

# **East Herts District Council**

## **Treasury Management Strategy Statement**

Minimum Revenue Provision Policy Statement  
and Annual Investment Strategy

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2017/18

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# 1 INTRODUCTION

## 1.1 Background

The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this 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.

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 occasions, any debt previously drawn may be restructured to meet Council risk or cost objectives.

CIPFA defines treasury management 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.”*

## 1.2 Reporting requirements

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.

**Prudential and treasury indicators and treasury strategy** (this report) - The first and most important report covers:

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

**A mid-year treasury management report** – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision

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

### Scrutiny

The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Joint Meeting of Scrutiny and Audit and Governance Committee.

### **1.3 Treasury Management Strategy for 2017/18**

The strategy for 2017/18 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.

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

### **1.4 Training**

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 responsible for scrutiny. The following training has been undertaken by members of the Audit Committee on 25th November 2015 and further training will be arranged as required.

The training needs of treasury management officers are periodically reviewed. Officers also attend regular workshops and seminars held by CIPFA and Capita Asset Services.

### **1.5 Treasury management consultants**

The Council uses Capita Asset Services, Treasury solutions as its external treasury management advisors.

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.

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.

## 2 THE CAPITAL PRUDENTIAL INDICATORS 2017/18 – 2019/20

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

### 2.1 Capital expenditure

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	2015/16 Actual £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m
<b>Total</b>	<b>22.4</b>	<b>5.1</b>	<b>3.4</b>	<b>2.7</b>	<b>1.9</b>

Other long-term liabilities. The above financing need excludes other long-term liabilities, such as PFI and leasing arrangements, which already include borrowing instruments.

The table below summarises 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.

Financing of capital expenditure	2015/16 Actual £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m
Capital receipts	2.1	2.9	0.8	0.5	0.5
Capital grants	0.5	1.2	0.4	0.7	0.3
Capital reserves	0.0	0.0	0.0	0.0	0.0
Revenue	1.0	0.3	0.1	0.1	0.1
<b>Net financing need for the year</b>	<b>18.8</b>	<b>0.7</b>	<b>2.1</b>	<b>1.4</b>	<b>1.0</b>

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

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.

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.

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. The Council currently has £296k of such schemes within the CFR.

The Council is asked to approve the CFR projections below:

	2015/16 Actual £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m
<b>Capital Financing Requirement</b>					
<b>Total CFR</b>	<b>(23.7)</b>	<b>(23.3)</b>	<b>(21.2)</b>	<b>(19.8)</b>	<b>(18.8)</b>
<b>Movement in CFR</b>	<b>18.2</b>	<b>0.4</b>	<b>2.1</b>	<b>1.4</b>	<b>1.0</b>

<b>Movement in CFR represented by</b>					
Net financing need for the year (above)	18.8	0.7	2.1	1.4	1.0
Less MRP/VRP and other financing movements	(0.6)	(0.3)	(0.0)	(0.0)	(0.0)
<b>Movement in CFR</b>	<b>18.2</b>	<b>0.4</b>	<b>2.1</b>	<b>1.4</b>	<b>1.0</b>

### 2.3 Core funds and expected investment balances

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Year End Resources	2015/16 Actual £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m
Fund balances / reserves	16.6	16.1	15.6	16.2	17.0
Capital receipts	0.0	0.0	0.0	0.0	0.0
Provisions	2.7	0.0	0.0	0.0	0.0
Other	(2.7)	(2.7)	(2.7)	(2.7)	(2.7)
<b>Total core funds</b>	<b>16.6</b>	<b>13.4</b>	<b>12.9</b>	<b>13.5</b>	<b>14.3</b>
Working capital*	(0.7)	(0.7)	(0.7)	(0.7)	(0.7)
Under/over borrowing**	32.4	32.0	29.9	28.5	27.5
<b>Expected investments</b>	<b>48.3</b>	<b>44.7</b>	<b>42.1</b>	<b>41.3</b>	<b>41.1</b>

\*Working capital balances shown are estimated year end; these may be higher mid-year

### 3 BORROWING

The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. 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 appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

#### 3.1 Current portfolio position

The Council's treasury portfolio position at 31 March 2016, with forward projections 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.

	<b>2015/16 Actual £m</b>	<b>2016/17 Estimate £m</b>	<b>2017/18 Estimate £m</b>	<b>2018/19 Estimate £m</b>	<b>2019/20 Estimate £m</b>
<b>External Debt</b>					
Debt at 1 April	7.5	7.5	7.5	7.5	7.5
Expected change in Debt	0.0	0.0	0.0	0.0	0.0
Other long-term liabilities (OLTL)	0.6	0.3	0.0	0.0	0.0
Expected change in OLTL	0.0	0.0	0.0	0.0	0.0
Actual gross debt at 31 March	<b>8.1</b>	<b>7.8</b>	<b>7.5</b>	<b>7.5</b>	<b>7.5</b>
The Capital Financing Requirement	<b>(23.7)</b>	<b>(23.3)</b>	<b>(21.2)</b>	<b>(19.8)</b>	<b>(18.8)</b>
Under / (over) borrowing	<b>(8.1)</b>	<b>(7.8)</b>	<b>(7.5)</b>	<b>(7.5)</b>	<b>(7.5)</b>

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 2017/18 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.

The Head of Strategic Finance and Property reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

### 3.2 Treasury Indicators: limits to borrowing activity

**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.

Operational boundary	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m
Debt	7.5	7.5	7.5	7.5
Other long term liabilities	0.3	0.0	0.0	0.0
<b>Total</b>	<b>8.8</b>	<b>7.5</b>	<b>7.5</b>	<b>7.5</b>

**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.

1. 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.
2. The Council is asked to approve the following authorised limit:

Authorised limit	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m
Debt	11.5	11.5	11.5	11.5
Other long term liabilities	0.5	0.2	0.2	0.2
<b>Total</b>	<b>12.0</b>	<b>11.7</b>	<b>11.7</b>	<b>11.7</b>

### 3.3 Prospects for interest rates

The Council has appointed Capita Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives our central view.

	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Bank rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
5yr PWLB rate	1.60%	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
10yr PWLB rate	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
25yr PWLB rate	2.90%	2.90%	2.90%	2.90%	3.00%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%
50yr PWLB rate	2.70%	2.70%	2.70%	2.70%	2.80%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%

The Monetary Policy Committee, (MPC), cut Bank Rate from 0.50% to 0.25% on 4th August in order to counteract what it forecast was going to be a sharp slowdown in growth in the second half of 2016. It also gave a strong steer that it was likely to cut



Bank Rate again by the end of the year. However, economic data since August has indicated much stronger growth in the second half 2016 than that forecast; also, inflation forecasts have risen substantially as a result of a continuation of the sharp fall in the value of sterling since early August. Consequently, Bank Rate was not cut again in November or December and, on current trends, it now appears unlikely that there will be another cut, although that cannot be completely ruled out if there was a significant dip downwards in economic growth. During the two-year period 2017 – 2019, when the UK is negotiating the terms for withdrawal from the EU, it is likely that the MPC will do nothing to dampen growth prospects, (i.e. by raising Bank Rate), which will already be adversely impacted by the uncertainties of what form Brexit will eventually take. Accordingly, a first increase to 0.50% is not tentatively pencilled in, as in the table above, until quarter 2 2019, after those negotiations have been concluded, (though the period for negotiations could be extended). However, if strong domestically generated inflation, (e.g. from wage increases within the UK), were to emerge, then the pace and timing of increases in Bank Rate could be brought forward.

Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. It has long been expected that, at some point, there would be a start to a switch back from bonds to equities after a historic long-term trend over about the last twenty-five years of falling bond yields. The action of central banks since the financial crash of 2008, in implementing substantial quantitative easing purchases of bonds, added further impetus to this downward trend in bond yields and rising prices of bonds. The opposite side of this coin has been a rise in equity values as investors searched for higher returns and took on riskier assets. The sharp rise in bond yields since the US Presidential election, has called into question whether, or when, this trend has, or may, reverse, especially when America is likely to lead the way in reversing monetary policy. Until 2015, monetary policy was focused on providing stimulus to economic growth but has since started to refocus on countering the threat of rising inflationary pressures as strong economic growth becomes more firmly established. The expected substantial rise in the Fed. rate over the next few years may make holding US bonds much less attractive and cause their prices to fall, and therefore bond yields to rise. Rising bond yields in the US are likely to exert some upward pressure on bond yields in other developed countries. However, the degree of that upward pressure is likely to be dampened by how strong or weak, the prospects for economic growth and rising inflation are in each country and on the degree of progress in the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

PWLB rates and gilt yields have been experiencing exceptional levels of volatility that have been highly correlated to geo-political, sovereign debt crisis and emerging market developments. It is likely that these exceptional levels of volatility could continue to occur for the foreseeable future.

The overall balance of risks to economic recovery in the UK is to the downside, particularly in view of the current uncertainty over the final terms of Brexit and the timetable for its implementation.

Apart from the above uncertainties, **downside risks to current forecasts** for UK gilt yields and PWLB rates currently include:

- Monetary policy action by the central banks of major economies reaching its limit of effectiveness and failing to stimulate significant sustainable growth, combat the threat of deflation and reduce high levels of debt in some countries, combined with a lack of adequate action from national governments to promote growth through structural reforms, fiscal policy and investment expenditure.
- Major national polls:
  - Italian constitutional referendum 4.12.16 resulted in a 'No' vote which led to the resignation of Prime Minister Renzi. This means that Italy needs to appoint a new government.
  - Spain has a minority government with only 137 seats out of 350 after already having had two inconclusive general elections in 2015 and 2016. This is potentially highly unstable.
  - Dutch general election 15.3.17;
  - French presidential election April/May 2017;
  - French National Assembly election June 2017;
  - German Federal election August – October 2017.
- A resurgence of the Eurozone sovereign debt crisis, with Greece being a particular problem, and stress arising from disagreement between EU countries on free movement of people and how to handle a huge influx of immigrants and terrorist threats
- Weak capitalisation of some European banks, especially Italian.
- Geopolitical risks in Europe, the Middle East and Asia, causing a significant increase in safe haven flows.
- UK economic growth and increases in inflation are weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU and US.

The potential for **upside risks to current forecasts** for UK gilt yields and PWLB rates, especially for longer-term PWLB rates, include: -

- UK inflation rising to significantly higher levels than in the wider EU and in the US, causing an increase in the inflation premium in gilt yields.
- A rise in US Treasury yields, as a result of Fed. funds rate increases and rising inflation expectations in the USA, dragging UK gilt yields upwards.
- The pace and timing of increases in the Fed. funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
- A downward revision to the UK's sovereign credit rating undermining investor confidence in holding sovereign debt (gilts).

### **Investment and borrowing rates**

- Investment returns are likely to remain low during 2017/18 and beyond;
- Borrowing interest rates have been on a generally downward trend during most of 2016 up to mid-August; they fell sharply to historically phenomenally low levels after

the referendum and then even further after the MPC meeting of 4<sup>th</sup> August when a new package of quantitative easing purchasing of gilts was announced. Gilt yields have since risen sharply due to a rise in concerns around a 'hard Brexit', the fall in the value of sterling, and an increase in inflation expectations. The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times when authorities will not be able to avoid new borrowing to finance capital expenditure and/or to refinance maturing debt;

- There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.

### **3.4 Borrowing strategy**

The Council is currently in a negative CFR position. This means that the capital borrowing need (the Capital Financing Requirement), has not been reached due to the level of the Council's reserves.

Against this background and the risks within the economic forecast, caution will be adopted with the 2017/18 treasury operations. The Section 151 Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

Any decisions which will result in a significant change to the CFR and this Council's need to borrow, will be reported to full council at the next available opportunity.

### **3.5 Policy on borrowing in advance of need**

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.

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

### **3.6 Debt rescheduling**

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).

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

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.

All rescheduling will be reported to the *Council*, at the earliest meeting following its action.

**Municipal Bond Agency** 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.

## 4 ANNUAL INVESTMENT STRATEGY

### 4.1 Investment policy

The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, then return.

In accordance with the above guidance from the CLG 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.

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.

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.

Investment instruments identified for use in the financial year are listed in Appendix 5.4 under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the Council's treasury management practices – schedules.

### 4.2 Creditworthiness policy

This Council applies the creditworthiness service provided by Capita Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;

- sovereign ratings to select counterparties from only the most creditworthy countries.

This modelling approach combines credit ratings, credit Watches and credit Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:

- Yellow: 5 years \*
- Dark pink: 5 years for Enhanced money market funds (EMMFs) with a credit score of 1.25
- Light pink: 5 years for Enhanced money market funds (EMMFs) with a credit score of 1.5
- Purple: 2 years
- Blue: 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange: 1 year
- Red: 6 months
- Green: 100 days
- No colour: not to be used

Y	Pi1	Pi2	P	B	O	R	G	N/C
1	1.25	1.5	2	3	4	5	6	7
Up to 5yrs	Up to 5yrs	Up to 5yrs	Up to 2yrs	Up to 1yr	Up to 1yr	Up to 6mths	Up to 100days	No Colour

	Colour (and long term rating where applicable)	Money Limit at Time of Investment per Banking Group / Fund / Authority	Time Limit
<b>Banks *</b>	<b>yellow</b>	<b>£10m</b>	<b>5yrs</b>
<b>Banks</b>	<b>purple</b>	<b>£10m</b>	<b>2 yrs</b>
<b>Banks</b>	<b>orange</b>	<b>£10m</b>	<b>1 yr</b>
<b>Banks – part nationalised</b>	<b>blue</b>	<b>£20m</b>	<b>1 yr</b>
<b>Banks</b>	<b>red</b>	<b>£10m</b>	<b>6 mths</b>
<b>Banks</b>	<b>green</b>	<b>£10m</b>	<b>100 days</b>
<b>Banks</b>	<b>No colour</b>	<b>Not to be used</b>	
<b>Limit 3 category – Council’s banker (not meeting Banks 1)</b>	<b>XXX</b>	<b>£20m</b>	<b>1 day</b>
<b>Property Funds</b>	<b>-</b>	<b>£20m</b>	<b>5yrs</b>
<b>DMADF</b>	<b>AAA</b>	<b>unlimited</b>	<b>6 months</b>
<b>Local authorities</b>	<b>n/a</b>	<b>£10m</b>	<b>5yrs</b>
	Fund rating	Money Limit per Fund	Time Limit
<b>Money market funds</b>	<b>AAA</b>	<b>£10m / %</b>	<b>liquid</b>
<b>Enhanced money market funds with a credit score of 1.25</b>	<b>Dark pink / AAA</b>	<b>£10m / %</b>	<b>liquid</b>
<b>Enhanced money market funds with a credit score of 1.5</b>	<b>Light pink / AAA</b>	<b>£10m / %</b>	<b>liquid</b>

*\* Please note: the yellow colour category is for UK Government debt, or its equivalent, money market funds and collateralised deposits where the collateral is UK Government debt – see Appendix 5.4.*

The Capita Asset Services’ creditworthiness service uses a wider array of information than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency’s ratings.

Typically the minimum credit ratings criteria the Council use will be a Short Term rating (Fitch or equivalents) of F1 and a Long Term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances, consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

All credit ratings will be monitored. The Council is alerted to changes to ratings of all three agencies through its use of the Capita Asset Services’ creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Capita Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information, information on any external support for banks to help support its decision making process.

### 4.3 Country limits

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch, or equivalent. The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 5.6. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

In addition:

- no more than 20% will be placed with any non-UK country at any time;
- limits in place above will apply to a group of companies;
- sector limits will be monitored regularly for appropriateness.

### 4.4 Investment strategy

**In-house funds.** 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.** Bank Rate is forecast to stay flat at 0.25% until quarter 2 2019 and not to rise above 0.75% by quarter 1 2020. Bank Rate forecasts for financial year ends (March) are:

- 2016/17 - 0.25%
- 2017/18 - 0.25%
- 2018/19 - 0.25%
- 2019/20 - 0.50%

The suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year are as follows:

2016/17	0.25%
2017/18	0.25%
2018/19	0.25%
2019/20	0.50%
2020/21	0.75%
2021/22	1.00%
2022/23	1.50%
2023/24	1.75%
Later years	2.75%

The overall balance of risks to these forecasts is currently probably slightly skewed to the downside in view of the uncertainty over the final terms of Brexit. If growth expectations

disappoint and inflationary pressures are minimal, the start of increases in Bank Rate could be pushed back. On the other hand, should the pace of growth quicken and / or forecasts for increases in inflation rise, there could be an upside risk i.e. Bank Rate increases occur earlier and / or at a quicker pace.

**Investment treasury indicator and limit** - total principal funds invested for greater than 364 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

The Council is asked to approve the treasury indicator and limit: -

<b>Maximum principal sums invested &gt; 364 days</b>			
<b>£m</b>	<b>2017/18</b>	<b>2018/19</b>	<b>2019/20</b>
Principal sums invested > 364 days	£30m	£30m	£30m

For its cash flow generated balances, the Council will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated deposits (overnight to 100 days) in order to benefit from the compounding of interest.

#### **4.5 Investment risk benchmarking**

This Council will use an investment benchmark to assess the investment performance of its investment portfolio of 7 day, 1, 3, 6 or 12 month LIBID un compounded

#### **4.6 End of year investment report**

At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.



## 5 APPENDICES

1. Prudential and treasury indicators and MRP statement
2. Interest rate forecasts
3. Economic background
4. Treasury management practice 1 – credit and counterparty risk management (option 1)
5. Treasury management practice 1 – credit and counterparty risk management (option 2)
6. Approved countries for investments
7. Treasury management scheme of delegation
8. The treasury management role of the section 151 officer

## 5.1 THE CAPITAL PRUDENTIAL AND TREASURY INDICATORS 2017/18 – 2019/20 AND MRP STATEMENT

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

### 5.1.1 Minimum revenue provision (MRP) policy statement

In accordance with current legislation the minimum revenue provision (MRP) for the redemption of debt is required to be calculated on a prudent basis having regard to guidelines set out for application of the prudential code. Following the disposal of the Council's Housing stock the calculated MRP is now nil.

### 5.1.2 Affordability prudential indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators:

#### a. Ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

%	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Ratio	4.70%	4.68%	4.42%	4.49%	4.35%

The estimates of financing costs include current commitments and the proposals in this budget report.

#### b. Incremental impact of capital investment decisions on Council tax

This indicator identifies the revenue costs associated with proposed changes to the three-year capital programme recommended in this budget report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three-year period.

#### c. Incremental impact of capital investment decisions on the band D Council tax

£	2015/16 Actual*	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Council tax - band D	£12.51	£12.36	£12.02	£11.67	£11.48

\* Please note calculation based on estimated council tax base Oct/15.

### 5.1.4 Treasury indicators for debt

There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing

risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- 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.

The Council is asked to approve the following treasury indicators and limits:

£m	2017/18	2018/19	2019/20
<b>Interest rate exposures</b>			
	<b>Upper</b>	<b>Upper</b>	<b>Upper</b>
<b>Limits on fixed interest rates based on net debt</b>	100%	100%	100%
<b>Limits on variable interest rates based on net debt</b>	50%	50%	50%
<b>Maturity structure of fixed interest rate borrowing 2017/18</b>			
	<b>Lower</b>	<b>Upper</b>	
Under 12 months	0%	0%	
12 months to 2 years	0%	0%	
2 years to 5 years	80%	80%	
5 years to 10 years	0%	0%	
10 years to 20 years	0%	0%	
20 years to 30 years	0%	0%	
30 years to 40 years	20%	20%	
40 years to 50 years	0%	0%	
<b>Maturity structure of variable interest rate borrowing 2017/18</b>			
	<b>Lower</b>	<b>Upper</b>	
Under 12 months	0%	0%	
12 months to 2 years	0%	0%	
2 years to 5 years	0%	0%	
5 years to 10 years	0%	0%	
10 years to 20 years	0%	0%	
20 years to 30 years	0%	0%	
30 years to 40 years	0%	0%	
40 years to 50 years	0%	0%	

## 5.2 INTEREST RATE FORECASTS 2016 – 2020

This appendix is in a separate downloadable file.

PWLB forecasts are based on PWLB certainty rates.

## 5.3 ECONOMIC BACKGROUND

**UK. GDP growth rates** in 2013, 2014 and 2015 of 2.2%, 2.9% and 1.8% were some of the strongest rates among the G7 countries. Growth is expected to have strengthened in 2016 with the first three quarters coming in respectively at +0.4%, +0.7% and +0.5%. The latest Bank of England forecast for growth in 2016 as a whole is +2.2%. The figure for quarter 3 was a pleasant surprise which confounded the downbeat forecast by the Bank of England in August of only +0.1%, (subsequently revised up in September, but only to +0.2%). During most of 2015 and the first half of 2016, the economy had faced headwinds for exporters from the appreciation of sterling against the Euro, and weak growth in the EU, China and emerging markets, and from the dampening effect of the Government's continuing austerity programme.

The **referendum vote for Brexit** in June 2016 delivered an immediate shock fall in confidence indicators and business surveys at the beginning of August, which were interpreted by the Bank of England in its August Inflation Report as pointing to an impending sharp slowdown in the economy. However, the following monthly surveys in September showed an equally sharp recovery in confidence and business surveys so that it is generally expected that the economy will post reasonably strong growth numbers through the second half of 2016 and also in 2017, albeit at a slower pace than in the first half of 2016.

The **Monetary Policy Committee, (MPC), meeting of 4<sup>th</sup> August** was therefore dominated by countering this expected sharp slowdown and resulted in a package of measures that included a cut in Bank Rate from 0.50% to 0.25%, a renewal of quantitative easing, with £70bn made available for purchases of gilts and corporate bonds, and a £100bn tranche of cheap borrowing being made available for banks to use to lend to businesses and individuals.

The **MPC meeting of 3<sup>rd</sup> November** left Bank Rate unchanged at 0.25% and other monetary policy measures also remained unchanged. This was in line with market expectations, but a major change from the previous quarterly Inflation Report MPC meeting of 4 August, which had given a strong steer, in its forward guidance, that it was likely to cut Bank Rate again, probably by the end of the year if economic data turned out as forecast by the Bank. The MPC meeting of 15 December also left Bank Rate and other measures unchanged.

The latest MPC decision included a forward view that **Bank Rate** could go either up or down depending on how economic data evolves in the coming months. Our central view remains that Bank Rate will remain unchanged at 0.25% until the first increase to 0.50% in quarter 2 2019 (unchanged from our previous forecast). However, we would not, as yet, discount the risk of a cut in Bank Rate if economic growth were to take a significant dip downwards, though we think this is unlikely. We would also point out that forecasting as far ahead as mid 2019 is highly fraught as there are many potential economic headwinds which could blow the UK economy one way or the other as well as political developments in the UK, (especially over the terms of Brexit), EU, US and beyond, which could have a major impact on our forecasts.

The pace of Bank Rate increases in our forecasts has been slightly increased beyond the three year time horizon to reflect higher inflation expectations.

The August quarterly Inflation Report was based on a pessimistic forecast of near to zero GDP growth in quarter 3 i.e. a sharp slowdown in growth from +0.7% in quarter 2, in reaction to the shock of the result of the referendum in June. However, **consumers** have very much stayed in a 'business as usual' mode and there has been no sharp downturn in spending; it is consumer expenditure that underpins the services sector which comprises about 75% of UK GDP. After a fairly flat three months leading up to October, retail sales in October surged at the strongest rate since September 2015 and were again strong in November. In addition, the GfK consumer confidence index recovered quite strongly to -3 in October after an initial sharp plunge in July to -12 in reaction to the referendum result. However, in November it fell to -8 indicating a return to pessimism about future prospects among consumers, probably based mainly around concerns about rising inflation eroding purchasing power.

**Bank of England GDP forecasts** in the November quarterly Inflation Report were as follows, (August forecasts in brackets) - 2016 +2.2%, (+2.0%); 2017 1.4%, (+0.8%); 2018 +1.5%, (+1.8%). There has, therefore, been a sharp increase in the forecast for 2017, a marginal increase in 2016 and a small decline in growth, now being delayed until 2018 as a result of the impact of Brexit.

**Capital Economics' GDP forecasts** are as follows: 2016 +2.0%; 2017 +1.5%; 2018 +2.5%. They feel that pessimism is still being overdone by the Bank and Brexit will not have as big an effect as initially feared by some commentators.

**The Chancellor** has said he will do 'whatever is needed' i.e. to **promote growth**; there are two main options he can follow – fiscal policy e.g. cut taxes, increase investment allowances for businesses, and/or increase government expenditure on infrastructure, housing etc. This will mean that the PSBR deficit elimination timetable will need to slip further into the future as promoting growth, (and ultimately boosting tax revenues in the longer term), will be a more urgent priority. The Governor of the Bank of England, Mark Carney, had warned that a vote for Brexit would be likely to cause a slowing in growth, particularly from a reduction in business investment, due to the uncertainty of whether the UK would have continuing full access, (i.e. without tariffs), to the EU single market. He also warned that the Bank could not do all the heavy lifting to boost economic growth and suggested that the Government would need to help growth e.g. by increasing investment expenditure and by using fiscal policy tools. The newly appointed Chancellor, Phillip Hammond, announced, in the aftermath of the referendum result and the formation of a new Conservative cabinet, that the target of achieving a budget surplus in 2020 would be eased in the Autumn Statement on 23 November. This was duly confirmed in the Statement which also included some increases in infrastructure spending.

The other key factor in forecasts for Bank Rate is **inflation** where the MPC aims for a target for CPI of 2.0%. The November Inflation Report included an increase in the peak forecast for inflation from 2.3% to 2.7% during 2017; (Capital Economics are forecasting a peak of just under 3% in 2018). This increase was largely due to the effect of the sharp fall in the value of sterling since the referendum, although during November, sterling has recovered some of this fall to end up 15% down against the dollar, and 8% down against the euro (as at the MPC meeting date – 15.12.16). This depreciation will feed through into a sharp increase in the cost of imports and materials used in production in the UK. However, the MPC is expected to look through the acceleration in inflation caused by external, (outside of the UK), influences, although it has given a clear warning that if wage inflation were to rise significantly as a result of these cost pressures on consumers, then they would take action to raise Bank Rate.

What is clear is that **consumer disposable income** will come under pressure, as the latest employers' survey is forecasting median pay rises for the year ahead of only 1.1% at a time when inflation will be rising significantly higher than this. The CPI figure has been on an upward trend in 2016 and reached 1.2% in November. However, prices paid by factories for inputs rose to 13.2% though producer output prices were still lagging behind at 2.3% and core inflation was 1.4%, confirming the likely future upwards path.

**Gilt yields, and consequently PWLB rates**, have risen sharply since hitting a low point in mid-August. There has also been huge volatility during 2016 as a whole. The year started with 10 year gilt yields at 1.88%, fell to a low point of 0.53% on 12<sup>th</sup> August, and hit a new peak on the way up again of 1.55% on 15 November. The rebound since August reflects the initial combination of the yield-depressing effect of the MPC's new round of quantitative easing on 4 August, together with expectations of a sharp downturn in expectations for growth and inflation as per the pessimistic Bank of England Inflation Report forecast, followed by a sharp rise in growth expectations since August when subsequent business surveys, and GDP growth in quarter 3 at +0.5% q/q, confounded the pessimism. Inflation expectations also rose sharply as a result of the continuing fall in the value of sterling.

**Employment** had been growing steadily during 2016 but encountered a first fall in over a year, of 6,000, over the three months to October. The latest employment data in December, (for November), was distinctly weak with an increase in unemployment benefits claimants of 2,400 in November and of 13,300 in October. **House prices** have been rising during 2016 at a modest pace but the pace of increase has slowed since the referendum; a downturn in prices could dampen consumer confidence and expenditure.

**USA.** The American economy had a patchy 2015 with sharp swings in the quarterly **growth rate** leaving the overall growth for the year at 2.4%. Quarter 1 of 2016 at +0.8%, (on an annualised basis), and quarter 2 at 1.4% left average growth for the first half at a weak 1.1%. However, quarter 3 at 3.2% signalled a rebound to strong growth. The Fed. embarked on its long anticipated first increase in rates at its December 2015 meeting. At that point, confidence was high that there would then be four more increases to come in 2016. Since then, more downbeat news on the international scene, and then the Brexit vote, have caused a delay in the timing of the second increase of 0.25% which came, as expected, in December 2016 to a range of 0.50% to 0.75%. Overall, despite some data setbacks, the US is still, probably the best positioned of the major world economies to make solid progress towards a combination of strong growth, full employment and rising inflation: this is going to require the central bank to take action to raise rates so as to make progress towards normalisation of monetary policy, albeit at lower central rates than prevailed before the 2008 crisis. The Fed. therefore also indicated that it expected three further increases of 0.25% in 2017 to deal with rising inflationary pressures.

The result of the **presidential election** in November is expected to lead to a strengthening of US growth if Trump's election promise of a major increase in expenditure on infrastructure is implemented. This policy is also likely to strengthen inflation pressures as the economy is already working at near full capacity. In addition, the unemployment rate is at a low point verging on what is normally classified as being full employment. However, the US does have a substantial amount of hidden unemployment in terms of an unusually large, (for a developed economy), percentage of the working population not actively seeking employment.

Trump's election has had a profound effect on the **bond market and bond yields** rose sharply in the week after his election. Time will tell if this is a reasonable assessment of his election promises to cut taxes at the same time as boosting expenditure. This could lead to a sharp rise in total debt issuance from the current level of around 72% of GDP

towards 100% during his term in office. However, although the Republicans now have a monopoly of power for the first time since the 1920s, in having a President and a majority in both Congress and the Senate, there is by no means any certainty that the politicians and advisers he has been appointing to his team, and both houses, will implement the more extreme policies that Trump outlined during his election campaign. Indeed, Trump may even rein back on some of those policies himself.

In the first week since the US election, there was a major shift in **investor sentiment** away from bonds to equities, especially in the US. However, gilt yields in the UK and bond yields in the EU have also been dragged higher. Some commentators are saying that this rise has been an overreaction to the US election result which could be reversed. Other commentators take the view that this could well be the start of the long expected eventual unwinding of bond prices propelled upwards to unrealistically high levels, (and conversely bond yields pushed down), by the artificial and temporary power of quantitative easing.

**EZ.** In the Eurozone, **the ECB** commenced, in March 2015, its massive €1.1 trillion programme of quantitative easing to buy high credit quality government and other debt of selected EZ countries at a rate of €60bn per month. This was intended to run initially to September 2016 but was extended to March 2017 at its December 2015 meeting. At its December and March 2016 meetings it progressively cut its deposit facility rate to reach -0.4% and its main refinancing rate from 0.05% to zero. At its March meeting, it also increased its monthly asset purchases to €80bn. These measures have struggled to make a significant impact in boosting economic growth and in helping inflation to rise significantly from low levels towards the target of 2%. Consequently, at its December meeting, it extended its asset purchases programme by continuing purchases at the current monthly pace of €80 billion until the end of March 2017, but then continuing at a pace of €60 billion until the end of December 2017, or beyond, if necessary, and in any case until the Governing Council sees a sustained adjustment in the path of inflation consistent with its inflation aim. It also stated that if, in the meantime, the outlook were to become less favourable or if financial conditions became inconsistent with further progress towards a sustained adjustment of the path of inflation, the Governing Council intended to increase the programme in terms of size and/or duration.

**EZ GDP growth** in the first three quarters of 2016 has been 0.5%, +0.3% and +0.3%, (+1.7% y/y). Forward indications are that economic growth in the EU is likely to continue at moderate levels. This has added to comments from many forecasters that those central banks in countries around the world which are currently struggling to combat low growth, are running out of ammunition to stimulate growth and to boost inflation. Central banks have also been stressing that national governments will need to do more by way of structural reforms, fiscal measures and direct investment expenditure to support demand and economic growth in their economies.

There are also significant specific political and other risks within the EZ: -

- **Greece** continues to cause major stress in the EU due to its tardiness and reluctance in implementing key reforms required by the EU to make the country more efficient and to make significant progress towards the country being able to pay its way – and before the EU is prepared to agree to release further bail out funds.
- **Spain** has had two inconclusive general elections in 2015 and 2016, both of which failed to produce a workable government with a majority of the 350 seats. At the eleventh hour, on 31<sup>st</sup> October, before it would have become compulsory to call a third General Election, the party with the biggest bloc of seats (137), was given a majority confidence vote to form a government. This is potentially a highly unstable situation, particularly

given the need to deal with an EU demand for implementation of a package of austerity cuts which will be highly unpopular.

- The under capitalisation of **Italian banks** poses a major risk. Some **German banks** are also undercapitalised, especially Deutsche Bank, which is under threat of major financial penalties from regulatory authorities that will further weaken its capitalisation. What is clear is that national governments are forbidden by EU rules from providing state aid to bail out those banks that are at risk, while, at the same time, those banks are unable realistically to borrow additional capital in financial markets due to their vulnerable financial state. However, they are also 'too big, and too important to their national economies, to be allowed to fail'.
- **4<sup>th</sup> December Italian constitutional referendum** on reforming the Senate and reducing its powers; this was also a confidence vote on Prime Minister Renzi who has resigned on losing the referendum. However, there has been remarkably little fall out from this result which probably indicates that the financial markets had already fully priced it in. A rejection of these proposals is likely to inhibit significant progress in the near future to fundamental political and economic reform which is urgently needed to deal with Italy's core problems, especially low growth and a very high debt to GDP ratio of 135%. These reforms were also intended to give Italy more stable government as no western European country has had such a multiplicity of governments since the Second World War as Italy, due to the equal split of power between the two chambers of the Parliament which are both voted in by the Italian electorate but by using different voting systems. It is currently unclear what the political, and other, repercussions are from this result.
- **Dutch general election 15.3.17**; a far right party is currently polling neck and neck with the incumbent ruling party. In addition, anti-big business and anti-EU activists have already collected two thirds of the 300,000 signatures required to force a referendum to be taken on approving the EU – Canada free trade pact. This could delay the pact until a referendum in 2018 which would require unanimous approval by all EU governments before it can be finalised. In April 2016, Dutch voters rejected by 61.1% an EU – Ukraine cooperation pact under the same referendum law. Dutch activists are concerned by the lack of democracy in the institutions of the EU.
- **French presidential election**; first round 13 April; second round 7 May 2017.
- **French National Assembly election June 2017.**
- **German Federal election August – 22<sup>nd</sup> October 2017.** This could be affected by significant shifts in voter intentions as a result of terrorist attacks, dealing with a huge influx of immigrants and a rise in anti EU sentiment.
- The core EU, (note, not just the Eurozone currency area), principle of **free movement of people** within the EU is a growing issue leading to major stress and tension between EU states, especially with the Visegrad bloc of former communist states.



Given the number and type of challenges the EU faces in the next eighteen months, there is an identifiable risk for the EU project to be called into fundamental question. The risk of an electoral revolt against the EU establishment has gained traction after the shock results of the UK referendum and the US Presidential election. But it remains to be seen whether any shift in sentiment will gain sufficient traction to produce any further shocks within the EU.

**Asia.** Economic growth in **China** has been slowing down and this, in turn, has been denting economic growth in emerging market countries dependent on exporting raw materials to China. Medium term risks have been increasing in China e.g. a dangerous build up in the level of credit compared to the size of GDP, plus there is a need to address a major over supply of housing and surplus industrial capacity, which both need to be eliminated. This needs to be combined with a rebalancing of the economy from investment expenditure to consumer spending. However, the central bank has a track record of supporting growth through various monetary policy measures, though these further stimulate the growth of credit risks and so increase the existing major imbalances within the economy.

Economic growth in **Japan** is still patchy, at best, and skirting with deflation, despite successive rounds of huge monetary stimulus and massive fiscal action to promote consumer spending. The government is also making little progress on fundamental reforms of the economy.

**Emerging countries.** There have been major concerns around the vulnerability of some emerging countries exposed to the downturn in demand for commodities from China or to competition from the increase in supply of American shale oil and gas reaching world markets. The ending of sanctions on Iran has also brought a further significant increase in oil supplies into the world markets. While these concerns have subsided during 2016, if interest rates in the USA do rise substantially over the next few years, (and this could also be accompanied by a rise in the value of the dollar in exchange markets), this could cause significant problems for those emerging countries with large amounts of debt denominated in dollars. The Bank of International Settlements has recently released a report that \$340bn of emerging market corporate debt will fall due for repayment in the final two months of 2016 and in 2017 – a 40% increase on the figure for the last three years.

Financial markets could also be vulnerable to risks from those emerging countries with major sovereign wealth funds, that are highly exposed to the falls in commodity prices from the levels prevailing before 2015, especially oil, and which, therefore, may have to liquidate substantial amounts of investments in order to cover national budget deficits over the next few years if the price of oil does not return to pre-2015 levels.

### **Brexit timetable and process**

- March 2017: UK government notifies the European Council of its intention to leave under the Treaty on European Union Article 50
- March 2019: two-year negotiation period on the terms of exit. This period can be extended with the agreement of all members i.e. not that likely.
- UK continues as an EU member during this two-year period with access to the single market and tariff free trade between the EU and UK.
- The UK and EU would attempt to negotiate, among other agreements, a bi-lateral trade agreement over that period.

- The UK would aim for a negotiated agreed withdrawal from the EU, although the UK may also exit without any such agreements.
- If the UK exits without an agreed deal with the EU, World Trade Organisation rules and tariffs could apply to trade between the UK and EU - but this is not certain.
- On exit from the EU: the UK parliament would repeal the 1972 European Communities Act.
- The UK will then no longer participate in matters reserved for EU members, such as changes to the EU's budget, voting allocations and policies.
- It is possible that some sort of agreement could be reached for a transitional time period for actually implementing Brexit after March 2019 so as to help exporters to adjust in both the EU and in the UK.

#### 5.4 TREASURY MANAGEMENT PRACTICE (TMP1) – CREDIT AND COUNTERPARTY RISK MANAGEMENT

**SPECIFIED INVESTMENTS:** All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum 'high' quality criteria where applicable.

**NON-SPECIFIED INVESTMENTS:** These are any investments which do not meet the specified investment criteria. A maximum of 75% will be held in aggregate in non-specified investment

A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the above categories.

The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

	Minimum credit criteria / colour band	Max % of total investments	Max. maturity period
<b>DMADF – UK Government</b>	N/A	<b>100%</b>	<b>6 months</b>
UK Government gilts	UK sovereign rating	80%	12 months
UK Government Treasury bills	UK sovereign rating	80%	12 months
Bonds issued by multilateral development banks	AAA (or state your criteria if different)	40%	6 months
Money Market Funds	AAA	100%	Liquid
Enhanced Cash Funds with a credit score of 1.25	AAA	100%	Liquid
Enhanced Cash Funds with a credit score of 1.5	AAA	100%	Liquid
Local authorities	N/A	100%	12 months
Term deposits with banks and building societies	Blue Orange Red Green No Colour	80%	12 months 12 months 6 months 100 days Not for use

	Minimum credit criteria / colour band	Max % of total investments	Max. maturity period
CDs or corporate bonds with banks and building societies	Blue Orange Red Green No Colour	80%	12 months 12 months 6 months 100 days Not for use
Gilt funds	UK sovereign rating	100%	12 Months

**SPECIFIED INVESTMENTS:**

(All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum 'high' rating criteria where applicable)

	* Minimum 'High' Credit Criteria / colour band	Use
Debt Management Agency Deposit Facility	Green	In-house
Term deposits – local authorities	Green	In-house
Term deposits – banks and building societies **	Green	In-house
Term deposits – banks and building societies **	* Short-term __, Long-term	Fund Managers

**Term deposits with nationalised banks and banks and building societies**

	* Minimum Credit Criteria	Use	Max % of total investments	Max. maturity period
UK part nationalised banks	Blue	In-house	100%	12 months
UK part nationalised banks	UK sovereign rating	Fund Managers	80%	12 months
Banks part nationalised by high credit rated (sovereign rating) countries – non UK	Sovereign rating	In-house and Fund Managers	80%	12 months

Collateralised deposit	UK sovereign rating	In-house and Fund Managers
UK Government Gilts	UK sovereign rating	In-house buy and hold and Fund Managers
Bonds issued by multilateral development banks	AAA (or state your criteria if different)	In-house buy and hold and Fund Managers

Bond issuance issued by a financial institution which is explicitly guaranteed by the UK Government e.g. National Rail	UK sovereign rating	In-house buy and hold and Fund Managers
Sovereign bond issues (other than the UK govt)	AAA (or state your criteria if different)	In-house buy and hold and Fund Managers
Treasury Bills	UK sovereign rating	In house and Fund Managers

<b>Collective Investment Schemes structured as Open Ended Investment Companies (OEICs): -</b>		
1. Government Liquidity Funds	AAA	In-house and Fund Managers
2. Money Market Funds	AAA	In-house and Fund Managers
3. Enhanced Cash Funds with a credit score of 1.25	AAA	In-house and Fund Managers
4. Enhanced Cash Funds with a credit score of 1.5	AAA	In-house and Fund Managers
5. Bond Funds	AAA	In-house and Fund Managers
6. Gilt Funds	AAA	In-house and Fund Managers

**Accounting treatment of investments.** The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

**NON-SPECIFIED INVESTMENTS:** A maximum of 75%\*\* will be held in aggregate in non-specified investment

### 1. Maturities of ANY period

	* Minimum Credit Criteria	Use	** Max % of total investments	Max. maturity period
<b>Fixed term deposits with variable rate and variable maturities:</b> -Structured deposits	Blue Orange Red Green	In-house	80%	12 months 12 months 6 months 100 days
Certificates of deposit issued by banks and building societies	Blue Orange Red Green	In-house and Fund Managers	80%	12 months 12 months 6 months 100 days

	<b>* Minimum Credit Criteria</b>	<b>Use</b>	<b>** Max % of total investments</b>	<b>Max. maturity period</b>
Fixed Bonds – Corporate, Financial, Supranational or Covered.	AAA	In-house and Fund Managers	10%	5 years
Floating rate notes	AAA	In house and Fund Managers	10%	5 years
<b>Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)</b>				
Corporate bond fund	AAA	In house and Fund Managers	10%	5 years
Property fund	Based on external credit assessment from the Council's Treasury Management Advisors. UK asset investment.	In house and Fund Managers	£20m at fund entry. Maximum of two Funds at any one time for viability.	Long Term

## 2. Maturities in excess of 1 year

	* Minimum Credit Criteria	Use	** Max % of total investments	Max. maturity period
Term deposits – local authorities	N/A	In-house and Fund Managers	60%	5 Years
Term deposits – banks and building societies	Blue Orange Red Green	In-house and Fund Managers	80%	12 months 12 months 6 months 100 days
Certificates of deposit issued by banks and building societies	Blue Orange Red Green	In-house and Fund Managers	80%	12 months 12 months 6 months 100 days
UK Government Gilts	UK sovereign rating	In-house and Fund Managers	80%	10 years
Fixed Bonds – Corporate, Financial, Supranational or Covered.	AAA	In-house and Fund Managers	10%	5 years
Sovereign bond issues (other than the UK govt)	AAA	Fund Managers	50%	10 years
<b>Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)</b>				
Property fund	Based on external credit assessment from the Council's Treasury Management Advisors. UK asset investment.	In house and Fund Managers	£20m at fund entry. Maximum of two Funds at any one time for viability.	Long Term

## 5.5 APPROVED COUNTRIES FOR INVESTMENTS

*This list is based on those countries which have sovereign ratings of AA- or higher (we show the lowest rating from Fitch, Moody's and S&P) and also, (except - at the time of writing – for Hong Kong, Norway and Luxembourg), have banks operating in sterling markets which have credit ratings of green or above in the Capita Asset Services credit worthiness service.*

### AAA

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland
- U.S.A.

**AA+**

- Finland
- Hong Kong

**AA**

- Abu Dhabi (UAE)
- France
- Qatar
- U.K.

**AA-**

- Belgium



## **5.6 TREASURY MANAGEMENT SCHEME OF DELEGATION**

### **(i) Full Council**

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.

### **(ii) Executive / Full Council**

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;
- approving the selection of external service providers and agreeing terms of appointment.

### **(iii) Joint Scrutiny / Audit and Governance Committee**

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

## **5.7 THE TREASURY MANAGEMENT ROLE OF THE SECTION 151 OFFICER**

### **The S151 (responsible) Officer**

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.