Bournemouth, Christchurch and Poole Council (BCP) Treasury Management Strategy Statement 2019/20

Introduction

Local Government Reorganisation in Dorset

1 Dorset's existing nine councils will be replaced with two new unitary councils from April 2019, with Bournemouth Borough Council, the Borough of Poole and Christchurch Borough Council forming one unitary council, and the six other councils forming the other.

2 It will therefore be necessary to 'disaggregate' existing investments and borrowings attributable to Christchurch Borough Council from the County Council's assets and liabilities. The process for doing this is being developed and agreed during 2018/19, in common with other services and activities of the County Council provided to Christchurch Borough Council.

Background

3 The Council defines its treasury management activities as: "The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks." Part of the treasury management operation is to ensure that the cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

4 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

5 Revised reporting is required for the 2019/20 reporting cycle due to revisions of the MHCLG Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code. The primary reporting changes include the introduction of a capital strategy, to provide a longer-term focus to the capital plans, and greater reporting requirements surrounding any commercial activity undertaken under the Localism Act 2011. The capital strategy is being reported separately.

Reporting Requirements

6 **Capital Strategy** - The CIPFA revised 2017 Prudential and Treasury Management Codes require, for 2019-20, all local authorities to prepare an additional report, a capital strategy report, which will provide the following:

- a high-level long term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services

- an overview of how the associated risk is managed
- the implications for future financial sustainability

The aim of this capital strategy is to ensure that all elected members on the full Council fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

This capital strategy is reported separately from the Treasury Management Strategy Statement; non-treasury investments will be reported through the former. This ensures the separation of the core treasury function under security, liquidity and yield principles, and the policy and commercialism investments usually driven by expenditure on an asset.

7 The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

8 **Prudential and treasury indicators and treasury strategy** - The first, and most important report covers:

a The capital plans (including prudential indicators);

b A minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);

c The treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and

d An investment strategy (the parameters on how investments are to be managed).

9 **Quarterly treasury management report** – This will update members with the progress of the capital position, amending prudential indicators if necessary, and whether any policies require revision. The reports will be presented to a yet to be formed committee for the BCP authority.

10 **An annual treasury management report** – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

11 The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the yet to be be formed committee for the BCP authority.

Treasury Management Strategy for 2019/20

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

Capital issues

- the capital plans and the prudential indicators;
- the minimum revenue provision (MRP) policy.

Treasury management issues

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;

- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

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

Training

14 The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsibe for scrutiny. Training will be organised alongside the Council's Treasury Management advisors and will be organised for members following the formation of the Bournemouth, Christchurch and Poole Authority in 2019/20.

15 The training needs of treasury management officers are periodically reviewed.

Treasury management consultants

16 Currently Bournemouth uses Link Asset Services and Christchurch and Poole use Arlingclose as its external treasury management advisors. The Finance team for Bournemouth and Poole and Christchurch are currently undertaking a tender to ensure one supplier is in place by the 1st April 2019.

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

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

The Capital Prudential Indicators 2019/20 – 2020/21

19 The Council's capital expenditure plans have a key influence over the treasury management activity. The capital expenditure plans are reflected in the prudential indicators, which are designed to assist members' in considering the impact and risk of this Council's capital expenditure plans. As the BCP authority is yet to be established the capital plans are limited to 3 years. These will be extended and represented once the BCP authority has established itself.

Capital expenditure

20 This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts:

Capital expenditure	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000
General Fund	112,749	87,456	18,112
Commercial activities/ non-financial investments	145,296	-	-
HRA	35,073	35,938	45,300
Total	**293,118**	**123,394**	**63,412**

* Commercial activities / non-financial investments relate to areas such as capital expenditure on investment properties, loans to third parties etc.

21 The tables below summarise the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

General Fund and Commercial Activity Capital Expenditure

Capital expenditure	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000
General Fund Total	**258,045**	**87,456**	**18,112**
Financed by:			
Capital receipts	5,571	5,564	-
Capital grants & Contributions	47,962	37,527	8,299
Other Contributions	7,168	7,033	500
Reserve Contributions	10,821	9,063	2,262
Internal Borrowing	41,227	28,269	7,051
External Borrowing	145,296	-	-
Total financing for the year	**258,045**	**87,456**	**18,112**

HRA Capital Expenditure

Capital expenditure	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000
HRA Total	**35,073**	**35,938**	**45,300**
Financed by:			
Capital receipts	5,919	4,044	6,438
Major Repairs Allowance	28,830	22,553	23,890
Other Contributions	60	7,382	6,252
Internal Borrowing	264	1,959	8,720
External Borrowing	-	-	-
Total financing for the year	**35,073**	**35,938**	**45,300**

The Council's borrowing need (the Capital Financing Requirement)

22 The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

23 The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life, and so charges the economic consumption of capital assets as they are used.

24 The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes.

25 The Council is asked to approve the CFR projections overleaf:

	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000
Capital Financing Requirement			
CFR – General Fund	289,220	309,401	331,541
CFR – HRA	144,995	146,954	155,674
Total CFR	**434,215**	**456,355**	**487,215**
Movement in CFR	33,698	22,140	7,682
Movement in CFR represented by			
Net movement in borrowing for the year (above)	41,491	30,229	15,771
Less MRP/VRP and other financing movements	(7,793)	(8,089)	(8,089)
Movement in CFR	**33,698**	**22,140**	**7,682**

26 A key aspect of the regulatory and professional guidance is that elected members are aware of the size and scope of any commercial activity in relation to the authority's overall financial position. The capital expenditure figures and the details above demonstrate the scope of this activity and, by approving these figures; consider the scale proportionate to the Authority's remaining activity.

Minimum Revenue Provision (MRP) policy statement

27 The Council is required to make a Minimum Revenue Provision (MRP). It is a statutory requirement to make a charge to the Council's General Fund to make provision for the repayment of the Council's past capital debt and other credit liabilities.

28 MHCLG regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement.

29 For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be either:

- **Existing practice** - MRP will follow the existing practice outlined in former CLG regulations (option 1);
- **Based on CFR** – MRP will be based on the CFR (option 2);

30 These options provide for an approximate 4% reduction in the borrowing need (CFR) each year.

31 From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be either:

- **Asset life method** – MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction) (option 3);

- **Depreciation method** – MRP will follow standard depreciation accounting procedures (option 4);

32 The type of approach intended by the MRP guidance is clearly to enable local circumstances and discretion to play a part, as the guidance in general contains a set of recommendations rather than representing a prescriptive process. The guidance makes it clear that councils can follow an alternative approach, provided they still make a prudent provision.

33 It was agreed by members of previous Councils that the following MRP policy was applied from 2016/17 onwards:

- In respect of all supported borrowing, capital expenditure incurred prior to 2016/17 (excluding assets acquired under PFI or finance lease arrangements) MRP will be provided at a rate of 2% on a straight line basis to ensure the balance is fully cleared over the period in line with the useful life of the assets the debt services.
- In respect of all unsupported borrowing, capital expenditure incurred prior to 2016/17 (excluding assets acquired under PFI or finance lease arrangements) the Council will apply the Asset life method as used in previous years and will apply an average life of 25 years for the unsupported borrowing requirement to be repaid over based on historical schemes that have required and applied unsupported borrowing.
- MRP charges from 1 April 2004 to 31 March 2016 exceeded what prudence required during the period under this revised policy. There will be a realignment of MRP charged to the revenue account in 2016/17 and subsequent years to recognise this excess sum. Total MRP after applying realignment will not be less than zero in any financial year.
- In respect of capital expenditure incurred in 2016/17 and subsequent financial years MRP will be provided at a rate of 4% on the written down balance.

34 In 2017/18 a proposed change was made that the 4% write down method will be used for all assets except for significant individual schemes exceeding £10m (such as asset investments) for which the specific asset life will be used for MRP purposes.

35 There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made (although there are transitional arrangements in place).

36 Repayments included in annual PFI or finance leases are applied as MRP.

MRP Overpayments

37 A change introduced by the revised MHCLG MRP Guidance was the allowance that any charges made over the statutory minimum revenue provision (MRP), voluntary revenue provision or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year. Up until the 31 March 2019 the total VRP overpayments were £4.5m.

Borrowing

38 The treasury management function ensures that the Council’s cash is organised in

accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

Current portfolio position

39 The overall Treasury Management portfolio as at 31 March 2018 and for the postion as at 31 October 2018 are shown below for both borrowing and investments.

Treasury investments	Actual 31/03/2018 £'000	Actual 31/03/2018 %	Current 31/10/2018 £'000	Current 31/10/2018 %
Money Market Funds	2,150	3%	2,000	2%
Bank Deposits	7,500	11%	13,100	16%
Local Authorities	23,000	33%	17,500	21%
Call Account	4,097	6%	11,960	15%
Debt Management Office	11,850	17%	12,850	16%
Cash Plus and Short Bond Funds	20,400	30%	25,000	30%
Total Treasury Investments	**68,997**	**100%**	**82,410**	**100%**
Treasury External Borrowing				
PWLB	153,187	62%	153,187	64%
Local Authorities	73,200	29%	64,600	27%
Private Sector	19,214	8%	18,863	8%
Salix	3,541	1%	2,695	1%
Total External Borrowing	**249,142**	**100%**	**239,345**	**100%**
Net treasury investment / (borrowing)	**(180,145)**		**(156,935)**	

40 It should be noted that Bournemouth Borough Council has secured a £49m forward loan which will be issued in May 2021. There will be a need to refinance the current £49m local authority loans which will be redeemed in September 2019.

41 The Council’s forward projections for borrowing are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000
External Debt			
Debt at 1 April	**249,142**	**249,142**	**200,142**
Expected change in Debt	0	(49,000)	49,000
Actual gross debt at 31 March	**249,142**	**200,142**	**249,142**
The Capital Financing Requirement	**434,215**	**456,355**	**487,215**
Under / (over) borrowing	**185,073**	**256,213**	**238,073**

42 Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2018/19 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

43 The predecessor Council's have complied with their prudential indicator in the current year and the new authority does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

Treasury Indicators: limits to borrowing activity

44 **The operational boundary.** This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

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

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

b The Council is asked to approve the following authorised limit:

	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Operational boundary	411	460	510
Authorised limit	459	510	560

46 It should be noted that the Operation boundary and Authorised limit have been set to allow sufficient headroom should any future Asset Investments be approved.

Maturity structure of borrowing

47 Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

Maturity structure of fixed interest rate borrowing 2019/20		
	Lower	Upper
Under 12 months	0%	40%
12 months to 2 years	0%	50%
2 years to 5 years	0%	80%
5 years to 10 years	0%	80%

10 years and above	50%	100%
Maturity structure of variable interest rate borrowing 2019/20		
	Lower	**Upper**
Under 12 months	0%	100%
12 months to 2 years	0%	100%
2 years to 5 years	0%	100%
5 years to 10 years	0%	25%
10 years and above	0%	25%

Prospects for interest rates

48 Link Asset Services as part of their service is to assist the Council to formulate a view on interest rates. The following table gives their view on the base rate and PWLB borrowing costs.

Link Asset Services Interest Rate View	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	1.75%	2.00%
3 Month LIBID	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%
6 Month LIBID	1.00%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%
12 Month LIBID	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%
5yr PWLB Rate	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.80%
10yr PWLB Rate	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%
25yr PWLB Rate	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%

49 The flow of generally positive economic statistics after the quarter ended 30 June meant that it came as no surprise that the Monetary Policy Committee (MPC) came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, from 0.5% to 0.75%. However, the MPC emphasised again, that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, than before the crash; indeed they gave a figure for this of around 2.5% in ten years' time but they declined to give a medium term forecast. It is unlikely that the MPC will increase Bank Rate in February 2019, ahead of the deadline in March for the UK exit of the European Union. Similarly, the MPC is more likely to wait until August 2019, than May 2019, before the next increase, to be followed by further increases of 0.25% in May and November 2020 to reach 1.5%. However, the cautious pace of even these limited increases is dependent on a reasonably orderly Brexit process.

Borrowing strategy

50 The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow have been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue that need to be considered.

51 The Chief Financial Officer has the delegated responsibility to arrange such loans as are legally permitted to meet the Council's borrowing requirement and to arrange terms of all loans to the Council including amounts, periods and rates of

interest.

52 Against this background and the risks within the economic forecast, caution will be adopted with the 2019/20 treasury operations. The Chief Financial Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

a If it was felt that there was a significant risk of a sharp FALL in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

b If it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

c Any decisions will be reported to the Audit and Governance comittee for the BCP authority at the next available opportunity.

Policy on borrowing in advance of need

53 The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

54 Risks associated with any borrowing in advance of activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

Debt rescheduling

55 As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

56 The reasons for any rescheduling to take place will include:

a The generation of cash savings and / or discounted cash flow savings;

b Helping to fulfil the treasury strategy;

c Enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

57 Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

58 All debt rescheduling will be reported to the Audit and Governance committee for

the BCP authority at the earliest meeting following its action.

Municipal Bond Agency

59 It is likely that the Municipal Bond Agency, currently in the process of being set up, will be offering loans to local authorities in the near future. It is also hoped that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). This Authority intends to make use of this new source of borrowing as and when appropriate.

Annual Investment Strategy

Investment Policy

60 The MHCLG and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with financial investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy, (a separate report).

61 The Council's investment policy has regard to the following: -

- MHCLG's Guidance on Local Government Investments ("the Guidance")
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the Code")
- CIPFA Treasury Management Guidance Notes 2018

The Council's investment priorities will be security first, portfolio liquidity second and then yield, (return).

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

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

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

Creditworthiness policy

65 The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that:

a It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and

b It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

66 The Chief Financial Officer will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to which types of investment instruments that can be used as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

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

68 The criteria for providing a pool of high quality investment counterparties (both specified and non-specified investments) is:

Sovereign Ratings

- AAA (non UK)

(Rating Description: AAA = Prime Rating, AA+, AA, AA- = High Grade Rating)

Appendix 2 to this document sets out the current list of countries that the Council can invest funds with.

The UK sovereign rating is currently AA. To ensure that the Treasury Function has capacity to operate effectively no specific minimum UK sovereign rating has been set out.

Selection Criteria

69 Banks 1 - the Council will use UK and non UK banks which have, as a minimum at least one of, the following Fitch, Moody's and Standard & Poors credit ratings (where rated):

	Fitch	**Moody's**	**Standard & Poors**
Short Term	F1	P1	A-1
Long Term	A-	A3	A-

70 Investments will include term deposits, call accounts, notice accounts and Certificate of Deposits.

a Banks 2 – Part nationalised UK bank – Royal Bank of Scotland. This bank can be included provided it continues to be part nationalised or it meets the ratings in Banks 1 above.

b Banks 3 – The Council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.

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

d Building societies. The Council will use societies which meet the ratings for Banks 1 outlined above.

e Market Funds (MMFs) Constant net asset value (CNAV)

f Money Market Funds (MMFs) Low-Volatility asset value (LNVAV)

g Money Market Funds (MMFs) Variable net asset value (VNAV)

h Ultra-Short Dated Bond Funds with a credit rating of at least 1.25

i Ultra-Short Dated Bond Funds with a credit rating of at least 1.50

j Cash Plus Funds

k UK Government (including gilts, Treasury Bills and the Debt Management Account Deposit Facility (DMADF))

l Local authorities, Parish Councils, BCP Council Companies (Subsidiaries) and Partnerships.

m Pooled Funds

Maximum Time and Monetary Limits applying to Investments

71 The maximum amount that can be invested in any one institution at the time of the investment (including call accounts) as a percentage of the total investment portfolio has been reviewed and rationalised. All AA- and above rated institutions have a maximum limit of 25%, all A+, A or A- rated institutions have a maximum limit of 20%. For practical reasons where the average investment balance falls below £10m it may become necessary to increase the percentage limit to 33% at the time of investment (this only applies to call accounts and money market funds).

72 The maximum time and monetary limits for institutions on the Council's Counterparty List are as follows (these will cover both Specified and Non-Specified Investments):

	Long Term Rating	Money Limit	Time Limit
Banks 1 higher quality	AA-	25%	2 years
Banks 1 medium quality	A	20%	1 year
Banks 1 lower quality	A-	20%	6 months

Banks 2 category – part-nationalised RBS / Nat West	N/A	20%	2 years
Banks 3 category – Council's banker HSBC	AA-	25%	3 months
DMADF/Treasury Bills	AAA	25%	6 months
Local Authorities	N/A	20%	5 years
Money Market Funds CNAV	AAA	25%	Instant access
Money Market Funds LVNAV	AAA	25%	Instant access
Money Market Funds VNAV	AAA	25%	Instant access
Ultra-Short Dated Bond Funds	N/A	25%	Unlimited
Cash Plus Funds	AAA	25%	Unlimited
UK Gilts	UK Sovereign Rate	25%	5 years

Use of additional information other than credit ratings

73 Additional requirements under the Code require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information will be applied to compare the relative security of differing investment counterparties.

Investment strategy

In-house funds

74 Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

Investment returns expectations

75 Bank Rate is forecast to increase steadily but slowly over the next few years to reach 2.00% by quarter 1 2022. Bank Rate forecasts for financial year ends (March) are:

a 2018/19 0.75%

b 2019/20 1.00%

c 2020/21 1.50%

d 2021/22 2.00%

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

77 **Investment treasury limit** – The maximum period for investments will be 5 years.

Appendices

Appendix 1 - Economic Background and interest rate forecasts

Appendix 2 - Approved Countries for investments

Appendix 3 - Treasury Management Policy, Practices and Schedules

Appendix 1: Economic Background (provided by Link Asset Services Ltd)

GLOBAL OUTLOOK. **World growth** has been doing reasonably well, aided by strong growth in the US. However, US growth is likely to fall back in 2019 and, together with weakening economic activity in China and the eurozone, overall world growth is likely to weaken.

Inflation has been weak during 2018 but, at long last, unemployment falling to remarkably low levels in the US and UK has led to a marked acceleration of wage inflation. The US Fed has therefore increased rates nine times and the Bank of England twice. However, the ECB is unlikely to start raising rates until late in 2019 at the earliest.

KEY RISKS - central bank monetary policy measures
Looking back on nearly ten years since the financial crash of 2008 when liquidity suddenly dried up in financial markets, it can be assessed that central banks' monetary policy measures to counter the sharp world recession were successful. The key monetary policy measures they used were a combination of lowering central interest rates and flooding financial markets with liquidity, particularly through unconventional means such as quantitative easing (QE), where central banks bought large amounts of central government debt and smaller sums of other debt.

The key issue now is that that period of stimulating economic recovery and warding off the threat of deflation, is coming towards its close. A new period is well advanced in the US, and started more recently in the UK, of reversing those measures i.e. by raising central rates and, (for the US), reducing central banks' holdings of government and other debt. These measures are now required in order to stop the trend of a reduction in spare capacity in the economy and of unemployment falling to such low levels, that the re-emergence of inflation is viewed as a major risk. It is, therefore, crucial that central banks get their timing right and do not cause shocks to market expectations that could destabilise financial markets. In particular, a key risk is that because QE-driven purchases of bonds drove up the price of government debt, and therefore caused a sharp drop in income yields, this also encouraged investors into a search for yield and into investing in riskier assets such as equities. Consequently, prices in both bond and equity markets rose to historically high valuation levels simultaneously. This meant that both asset categories were exposed to the risk of a sharp downward correction and we have indeed, seen a sharp fall in equity values in the last quarter of 2018. It is important, therefore, that central banks only gradually unwind their holdings of bonds in order to prevent destabilising the financial markets. It is also likely that the timeframe for central banks unwinding their holdings of QE debt purchases will be over several years. They need to balance their timing to neither squash economic recovery, by taking too rapid and too strong action, or, conversely, let inflation run away by taking action that was too slow and/or too weak. **The potential for central banks to get this timing and strength of action wrong are now key risks.** At the time of writing, (early January 2019), financial markets are very concerned that the Fed is being too aggressive with its policy for raising interest rates and was likely to cause a recession in the US economy.

The world economy also needs to adjust to a sharp change in **liquidity creation** over the last five years where the US has moved from boosting liquidity by QE purchases, to reducing its holdings of debt, (currently about $50bn per month). In addition, the European Central Bank ended its QE purchases in December 2018.

UK. The flow of positive economic statistics since the end of the first quarter of 2018 has shown that pessimism was overdone about the poor growth in quarter 1 when adverse weather caused a temporary downward blip. Quarter 1 at 0.1% growth in GDP was followed by a return to 0.4% in quarter 2 and by a strong performance in quarter 3 of +0.6%. However, growth in quarter 4 is expected to weaken significantly.

At their November quarterly Inflation Report meeting, the MPC repeated their well-worn phrase that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary of contractionary), than before the crash; indeed they gave a figure for this of around 2.5% in ten years time, but declined to give a medium term forecast. However, with so much uncertainty around Brexit, they warned that the next move could be up or down, even if there was a disorderly Brexit. While it would be expected that Bank Rate could be cut if there was a significant fall in GDP growth as a result of a disorderly Brexit, so as to provide a stimulus to growth, they warned they could also *raise* Bank Rate in the same scenario if there was a boost to inflation from a devaluation of sterling, increases in import prices and more expensive goods produced in the UK replacing cheaper goods previously imported, and so on. In addition, the Chancellor could potentially provide fiscal stimulus to support economic growth, though at the cost of increasing the budget deficit above currently projected levels.

It is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. Getting parliamentary approval for a Brexit agreement on both sides of the Channel will take well into spring 2019. However, in view of the hawkish stance of the MPC at their November meeting, the next increase in Bank Rate is now forecast to be in May 2019, (on the assumption that a Brexit deal is agreed by both the UK and the EU). The following increases are then forecast to be in February and November 2020 before ending up at 2.0% in February 2022.

Inflation. The Consumer Price Index (CPI) measure of inflation has been falling from a peak of 3.1% in November 2017 to 2.3% in November. In the November Bank of England quarterly Inflation Report, inflation was forecast to still be marginally above its 2% inflation target two years ahead, (at about 2.1%), given a scenario of minimal increases in Bank Rate. This inflation forecast is likely to be amended upwards due to the Bank's report being produced prior to the Chancellor's announcement of a significant fiscal stimulus in the Budget; this is likely to add 0.3% to GDP growth at a time when there is little spare capacity left in the economy, particularly of labour.

As for the **labour market** figures in October**,** unemployment at 4.1% was marginally above a 43 year low of 4% on the Independent Labour Organisation measure. A combination of job vacancies hitting an all-time high, together with negligible growth in total employment numbers, indicates that employers are now having major difficulties filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to 3.3%, (3 month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates less CPI inflation), earnings are currently growing by about 1.0%, the highest level since 2009. This increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. This tends to confirm that the MPC was right to start on a cautious increase in Bank Rate in August as it views wage inflation in excess of 3% as increasing inflationary pressures within the UK economy.

In the **political arena**, there is a risk that the current Conservative minority government may be unable to muster a majority in the Commons over Brexit. However, our central position is that Prime Minister May's government will endure, despite various setbacks, along the route to reaching an orderly Brexit in March 2019. If, however, the UK faces a general election in the next 12 months, this could result in a potential loosening of monetary and fiscal policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up.

USA. President Trump's massive easing of fiscal policy is fuelling a, (temporary), boost in consumption which has generated an upturn in the rate of strong growth which rose from 2.2%, (annualised rate), in quarter 1 to 4.2% in quarter 2 and 3.5%, (3.0% y/y), in quarter 3, but also an upturn in inflationary pressures. The strong growth in employment numbers and the reduction in the unemployment rate to 3.9%, near to a recent 49 year low, has fed through to an upturn in wage inflation which hit 3.2% in November, However, CPI inflation overall fell to 2.2% in November and looks to be on a falling trend to drop below the Fed's target of 2% during 2019. The Fed has continued on its series of increases in interest rates with another 0.25% increase in December to between 2.25% and 2.50%, this being the fifth increase in 2018 and the ninth in this cycle. However, they did also reduce their forecast for further increases from three to two. This latest increase compounded investor fears that the Fed is over doing the rate and level of increases in rates and that it is going to cause a US recession as a result. There is also much evidence in previous monetary policy cycles, of the Fed's series of increases doing exactly that. Consequently, we have seen stock markets around the world plunging under the weight of fears around the Fed's actions, the trade war between the US and China, an expectation that world growth will slow, Brexit etc.

The tariff war between the US and China has been generating a lot of heat during 2018, but it is not expected that the current level of actual action would have much in the way of a significant effect on US or world growth. However, there is a risk of escalation if an agreement is not reached soon between the US and China.

Eurozone. Growth was 0.4% in quarters 1 and 2 but fell back to 0.2% in quarter 3, though this was probably just a temporary dip. In particular, data from Germany has been mixed and it could be negatively impacted by US tariffs on a significant part of manufacturing exports e.g. cars. For that reason, although growth is still expected to be in the region of nearly 2% for 2018, the horizon is less clear than it seemed just a short while ago. Having halved its quantitative easing purchases of debt in October 2018 to €15bn per month, the European Central Bank ended all further purchases in December 2018. The ECB is forecasting inflation to be a little below its 2% top limit through the next three years so it may find it difficult to warrant a start on raising rates by the end of 2019 if the growth rate of the EU economy is on a weakening trend.

INTEREST RATE FORECASTS

The interest rate forecasts provided by Link Asset Services are predicated on an assumption of an agreement being reached on Brexit between the UK and the EU. In the event of an orderly non-agreement exit, it is likely that the Bank of England would take action to cut Bank Rate from 0.75% in order to help economic growth deal with the adverse effects of this situation. This is also likely to cause short to medium term gilt yields to fall. If there was a disorderly Brexit, then any cut in Bank Rate would be likely to last for a longer period and also depress short and medium gilt yields correspondingly. It is also possible that the government could act to protect economic growth by implementing fiscal stimulus.

The balance of risks to the UK

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

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

Appendix 2: Approved countries for investments

AA

- United Kingdom

AAA

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