £4m<br>2 years         | £4m<br>5 years          | £2m<br>2 years      | £2m<br>5 years       |
| A-  | £2m<br>6 months  | £4m<br>13 months       | £4m<br>5 years          | £2m<br>13 months    | £2m<br>5 years       |
| None  | £1m<br>6 months  | n/a                    | £3m<br>25 years         | £500,000<br>5 years | £3m<br>5 years       |
| <b>Pooled funds and real estate investment trusts</b> |                  | £10m per fund or trust |                         |                     |                      |

This table must be read in conjunction with the notes below

**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.

**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 generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

**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 following an external credit assessment and 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 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.

**Pooled funds:** Shares or units 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.

**Real estate investment trusts:** Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties. Investments in REIT shares cannot be withdrawn but can be sold on the stock market to another investor.

**Operational bank accounts:** The Authority may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £2m 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, reports in the quality financial press and analysis and advice from the Authority'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 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.

**Investment limits:** The Authority has revenue reserves available to cover investment losses. In order that only an acceptable level of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £6 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, 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*

|   | <b>Cash limit</b> |
|---|-------------------|
| Any single organisation, except the UK Central Government | £6m each          |
| UK Central Government                                     | unlimited         |
| Any group of organisations under the same ownership       | £6m per group     |
| Any group of pooled funds under the same management       | £15m per manager  |
| Negotiable instruments held in a broker's nominee account | £10m per broker   |
| Foreign countries   | £6m per country   |
| Registered providers and registered social landlords      | £10m in total     |
| Unsecured investments with building societies             | £5m in total      |
| Loans to unrated corporates                               | £5m in total      |
| Money market funds  | £16m in total     |
| Real estate investment trusts                             | £10m in total     |

**Liquidity management:** The Authority uses purpose-built cash flow forecasting tools 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.

### **Treasury Management Indicators**

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

**Security:** The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit score of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

| Credit risk indicator          | Target |
|--------------------------------|--------|
| Portfolio average credit score | 6.0    |

**Liquidity:** The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount it can borrow each quarter without giving prior notice.

| Liquidity risk indicator                                 | Target |
|--|--------|
| Total sum borrowed in past 3 months without prior notice | £10m   |

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

| Interest rate risk indicator   | Limit    |
|--|----------|
| Upper limit on one-year revenue impact of a 1% <u>rise</u> in interest rates | £600,000 |
| Upper limit on one-year revenue impact of a 1% <u>fall</u> in interest rates | £600,000 |

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

**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 borrowing will be:

| Refinancing rate risk indicator | Upper limit | Lower limit |
|---------------------------------|-------------|-------------|
| Under 12 months                 | 100%        | 0%          |
| 12 months and within 24 months  | 100%        | 0%          |
| 24 months and within 5 years    | 100%        | 0%          |
| 5 years and within 10 years     | 100%        | 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 a year:** 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:

| <b>Price risk indicator</b>                 | <b>2020/21</b> | <b>2021/22</b> | <b>2022/23</b> |
|---|----------------|----------------|----------------|
| Limit on principal invested beyond year end | £50m           | £50m           | £50m           |

### **Related Matters**

The CIPFA Code requires the Authority to include the following in its treasury management strategy.

**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 Authority 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 Authority 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 Authority will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.

**Markets in Financial Instruments Directive:** The Authority has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Authority’s treasury management activities, the Chief Financial Officer believes this to be the most appropriate status.

## **Financial Implications**

The budget for investment income in 2020/21 is £1.3 million, based on an average investment portfolio of £40.1 million at an interest rate of 3.3%. The budget for debt interest paid in 2020/21 is £0.4 million, based on an average debt portfolio of £13.9 million at an average interest rate of 2.58%. If actual levels of investments and borrowing, or actual interest rates, differ from those forecast, performance against budget will be correspondingly different.

## **Other Options Considered**

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

| <b>Alternative</b>  | <b>Impact on income and expenditure</b>  | <b>Impact on risk management</b>  |
|---|--|---|
| Invest in a narrower range of counterparties and/or for shorter times | Interest income will be lower  | Lower chance of losses from credit related defaults, but any such losses may be greater   |
| Invest in a wider range of counterparties and/or for longer times     | Interest income will be higher   | Increased risk of losses from credit related defaults, but any such losses may be smaller   |
| Borrow additional sums at long-term fixed interest rates              | Debt interest costs will rise; this is unlikely to be offset by higher investment income | Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain            |
| Borrow short-term or variable loans instead of long-term fixed rates  | Debt interest costs will initially be lower  | Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain |
| Reduce level of borrowing   | Saving on debt interest is likely to exceed lost investment income                       | Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain            |

## **Appendix A – Arlingclose Economic & Interest Rate Forecast November 2019**

### **Underlying assumptions:**

- The global economy is entering a period of slower growth in response to political issues, primarily the trade policy stance of the US. The UK economy has displayed a marked slowdown in growth due to both Brexit uncertainty and the downturn in global activity. In response, global and UK interest rate expectations have eased.
- Some positivity on the trade negotiations between China and the US has prompted worst case economic scenarios to be pared back. However, information is limited, and upbeat expectations have been wrong before.
- Brexit has been delayed until 31 January 2020. While the General Election has maintained economic and political uncertainty, the opinion polls suggest the Conservative position in parliament may be strengthened, which reduces the chance of Brexit being further frustrated. A key concern is the limited transitional period following a January 2020 exit date, which will maintain and create additional uncertainty over the next few years.
- UK economic growth has stalled despite Q3 2019 GDP of 0.3%. Monthly figures indicate growth waned as the quarter progressed and survey data suggest falling household and business confidence. Both main political parties have promised substantial fiscal easing, which should help support growth.
- While the potential for divergent paths for UK monetary policy remain in the event of the General Election result, the weaker external environment severely limits potential upside movement in Bank Rate, while the slowing UK economy will place pressure on the MPC to loosen monetary policy. Indeed, two MPC members voted for an immediate cut in November 2019.
- Inflation is running below target at 1.7%. While the tight labour market risks medium-term domestically-driven inflationary pressure, slower global growth should reduce the prospect of externally driven pressure, although political turmoil could push up oil prices.
- Central bank actions and geopolitical risks will continue to produce significant volatility in financial markets, including bond markets.

### **Forecast:**

- Although we have maintained our Bank Rate forecast at 0.75% for the foreseeable future, there are substantial risks to this forecast, dependant on General Election outcomes and the evolution of the global economy.
- Arlingclose judges that the risks are weighted to the downside.

- Gilt yields have risen but 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.

|                                  | Dec-19 | Mar-20 | Jun-20 | Sep-20 | Dec-20 | Mar-21 | Jun-21 | Sep-21 | Dec-21 | Mar-22 | Jun-22 | Sep-22 | Dec-22 | Average |
|----------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------|
| <b>Official Bank Rate</b>        |        |        |        |        |        |        |        |        |        |        |        |        |        |         |
| Upside risk                      | 0.00   | 0.00   | 0.25   | 0.25   | 0.25   | 0.25   | 0.25   | 0.25   | 0.25   | 0.25   | 0.25   | 0.25   | 0.25   | 0.21    |
| 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   | 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  | -0.73   |
| <b>3-month money market rate</b> |        |        |        |        |        |        |        |        |        |        |        |        |        |         |
| 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   | 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   | 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  | -0.73   |
| <b>1yr money market rate</b>     |        |        |        |        |        |        |        |        |        |        |        |        |        |         |
| 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   | 0.23    |
| 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   | 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  | -0.60   |
| <b>5yr gilt yield</b>            |        |        |        |        |        |        |        |        |        |        |        |        |        |         |
| 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   | 0.37    |
| Arlingclose Central Case         | 0.50   | 0.50   | 0.50   | 0.55   | 0.60   | 0.60   | 0.60   | 0.60   | 0.60   | 0.60   | 0.60   | 0.60   | 0.60   | 0.57    |
| Downside risk                    | -0.35  | -0.50  | -0.50  | -0.55  | -0.60  | -0.60  | -0.60  | -0.60  | -0.60  | -0.60  | -0.60  | -0.60  | -0.60  | -0.56   |
| <b>10yr gilt yield</b>           |        |        |        |        |        |        |        |        |        |        |        |        |        |         |
| 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   | 0.37    |
| Arlingclose Central Case         | 0.75   | 0.75   | 0.80   | 0.80   | 0.85   | 0.85   | 0.90   | 0.90   | 0.95   | 0.95   | 1.00   | 1.00   | 1.00   | 0.88    |
| 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  | -0.45   |
| <b>20yr gilt yield</b>           |        |        |        |        |        |        |        |        |        |        |        |        |        |         |
| 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   | 0.37    |
| Arlingclose Central Case         | 1.20   | 1.20   | 1.25   | 1.25   | 1.25   | 1.30   | 1.30   | 1.30   | 1.35   | 1.35   | 1.35   | 1.40   | 1.40   | 1.30    |
| 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  | -0.45   |
| <b>50yr gilt yield</b>           |        |        |        |        |        |        |        |        |        |        |        |        |        |         |
| 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   | 0.37    |
| Arlingclose Central Case         | 1.20   | 1.20   | 1.25   | 1.25   | 1.25   | 1.30   | 1.30   | 1.30   | 1.35   | 1.35   | 1.35   | 1.40   | 1.40   | 1.30    |
| 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  | -0.45   |

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 at 31/12/2019

|                                   | Actual Portfolio<br>£m | Average Rate<br>% |
|-----------------------------------|------------------------|-------------------|
| <b>External borrowing:</b>        |                        |                   |
| Local authorities short-term      | 7.5                    | 0.76%             |
| <b>Total gross external debt</b>  | <b>7.5</b>             | <b>0.76%</b>      |
| <b>Treasury investments:</b>      |                        |                   |
| Money Market Funds                | 5.655                  | 0.74%             |
| Pooled funds                      | 32.000                 | 3.38%             |
| <b>Total treasury investments</b> | <b>37.655</b>          | <b>2.98%</b>      |
| <b>Net debt</b>                   | <b>30.155</b>          |                   |