Item 5

Cabinet

15 February 2018

Treasury Management Strategy 2018/19

Recommendations

That:

1) Cabinet recommends to the County Council that the Treasury Management Strategy and Investment Strategy for 2018/19 be approved and its provisions have immediate effect in the current financial year 2017/18.

2) The Prudential Indicators (see **Appendix A**) are noted and commented on.

3) Cabinet recommends that the County Council requires the Head of Finance to ensure that gross borrowing does not exceed the prudential level as specified in **Appendix A**, taking into account current commitments, existing plans, and the proposals in the budget report.

4) Cabinet recommends that the County Council delegate authority to the Head of Finance to undertake all the activities listed in **Appendix G** of this report, subject to the use of any new financial instruments being approved by Cabinet.

5) Cabinet recommends that the County Council requires the Head of Finance to implement the Minimum Revenue Provision Policy as specified in **Appendix H**.

1 Introduction

Background

1.1 Treasury management is defined 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 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 security of capital and sufficient liquidity initially before considering investment return.

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

Statutory Requirements

1.4 The Local Government Act 2003 (the Act) and supporting regulations require the Council to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

1.5 The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance subsequent to the Act and included in section 7 of this report). This sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

CIPFA Requirements

1.7 The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by the full Council of an annual Treasury Management Strategy Statement, to include the Annual Investment Strategy and Minimum Revenue Provision Policy for the year ahead, a Mid-year Review Report and an Annual (stewardship) Report covering activities during the previous year. The authority has a Capital Strategy for which full council maintains overall responsibility.
4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is Resources and Fire & Rescue Overview and Scrutiny Committee.

Treasury Management Strategy for 2018/19

1.8 The proposed strategy for 2018/19 is based upon the treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury adviser, Link Asset Services (Formerly known as Capita).

1.9 The strategy covers:

- Treasury limits for 2018/19 to 2020/21
- Prudential Indicators
- Prospects for Interest Rates
- Borrowing Strategy
- Debt Rescheduling
- Annual Investment Strategy
- Minimum Revenue Provision Strategy

Balanced Budget Requirement

1.10 Under Section 42B of the Local Government Finance Act 1992, it is a statutory requirement for the Council to produce a balanced budget. In particular, Section 42A states a local authority must include the revenue costs that flow from capital financing decisions in its budget requirement for each financial year. Therefore increases in capital expenditure must be limited to a level whereby charges to revenue derived from increases in interest charges (caused by increased borrowing to finance additional capital expenditure and any increases in running costs from new capital projects) are limited.

MiFID II

1.11 The Markets in Financial Instruments Directive ('MiFID') was introduced due to increasing complexity of financial products and issues related to the 2008 financial crisis. It has now been revised (as MiFID II) to improve the functioning of financial markets in light of the financial crisis and to strengthen investor protection. MiFID II came into effect in January 2018 which re-classifies investors into 'professional' or 'retail' clients.

1.12 Officers have demonstrated with all appropriate providers that we have suitably qualified staff with the necessary skills, training and experience to fulfil the role of "professional client". This has enabled the current treasury asset allocation to continue without disruption.

2 Treasury Limits for 2018/19 to 2020/1

2.1 It is a statutory duty under Section 3 of the Act and supporting regulations for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Affordable Borrowing Limit".

In England and Wales, the Authorised Limit represents the legislative limit specified in the Act.

2.2 The Council must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and the impact upon its future council tax is ‘acceptable’.

2.3 Whilst termed an “Affordable Borrowing Limit”, the capital to be considered for inclusion in corporate financing is both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years. Details of the Authorised Limit can be found in **Appendix A** of this report. Explanations of the terminology employed in the Appendix can be found in **Appendix B.**

3 Prudential Indicators for 2018/19 to 2020/21

3.1 Prudential and Treasury Indicators (**Appendix A** to this report) are relevant for the purposes of setting an integrated Treasury Management Strategy.

3.2 Council will approve the Prudential Indicators as part of the budget resolution in February 2017. These indicators will be revised, if necessary, for the Council approved capital programme.

3.3 The Prudential Indicators are relevant for the purposes of setting an integrated Treasury Management Strategy. The indicators are provisional and based on the current agreed capital programme.

4 Prospects for Interest Rates

4.1 The Council has appointed Link as treasury advisor to the Council and part of their service is to assist the Council to formulate a view on interest rates. The table below sets out Link’s view on the future Bank Rate.

Link Bank Rate Forecast

Period	Bank Rate %
Jan 2018 to Dec 2018	0.50
Jan 2019 to Dec 2019	0.75
Jan 2020 to Dec 2020	1.00
Jan 2021 onwards	1.25

4.2 A detailed view of the current economic background is contained within **Appendix C** to this report.

5 Borrowing Strategy

5.1 The Council is currently maintaining an over borrowed position. This means there is no current need for capital borrowing (the Capital Financing

Requirement). Based on the estimates of medium term capital expenditure, the Council's gross borrowing covers the Capital Financing Requirement until 2020/21.

5.2 The borrowing strategy is consistent with the County Council's Capital Strategy. This document describes the Council's capital programme, how the capital programme is financed and managed and how it contributes to the Council's priorities. This strategy is also updated annually and forms part of the Budget resolution process. Full Treasury management implications are built within this strategy.

5.3 The Treasury Team will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances. Any decisions will be reported to the Resources and Fire & Rescue Overview and Scrutiny Committee at the next opportunity.

5.4 The Link forecast for the PWLB new borrowing rate is as follows:

Annual Average %	**PWLB Borrowing Rates % (including certainty rate adjustment)**		
	5 year	**25 year**	**50 year**
Mar-18	1.60	2.90	2.60
Jun-18	1.60	3.00	2.70
Sep-18	1.70	3.00	2.80
Dec-18	1.80	3.10	2.90
Mar-19	1.80	3.10	2.90
Jun-19	1.90	3.20	3.00
Sep-19	1.90	3.20	3.00
Dec-19	2.00	3.30	3.10
Mar-20	2.10	3.40	3.20
Jun-20	2.10	3.50	3.30
Sep-20	2.20	3.50	3.30
Dec-20	2.30	3.60	3.40

5.5 In view of the above forecast, the Council's borrowing strategy will be based upon the following:

- The cheapest borrowing will be internal borrowing by running down cash balances and foregoing interest earned at historically low rates.
- Internal borrowing will be weighed against potential long term costs that will be incurred if market loans at long term rates are higher in future years.

- Long term fixed rate market loans at rates significantly below PWLB rates for the equivalent maturity period (where available) and to maintain an appropriate balance between PWLB and market debt in the debt portfolio.
- PWLB borrowing for periods under ten years where rates are expected to be significantly lower than rates for longer periods. This offers a range of options for new borrowing which will spread debt maturities away from a current concentration in longer dated debt.

5.6 Against this background and the risks within the economic forecast, caution will be adopted within the treasury operations in 2018/19. The Head of Finance will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances, for example:

- 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 may be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered

- 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 in world economic activity or a sudden increase in inflation risks, then the portfolio position will be reappraised with the likely action that fixed rate funding will be drawn whilst interest rates are still lower than they will be in the next few years

5.7 **Appendix I** sets out a graph of the existing Councils existing PWLB debt portfolio and how that debt will mature over the life of the underlying loans (assuming no further re-structuring takes place).

Policy on borrowing in advance of need

5.8 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 considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds.

5.9 In determining whether borrowing will be undertaken in advance of need, the Council will:

- ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to fund in advance of need;
- ensure the ongoing revenue liabilities created, and the implications on future plans and budgets have been considered;
- evaluate the economic and market factors that might influence the manner and timing of any decision;
- consider the merits and demerits of alternative forms of funding;
- consider the alternative interest rate bases available, the most appropriate time periods and repayment profiles;

- consider the impact on temporarily (until required to finance capital expenditure) increasing cash balances and the consequent increase in exposure to counterparty and other risks in light of the residual level of such risks given the controls in place to manage them.

Scheme of Delegation

5.10 The scheme of delegation in terms of financing options and decisions to be taken by the Head of Finance is shown in **Appendix G.**

6 Debt Rescheduling

6.1 As short term borrowing rates will be considerably cheaper than longer term rates, there may be 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 their short term nature and the likely cost of debt repayments.

6.2 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 strategy
- enhancing the balance of the portfolio (amending the maturity profile and/or the balance of volatility).

6.3 Consideration will also be given to identify if there is any potential for making savings by running down investment balances in order to repay debt prematurely as short term interest received on investments is likely to be lower than interest paid on current debt.

6.4 The Council has examined the potential for undertaking early repayment of some external debt to the PWLB in order to reduce the difference between its gross and net debt position. However, the premium that would be incurred by doing so means there would need to be careful analysis of the cost and benefit from such early repayment. The Municipal Bonds Agency is offering loans to local authorities. It is envisaged that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). This Authority is a founder member and would consider the agency alongside the PWLB in the event that borrowing was required.

7 Annual Investment Strategy

Investment Policy

7.1 The Council will have regard to the MHCLG'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").

7.2 The Council's investment priorities will be security first, liquidity second and then return.

7.3 In accordance with the above, and in order to minimise the risk to investments, the Council has stipulated in **Appendix E**, the minimum acceptable credit quality of counterparties for inclusion on the lending list.

7.4 Furthermore, the Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that 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 the 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 monitor market pricing such as Credit Default Swaps and overlay that information on top of the credit ratings.

7.5 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 of the suitability of potential investment counterparties. The aim of the strategy is to generate a list of highly creditworthy counterparties which will enable diversification and therefore avoid concentration risk. The intention of the strategy is to provide security of investment and minimisation of risk.

7.6 Investment instruments identified for use in the financial year are listed in **Appendix E** under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices Schedules.

7.7 The Council on occasion will hold long term investments or provide loans for operational policy reasons, for example, to our local authority traded companies. Operational loans and investments will be assessed and approval sought from members on a case-by-case basis. This will include a full assessment of the risk, including credit risk and how this will be managed.

Creditworthiness Policy

7.8 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 it maintains a policy covering both the categories and types of investment that It will invest in and the criteria for choosing investment counterparties with adequate security and the monitoring of their security. This is set out in the specified and non-specified investment sections in **Appendix E**. Also that 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.

7.9 The Head of Finance will maintain a counterparty list in compliance with the criteria and will revise and submit the criteria to Council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified 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.

7.10 The Council will ensure that it maintains its policy covering both the categories and types of investment, the criteria for choosing investment counterparties with adequate security, and the monitoring of that security. Moreover, it will ensure it has sufficient liquidity in its investments. For this purpose, it will follow procedures for determining the maximum periods for which funds may be committed according to future cash flow requirements. The Head of Finance will maintain a list of counterparties in compliance with the stated criteria, providing a high quality pool of counterparties which the Council may use.

7.11 Credit rating information is supplied by Link, our treasury consultants, on all counterparties that comply with the stated criteria. Any counterparty failing to meet the criteria will be deleted from the counterparty lending list. Any rating changes, watches (notification of a likely change), or outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing.

Country Limits

7.12 The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA from Fitch Ratings (or an equivalent rating from other agencies if Fitch does not provide). The list of countries that qualify using this credit criteria at the current time are shown in **Appendix F**. This list will be amended by officers as and when ratings change in accordance with this policy.

Investment Strategy

7.13 The Council has in-house managed funds that are mainly cash flow derived and a core balance available for investment over a maximum one year period. Investments will be made with regard to the core balance, cash flow requirements and the outlook for short term interest rates.

7.14 For its cash flow generated balances, the Council will seek to utilise its business reserve accounts, money market funds, and short dated deposits (overnight to three months) in order to benefit from the compounding of interest.

End of Year Investment Report

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

External Fund Managers

7.16 The County Council uses a number of external managers to spread risk and obtain maximum market exposure. The fund managers will use both specified and non-specified investments and must comply with the terms set out in **Appendix E**. External fund managers actively used are listed below.

Fund Manager	Product/Fund Name
CCLA	Public Sector Deposit Fund
CCLA	Local Authority Property Fund
Standard Life	Short Duration Cash Fund
Aberdeen Asset Management	Sterling Liquidity Fund
Federated Investors	Sterling Liquidity Fund
Columbia Threadneedle	UK Social Bond Fund
Aviva Investors	Sterling Core Liquidity Fund

Policy on the Use of External Service Providers

7.17 The Council uses Link as its external treasury management advisers. 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. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed, documented and subject to regular review.

Role of the Section 151 Officer

7.18 Please see **Appendix G**.

Pension Fund Cash

7.19 This Council will comply with the requirements of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009, implemented 1 January 2010. With effect 1 April 2010, the Council does not pool pension fund cash with its own cash balances for investment purposes. Any investments made by the pension fund directly with this local authority after 1 April 2010 must comply with the requirements of SI 2009 No 393.

8 Minimum Revenue Provision

8.1 The Council's policy on Minimum Revenue Provision (MRP) is shown in Appendix H.

Background papers

None

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The report was not circulated to embers prior to publication.

APPENDICES

A. Prudential and Treasury Indicators

B. Prudential Term Explanations

C. Link Economic Commentary

D. Treasury Management Scheme of Delegation

E. Schedule of Specified and Non Specified Investments

F. Approved Countries for Investments

G. The Treasury Management Role of the S151 (Responsible) Officer: Head of Finance

H. Minimum Revenue Provision

Appendix A

(1). AFFORDABILITY PRUDENTIAL INDICATORS	2016/17	2017/18	2018/19	2019/20	2020/21
	Actual	**Approved**	**estimate**	**estimate**	**estimate**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
Capital Expenditure	83,607	97,112	171,573	115,385	12,637
	%	**%**	**%**	**%**	**%**
Ratio of financing costs to net revenue stream	8.78	7.10	7.09	7.73	7.55
Gross borrowing requirement	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Gross Debt	363,424	362,274	362,274	352,274	332,274
Capital Financing Requirement as at 31 March	316,694	322,953	393,952	397,291	382,586
Under/(Over) Borrowing	(46,730)	(39,321)	31,678	45,017	50,312
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
In year Capital Financing Requirement	(2,668)	6,259	70,999	3,339	(14,705)
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
Capital Financing Requirement as at 31 March	316,694	322,953	393,952	397,291	382,586

PRUDENTIAL INDICATOR (2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	2016/17	2017/18	2018/19	2019/20	2020/21
	Approved	**Approved**	**estimate**	**estimate**	**estimate**
Authorised limit for external debt -	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Borrowing	497,346	549,049	516,818	532,824	527,178
other long term liabilities	12,000	12,000	12,000	12,000	12,000
TOTAL	**509,346**	**561,049**	**528,818**	**544,824**	**539,178**
Operational boundary for external debt -	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Borrowing	414,455	457,540	430,681	444,020	439,315
other long term liabilities	10,000	10,000	10,000	10,000	10,000
TOTAL	**424,455**	**467,540**	**440,681**	**454,020**	**449,315**
Upper limit for fixed interest rate exposure					
Net principal re fixed rate borrowing / fixed term investments	100%	100%	100%	100%	100%
Upper limit for variable rate exposure					
Net principal re fixed rate borrowing / fixed term investments	25%	25%	25%	25%	25%
Upper limit for total principal sums invested for over 365 days	£	£	£	£	£
(per maturity date)	£0	£0	£0	£0	£0

Maturity structure of new fixed rate borrowing during year	upper limit	lower limit
under 12 months	20%	0%
12 months and within 24 months	20%	0%
24 months and within 5 years	60%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

Maturity structure of new variable rate borrowing during year	upper limit	lower limit
under 12 months	20%	0%
12 months and within 24 months	20%	0%
24 months and within 5 years	60%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

Appendix B

PRUDENTIAL INDICATORS

Ratio of financing costs to net revenue stream

The ratio of financing costs to net revenue stream shows the estimated annual revenue costs of borrowing, less net interest receivable on investments, plus repayments of capital, as a proportion of annual income from council taxpayers and central government. The estimates of financing costs include current and future commitments based on the capital programme.

Gross Borrowing

Gross borrowing refers to the Authority's total external borrowing and other long term liabilities versus the Capital Financing Requirement.

Actual and Estimated Capital Expenditure

Actual and estimates of capital expenditure for the current and future years.

Capital Financing Requirement

The Capital Financing Requirement (CFR) represents capital expenditure financed by external debt and not by capital receipts, revenue contributions, capital grants or third party contributions at the time of spending. The CFR measures the Authority's underlying need to borrow externally for a capital purpose. The Authority has a treasury management strategy which accords with the CIPFA Code of Practice for Treasury Management in the Public Services.

Authorised Limit

In respect of its external debt, the Authority approves authorised limits for its total external debt gross of investments. These limits separately identify borrowing from other long-term liabilities such as finance leases. Authorised Limits are consistent with the Authority's current commitments, service plans, proposals for capital expenditure and associated financing, cash flow and accord with the approved Treasury Management Policy statement and practices. The Authorised Limit is based on the estimate of most likely prudent, but not necessarily the worst case scenario and provides sufficient additional headroom over and above the Operational Boundary.

Operational Boundary

The Operational Boundary for external debt is based on the same estimates as the authorised limit but reflects the Head of Finance's estimate of the most likely, prudent but not worst case scenario, without the additional headroom included within the authorised limit to allow for unusual cash movements, and equates to the maximum of external debt projected by this estimate. The operational boundary represents a key management tool for in-year monitoring. Within the operational boundary, figures for borrowing and other long-term liabilities are separately identified.

Limits on Interest Rate Exposure

This means that the Authority will manage fixed and variable interest rate exposure within the ranges. This provides flexibility to take advantage of any favourable movements in interest rates.

Appendix C

Economic Commentary (Link's View)

Economic Background

GLOBAL OUTLOOK. World growth looks to be on an encouraging trend of stronger performance, rising earnings and falling levels of unemployment. In October, the IMF upgraded its forecast for world growth from 3.2% to 3.6% for 2017 and 3.7% for 2018.

In addition, **inflation prospects are generally muted** and it is particularly notable that **wage inflation** has been subdued despite unemployment falling to historically very low levels in the UK and US. This has led to many comments by economists that there appears to have been a fundamental shift downwards in the Phillips curve (this plots the correlation between levels of unemployment and inflation e.g. if the former is low the latter tends to be high). In turn, this raises the question of what has caused this? The likely answers probably lay in a combination of a shift towards flexible working, self-employment, falling union membership and a consequent reduction in union power and influence in the economy, and increasing globalisation and specialisation of individual countries, which has meant that labour in one country is in competition with labour in other countries which may be offering lower wage rates, increased productivity or a combination of the two. In addition, technology is probably also exerting downward pressure on wage rates and this is likely to grow with an accelerating movement towards automation, robots and artificial intelligence, leading to many repetitive tasks being taken over by machines or computers. Indeed, this is now being labelled as being the start of the **fourth industrial revolution.**

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 and a new period has already started in the US, and more recently, in the UK, on 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 an on-going 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 then also encouraged investors into a search for yield and into investing in riskier assets such as equities. This resulted in bond markets and equity market prices both rising to historically high valuation levels simultaneously. This, therefore, makes both asset categories vulnerable to a sharp correction. 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, alternatively, 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.**

There is also a potential key question over whether economic growth has become too dependent on strong central bank stimulus and whether it will maintain its momentum against a backdrop of rising interest rates and the reversal of QE. In the UK, a key vulnerability is the **low level of productivity growth**, which may be the main driver for increases in wages; and **decreasing consumer disposable income,** which is important in the context of consumer expenditure primarily underpinning UK GDP growth.

A further question that has come to the fore is whether **an inflation target for central banks of 2%**, is now realistic given the shift down in inflation pressures from internally generated inflation, (i.e. wage inflation feeding through into the national economy), given the above mentioned shift down in the Phillips curve.

- Some economists favour a shift to a **lower inflation target of 1%** to emphasise the need to keep the lid on inflation. Alternatively, it is possible that a central bank could simply 'look through' tepid wage inflation, (i.e. ignore the overall 2% inflation target), in order to take action in raising rates sooner than might otherwise be expected.
- However, other economists would argue for a **shift *UP* in the inflation target to 3%** in order to ensure that central banks place the emphasis on maintaining economic growth through adopting a slower pace of withdrawal of stimulus.
- In addition, there is a strong argument that central banks should **target financial market stability**. As mentioned previously, bond markets and equity markets could be vulnerable to a sharp correction. There has been much commentary, that since 2008, QE has caused massive distortions, imbalances and bubbles in asset prices, both financial and non-financial. Consequently, there are widespread concerns at the potential for such bubbles to be burst by exuberant central bank action. On the other hand, too slow or weak action would allow these imbalances and distortions to continue or to even inflate them further.
- Consumer debt levels are also at historically high levels due to the prolonged period of low cost of borrowing since the financial crash. In turn, this cheap borrowing has meant that **other non-financial asset prices**, particularly house prices, have been driven up to very high levels, especially compared to income levels. Any sharp downturn in the availability of credit, or increase in the cost of credit, could potentially destabilise the housing market and generate a sharp downturn in house prices. This could then have a destabilising effect on consumer confidence, consumer expenditure and GDP growth. However, no central bank would accept that it ought to have responsibility for specifically targeting house prices.

UK. After the UK surprised on the upside with strong economic growth in 2016, **growth in 2017 has been disappointingly weak**; quarter 1 came in at only +0.3% (+1.8% y/y), quarter 2 was +0.3% (+1.5% y/y) and quarter 3 was +0.4% (+1.5% y/y). The main reason for this has been the sharp increase in inflation, caused by the devaluation of sterling after the EU referendum, feeding increases in the cost of imports into the economy. This has caused, in turn, a reduction in consumer disposable income and spending power and so the services sector of the economy, accounting for around 80% of GDP, has seen weak growth as consumers cut back on their expenditure. However, more recently there have been encouraging statistics from the **manufacturing sector** which is seeing strong growth, particularly as a result of increased demand for exports. It has helped that growth in the EU, our main trading partner, has improved significantly over the last year while robust world growth has also been supportive. However, this sector only accounts for around 10% of GDP so expansion in this sector will have a much more muted effect on the overall GDP growth figure for the UK economy as a whole.

While the Bank of England is expected to give forward guidance to prepare financial markets for gradual changes in policy, the **Monetary Policy Committee, (MPC), meeting of 14 September 2017** managed to shock financial markets and forecasters by suddenly switching to a much more aggressive tone in terms of its words around warning that Bank Rate will need to rise soon. The Bank of England Inflation Reports during 2017 have clearly flagged up that it expected CPI inflation to peak at just under 3% in 2017, before falling back to near to its target rate of 2% in two years' time. The Bank revised its forecast for the peak to just over 3% at the 14 September meeting. (Inflation actually came in at 3.0% in both September and October so that might prove now to be the peak.) This marginal revision in the Bank's forecast can hardly justify why the MPC became so aggressive with its wording; rather, the focus was on an emerging view that with unemployment having already fallen to only 4.3%, the lowest level since 1975, and improvements in productivity being so weak, that **the amount of spare capacity in the economy was significantly diminishing** towards a point at which they now needed to take action. In addition, the MPC took a more tolerant view of low wage inflation as this now looks like a common factor in nearly all western economies as a result of automation and globalisation. However, the Bank was also concerned that the withdrawal of the UK from the EU would effectively lead to a *decrease* in such globalisation pressures in the UK, and so this would cause additional inflationary pressure over the next few years.

At Its 2 November meeting, the MPC duly delivered a 0.25% increase in Bank Rate. It also gave forward guidance that they expected to increase Bank Rate only twice more in the next three years to reach 1.0% by 2020. This is, therefore, not quite the 'one and done' scenario but is, nevertheless, a very relaxed rate of increase prediction in Bank Rate in line with previous statements that Bank Rate would only go up very gradually and to a limited extent.

However, some forecasters are flagging up that they expect growth to accelerate significantly towards the end of 2017 and then into 2018. This view is based primarily on the coming fall in inflation, (as the effect of the effective devaluation of sterling after the EU referendum drops out of the CPI statistics), which will bring to an end the negative impact on consumer spending power. In addition, a strong export performance will compensate for weak services sector growth. If this scenario was indeed to materialise, then the MPC would be likely to accelerate its pace of increases in Bank Rate during 2018 and onwards.

It is also worth noting the **contradiction within the Bank of England** between action in 2016 and in 2017 **by two of its committees**. After the shock result of the EU referendum, the **Monetary Policy Committee (MPC)** voted in August 2016 for emergency action to cut Bank Rate from 0.50% to 0.25%, restarting £70bn of QE purchases, and also providing UK banks with £100bn of cheap financing. The aim of this was to lower borrowing costs, stimulate demand for borrowing and thereby increase expenditure and demand in the economy. The MPC felt this was necessary in order to ward off their expectation that there would be a sharp slowdown in economic growth. Instead, the economy grew robustly, although the Governor of the Bank of England strongly maintained that this was *because* the MPC took that action. However, other commentators regard this emergency action by the MPC as being proven by events to be a mistake. Then in 2017, we had the **Financial Policy Committee (FPC)** of the Bank of England taking action in June and September over its concerns that cheap borrowing rates, and easy availability of consumer credit, had resulted in too rapid a rate of growth in consumer borrowing and in the size of total borrowing, especially of unsecured borrowing. It, therefore, took punitive action to clamp down on the ability of the main banks to extend such credit! Indeed, a PWC report in October 2017 warned that credit card, car and personal loans and student debt will hit the equivalent of an average of £12,500 per household by 2020. However, averages belie wide variations in levels of debt with much higher exposure being biased towards younger people, especially the 25 - 34 year old band, reflecting their lower levels of real income and asset ownership.

One key area of risk is that consumers may have become used to cheap rates since 2008 for borrowing, especially for mortgages. It is a major concern that **some consumers may have over extended their borrowing** and have become complacent about interest rates going up after Bank Rate had been unchanged at 0.50% since March 2009 until falling further to 0.25% in August 2016. This is why forward guidance from the Bank of England continues to emphasise slow and gradual increases in Bank Rate in the coming years. However, consumer borrowing is a particularly vulnerable area in terms of the Monetary Policy Committee getting the pace and strength of Bank Rate increases right - without causing a sudden shock to consumer demand, confidence and thereby to the pace of economic growth.

Moreover, while there is so much uncertainty around the Brexit negotiations, consumer confidence, and business confidence to spend on investing, it is far too early to be confident about how the next two to three years will actually pan out.

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: initial two-year negotiation period on the terms of exit. In her Florence speech in September 2017, the Prime Minister proposed a two year transitional period after March 2019.
- UK continues as a full EU member until March 2019 with access to the single market and tariff free trade between the EU and UK. Different sectors of the UK economy will leave the single market and tariff free trade at different times during the two year transitional period.
- 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 could also exit without any such agreements in the event of a breakdown of negotiations.
- 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 full 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.

APPENDIX D

Treasury Management Scheme of Delegation

(i) County Council

- approval of annual strategy.
- budget consideration and approval.
- approval of the division of responsibilities.

(ii) Cabinet

- scrutinise the proposed annual strategy.
- approval of/amendments to the organisation’s adopted clauses, treasury management policy statement and treasury management practices.

(iii) Resources and Fire & Rescue Overview and Scrutiny Committee

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.
- receiving and reviewing regular monitoring reports and acting on recommendations.

Appendix E

Specified Investments

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

	Minimum 'High' Credit Criteria	**Use**
DMO Deposit Facility	--	In-house
Term deposits: Local Authorities	--	In-house
Nationalised Banks	Short-term F1, Support 1	In-house and External Manager
Term deposits: UK Banks	Short-term F1, Long-term A, Viability a, Support 3	In-house and External Manager
Term deposits: Bank Council uses for current account	--	In-house and External Manager
Term deposits: UK Building Societies	Top five largest societies as reported semi-annually. (To be continually monitored)	In-house and External Manager
Term deposits: Overseas Banks	Short-term F1+, Long-term AA, Viability aa, Support 1	In-house and External Manager
Certificates of deposits issued by UK banks and building societies	Short-term F1, Long-term A, Viability a, Support 3	External Manager
Money Market Funds	AA	In-house and External Manager
UK Government Gilts, Treasury Bills	--	External Manager
Gilt Funds and Bond Funds	Long-term A-	External Manager

Non-Specified Investments

	*** Minimum Credit Criteria**	**Use**
Term deposits: UK banks and building societies with maturities in excess of one year with a maximum of three years allowed for in-house deposits	Short-term F1, Long-term A, Viability a, Support 3	In-house and External Manager
Fixed Term Deposit with Variable Rates and Variable Maturities	Short-term F1, Long-term A, Viability a+, Support 3	In-house and External Manager
Certificates of Deposits issued by UK banks and building societies	Short-term F1, Long-term A, Viability a, Support 3	External Manager
UK Government Gilts with maturities in excess of 1 year	--	External Manager
Local Authority Mortgage Scheme	As per scheme conditions	In-house
Investment in the Local Government Association Mutual Bond Agency, the local Government Money Market and Property investment vehicles managed on behalf of the Local Government Association by CCLA.	--	--
Local Authority wholly owned trading company	--	In-house

The maximum sum that can be deposited with a single organisation (with the exception of the Debt Management Agency Deposit Facility and Local Authorities) is £20m. Investments can be made to other Local Authorities with a maximum of £10m per individual authority.

Appendix F

Approved Countries for Investments

AAA

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

AA+

- Finland

AA

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

Appendix G

The Treasury Management Role of the S151 (Responsible) Officer: Head of Finance

- 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
- entering into repurchase transactions where appropriate

Appendix H

MINIMUM REVENUE PROVISION

1. What is a Minimum Revenue Provision?

Capital expenditure is generally expenditure on assets which have a life expectancy of more than one year e.g. buildings, vehicles, machinery etc. It would be impractical to charge the entirety of such expenditure to revenue in the year in which it was incurred and so such expenditure is spread over several years so as to try to match the years over which such assets benefit the local community through their useful life. The manner of spreading these costs is through an annual Minimum Revenue Provision (MRP).

Revised MRP guidance will be released for 2018/19 but it was not available when this report was drafted. No changes to current policy are anticipated but if required, a revised MRP policy will be presented to Members during 2018/19 financial year.

2. Statutory Duty

Statutory Instrument 2008 no. 414 s4 lays down that:

“A local authority shall determine for the current financial year an amount of minimum revenue provision that it considers to be prudent.”

There is no requirement to charge MRP where the Capital Financing Requirement is nil or negative at the end of the preceding financial year.

3. Government Guidance

Along with the above duty, the Government issued guidance in February 2008 which requires that a Statement on the Council’s policy for its annual MRP should be submitted to the full Council for approval before the start of the financial year to which the provision will relate.

The Council is legally obliged to “have regard” to the guidance, which is intended to enable a more flexible approach to assessing the amount of annual provision than was required under the previous statutory requirements. The guidance offers four main options under which MRP could be made with an overriding recommendation that the Council should make prudent provision to redeem its debt liability over a period which is reasonably commensurate with that over which the capital expenditure is estimated to provide benefits. The requirement to “have regard” to the guidance therefore means that:

a. Although four main options are recommended in the guidance, there is no intention to be prescriptive by making these the only methods of charge under which a local authority may consider its MRP to be prudent.

b. It is the responsibility of each authority to decide upon the most appropriate method of making a prudent provision, after having had regard to the guidance.

4. Warwickshire County Council Policy

We have decided not to use any of the options outlined in the statutory guidance but to adopt an alternative approach, which we believe is prudent.

The MRP provision will be calculated on the average remaining useful life of the Council's asset portfolio. We will calculate and apply the remaining useful life over two categories of asset:

- Land, buildings and infrastructure;
- Vehicles, plant and equipment.

The proportion of debt outstanding in each category of asset will be determined by the value of assets included in the balance sheet at the end of each financial year.

The 2017 review shows that the remaining useful life of our assets is now 28 years. By using an average life of 28 years for our assets equates to an annual provision of 4% straight line MRP.

For vehicles, plant and equipment, the remaining useful life is assumed to be five years e.g. 5 years average remaining useful life will result in 20% straight line MRP.

Appendix I

As part of the revised CIPFA code on Treasury Management there is a requirement for the Council to look at long term affordability over the life of the underlying debt levels of the authority.

The graph below shows current debt levels to maturity and the associated costs to service the loans. It does not take into account any further capital expenditure or any future re-financing.

All levels are within the 2017/18 Operational Boundary approved by County Council in March 2017.