ARUN DISTRICT COUNCIL

REPORT TO AUDIT AND GOVERNANCE COMMITTEE
ON 13 February 2020

PART A: REPORT

SUBJECT: Treasury Management Strategy Statement and Annual Investment Strategy 2020/21

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EXTN: 37861
PORTFOLIO AREA: Corporate Support

EXECUTIVE SUMMARY:

The purpose of this report is to present the Treasury Management Strategy Statement and Annual Investment Strategy 2020/2021 and to enable the Audit and Governance Committee to scrutinise the report prior to making comment to Full Council (18 March 2020).

RECOMMENDATIONS:

The Committee is requested to recommend Full Council to:

(i) approve the Treasury Management Strategy for 2020/21;
(ii) approve the Annual Investment Strategy for 2020/21; and
(iii) approve the Prudential Indicators for 2020/21, 2021/2022 and 2022/23 as contained in appendix 1 and the body of the report.

BACKGROUND:

1 <u>Introduction</u>

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 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 previous debt taken out may be restructured to meet Council risk or cost objectives.

The contribution that the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities, (arising usually from capital expenditure) and are separate from the day to day treasury management activities.

CIPFA defines treasury management as:

"The management of the local authority's borrowing, 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

1.2.1 Capital Strategy

The CIPFA 2017 Prudential and Treasury Management Codes require all local authorities to prepare a capital strategy report which will provide the following:

- a high-level long term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial sustainability

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

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

1.2.2 Treasury Management reporting

The Council is currently required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals. These reports are required to be adequately scrutinised by committee before being recommended to the Council. This role is undertaken by the Audit and Governance Committee.

- **Prudential and Treasury Indicators and Treasury Strategy** (this report) - The first and most important report is forward looking and covers:
  - the capital plans (including prudential indicators) (2.0);
  - a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time) (2.4);
  - the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators (3.0); and
  - an investment strategy (the parameters on how investments are to be managed) (4.0).

- **A Mid-Year Treasury Management Report** – This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision. The Audit and Governance Committee will receive a mid-year report at its November meeting prior to approval by Full Council.

- **An Annual Treasury Report** – This is a backward looking review document providing details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy which the Audit and Governance Committee will receive at its July meeting prior to approval by Full Council.

1.3 Treasury Management Strategy for 2020/21

The strategy for 2020/21 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 will 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 Treasury Management Code, the CIPFA Prudential Code, MHCLG Investment Guidance and the MHCLG Minimum Revenue Provision (MRP) Guidance.

A Voluntary Repayment Provision (VRP) is sufficient as Arun's debt is all HRA. However, there is a possibility that the Council may wish to borrow for General Fund purposes at some point in the future.

1.4 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training. This especially applies to members responsible for scrutiny. Accordingly, all members were invited to attended a workshop presented by Link Asset Services (Treasury advisors) explaining the roles and responsibilities of elected members and giving them an economic update. The latest session was held on 21st November 2019.

The training needs of treasury management officers are reviewed periodically and senior officers attend seminars at least once a year.

1.5 Treasury management consultants

The Council uses Link Asset Services, 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 external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.

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

The scope of investments within the Council's operations now includes both conventional treasury investments, (the placing of residual cash from the Council's functions), and 2 commercial type investments, such as investment properties (East Preston Depot and currently the Bognor Regis Arcade). Any further commercial type investments will require specialist advisers in relation to this activity.

2 The Capital Prudential Indicators 2020/21 to 2022/23 (Appendix 1)

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in 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. The Council's capital expenditure is considered as part of the budget setting process and a report for approval is going to Full Council on 19th February 2020.

Currently Arun's only borrowing relates to the HRA self-financing settlement. However, the Council has a significant capital programme including HRA acquisition/new build and smaller projects such as work to carparks, public convenience's and cemeteries. Much of this programme will be funded from capital receipts and revenue resources but it is likely that additional borrowing will be required at some point in the near future, however the source has not yet been identified.

The need to borrow is reviewed annually as part of the Treasury Management Strategy and budget setting process and will be dependent on the HRA Business Plan and the Capital programme.

The table below summarises the 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;

Capital Expenditure	Actual 2018/19 £,000	Current Estimate 2019/20 £,000	Estimate 2020/21 £,000	Estimate 2021/22 £,000	Estimate 2022/23 £,000
Non HRA	13,764	3,520	4,228	3,244	3,244
HRA	4,125	10,423	13,336	4,545	4,995
HRA settlement	-	-	-	-	-
Total	**17,889**	**13,943**	**17,564**	**7,789**	**8,239**
Financed by:					
Capital receipts (1-4-1)	3,398	1,500	0	0	0
Capital grants	2,193	1,500	1,500	1,500	1,500
Capital reserves	1,613	5,393	3,965	4,515	4,965
Revenue	7,026	2,050	2,858	1,774	1,774
	14,230	**10,443**	**8,323**	**7,789**	**8,239**
Net financing need for the year	**3,659**	**3,500**	**9,421**	**0**	**0**

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 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 indebtedness and so its 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, and so charges the economic consumption of capital assets as they are used.

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 schemes include a borrowing facility and so the Council is not required to separately borrow for these schemes.

The Council is asked to approve the CFR projections in Appendix 1 also shown below:

CFR at 31 March	**Actual 2018/19 £,000**	**Current Estimate 2019/20 £,000**	**Estimate 2020/21 £,000**	**Estimate 2021/22 £,000**	**Estimate 2022/23 £,000**
Capital Financing Requirement					
General Fund	(1,876)	(4,009)	(4,223)	(4,442)	(4,642)
HRA	53,594	52,481	51,674	49,212	47,869
Total CFR	**51,718**	**48,472**	**47,451**	**44,770**	**43,227**
Movement in CFR	**(89)**	**(3,245)**	**(1,021)**	**(2,681)**	**(1,543)**

Movement in CFR represented by					
Leasing arrangements (GF)	0	0	0	0	0
HRA unfinanced	3,660	0	0	0	0
Increase in new borrowings	0	2,431	2,818	1,257	239
Repayments	0	-1,923	0	0	0
Less MRP/VRP	(3,749)	(3,754)	(3,839)	(3,938)	(1,782)
Movement in CFR	**(89)**	**(3,245)**	**(1,021)**	**(2,681)**	**(1,543)**

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 £m	2018/19 Actual £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m
Fund balance	15.47	12.71	10.18	4.45	0
Earmarked Reserves	15.40	7.28	4.98	4.98	4.98
Capital Receipts	2.79	2.72	1.60	1.30	1.44
Other	2.87	1.4	1.4	1.4	1.4
Total core funds	**36.53**	**24.11**	**18.16**	**11.94**	**7.96**
Under/over borrowing	16.47	24.89	20.84	15.06	12.04
Expected investments	**53.00**	**49.00**	**39.00**	**27.00**	**20.00**

2.4 Minimum revenue provision (MRP) policy statement

Councils are required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

MHCLG regulations have been issued which require the Full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the MRP Statement in Appendix 2 written as part of the 2018/19 Strategy with no revisions at this time. The policy will need to be reviewed at such time as the need to borrow has been agreed. There may also be further HRA borrowing relating to the current acquisition/new build programme.

The Council does not currently have any General Fund external debt and therefore is not statutorily required to make Minimum Revenue Provision (MRP) in respect of its CFR, but there is a requirement for a charge for depreciation to be made.

It is considered prudent to make VRP in respect of the PWLB maturity loans funding the HRA self-financing settlement payment. The table shows the VRP reducing the CFR. The VRP is incorporated in the HRA Business Plan and in the 2020/21 HRA budget. If borrowing is taken out for general fund in 2020/21, the MRP policy will need to be reviewed.

MRP Overpayments

A change introduced by the revised MHCLG MRP Guidance was the allowance that any charges made over the statutory minimum revenue provision (MRP), voluntary revenue provision or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year. Up until the 31 March 2019 there were no VRP overpayments.

2.5 Affordability Prudential Indicators

This report covers 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 indicator contained in Appendix 1.

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.

	Actual 2018/19 %	Current Estimate 2019/20 %	Estimate 2020/21 %	Estimate 2021/22 %	Estimate 2022/23 %
Non-HRA	-2.62	-2.32	-2.17	-2.17	-2.17
HRA	33.11	32.97	32.84	33.19	31.24

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 and the Council's capital strategy. 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 Investment and debt portfolio position at 31 March 2019 and 31 December 2019 summarised below;

TREASURY PORTFOLIO				
	actual **31.3.19**	actual **31.3.19**	current **31.12.19**	current **31.12.19**
Treasury investments	£000	%	£000	%
Banks	37,000	70%	54,000	74%
building societies – unrated	1,000	2%	3,000	4%
building societies – rated	0	0%	0	0%
local authorities	2,000	4%	2,000	3%
DMADF (H.M.Treasury)	0	0%	0	0%
money market funds	8,000	15%	9,030	12%
certificates of deposit	0	0%	0	0%
Total managed in house	**48,000**	**91%**	**68,030**	**93%**
bond funds	0	0%	0	0%
property funds	5,000	9%	5,000	7%
Total managed externally	**5,000**	**9%**	**5,000**	**7%**
Total treasury investments	**53,000**	**100%**	**73,030**	**100%**
Treasury external borrowing				
local authorities	0	0%	0	0%
PWLB	53,180	100%	53,180	100%
LOBOs	0	0%	0	0%
Total external borrowing	**53,180**	**100%**	**53,180**	**100%**
Net treasury investments / (borrowing)	**(180)**	**0**	**19,850**	**0**

The investments held at 31st December 2019 are shown in Appendix 3.

Within the range of 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 2020/21 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 or speculative purposes.

The Council is technically in an over borrowed position as the only borrowing relates to the HRA Self-Financing settlement (£70.9m now £53.18m). Prior to this borrowing being undertaken, the Council had a negative CFR of £2.6m which has arisen over a number of

years and was due more to changes in the capital accounting regulations rather than to any specific policy decision. As a consequence of these factors, the Council's gross debt currently exceeds its CFR, however £8.86m will be repaid on the 28 March 2020 reducing the external borrowing to £44.32m.

The Group Head of Corporate Support reports that the Council complied with the prudential indicators 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 the budget report.

3.2 Treasury Indicators: Limits to Borrowing Activity

3.2.1 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 and the ability to fund under-borrowing by other cash resources.

The Council is requested to approve an operational boundary of £58M in Appendix 1 (2020/21).

3.2.2 The Authorised Limit for external debt.

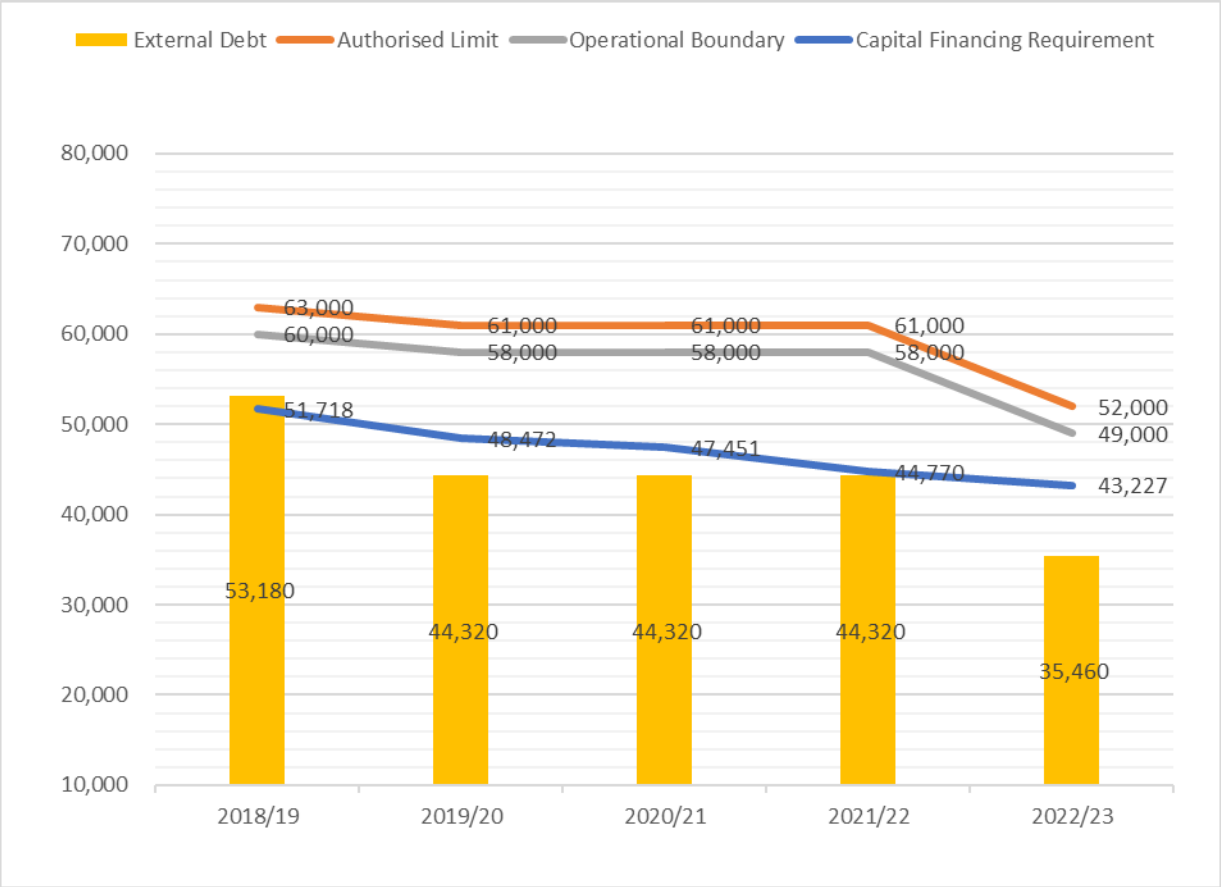
This is a key prudential indicator represents a control on the maximum level of borrowing.

This represents a legal 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.

i. 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.

ii. The Council is asked to approve an Authorised Limit of £61M (appendix 1 2020/21).

3.2.3 The chart below shows the Councils projection of CFR and borrowing.



The bars in the chart above show the actual external debt (£53M-35M) and does not include any potential future borrowing. The Authorised limit and operational boundary do factor in £9m potential borrowing. The debt repayment on 28 March 2020 has been accounted for but there will be a further debt repayment on 28 March 2022 (reducing the borrowing from £44M to £35M at this date)

3.3 Prospects for Interest Rates

3.3.1 The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Appendix 4 draws together two views of the forecasts for short term (Bank Rate) and longer fixed interest rates. The following table gives the Link Asset Services central view.

Link Asset Services Interest Rate View														
	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25	1.25	1.25	1.25
3 Month LIBID	0.70	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.30	1.30
6 Month LIBID	0.80	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40	1.50	1.50	1.50	1.50
12 Month LIBID	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60	1.70	1.70	1.70	1.70
5yr PWLB Rate	2.30	2.40	2.40	2.50	2.50	2.60	2.70	2.80	2.90	2.90	3.00	3.10	3.20	3.20
10yr PWLB Rate	2.60	2.70	2.70	2.70	2.80	2.90	3.00	3.10	3.20	3.20	3.30	3.30	3.40	3.50
25yr PWLB Rate	3.20	3.30	3.40	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00	4.10	4.10
50yr PWLB Rate	3.10	3.20	3.30	3.30	3.40	3.50	3.60	3.60	3.70	3.80	3.90	3.90	4.00	4.00

3.3.2 The above forecasts have been based on an assumption that there is an agreed deal on Brexit, including agreement on the terms of trade between the UK and EU, at some point in time. The result of the general election has removed much uncertainty around this major assumption. However, it does not remove uncertainty around whether agreement can be reached with the EU on a trade deal within the short time to December 2020, as the prime minister has pledged.

It has been little surprise that the Monetary Policy Committee (MPC) has left Bank Rate unchanged at 0.75% so far in 2019 due to the ongoing uncertainty over Brexit and the outcome of the general election. In its meeting on 7 November, the MPC became more dovish due to increased concerns over the outlook for the domestic economy if Brexit uncertainties were to become more entrenched, and for weak global economic growth: if those uncertainties were to materialise, then the MPC were likely to cut Bank Rate. However, if they were both to dissipate, then rates would need to rise at a “gradual pace and to a limited extent”. Brexit uncertainty has had a dampening effect on UK GDP growth in 2019, especially around mid-year. There is still some residual risk that the MPC could cut Bank Rate as the UK economy is still likely to only grow weakly in 2020 due to continuing uncertainty over whether there could effectively be a no deal Brexit in December 2020 if agreement on a trade deal is not reached with the EU. Until that major uncertainty is removed, or the period for agreeing a deal is extended, it is unlikely that the MPC would raise Bank Rate.

Bond yields / PWLB rates. There has been much speculation during 2019 that the bond market has gone into a bubble, as evidenced by high bond prices and remarkably low yields. However, given the context that there have been heightened expectations that the US was heading for a recession in 2020, and a general background of a downturn in world economic growth, together with inflation generally at low levels in most countries and expected to remain subdued, conditions are ripe for low bond yields.

Investment and borrowing rates

- Investment returns are likely to remain low during 2020/21 with little increase in the following two years. However, if major progress was made with an agreed Brexit, then there is upside potential for earnings.

- Borrowing interest rates were on a major falling trend during the first half of 2019-20 but then jumped up by 100 bps on 9.10.19. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years. However, the unexpected increase of 100 bps in PWLB rates requires a major rethink of local authority treasury management strategy and risk management.

- While this authority will not be able to avoid borrowing to finance new capital expenditure, to replace maturing debt and the rundown of reserves, there will be a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new short or medium-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

3.4 Borrowing Strategy

3.4.1 The Council has a significant capital programme including HRA acquisition/new build and many smaller projects such as work to carparks, public convenience's and cemeteries.

The level of expenditure within the HRA will almost certainly require additional borrowing. This will be reflected in the HRA 30 year financial model which will form an integral part of the Business Plan. The HRA business plan will include a programme of new build/stock acquisition, in addition to ongoing maintenance and decent homes programme.

The source of any of this potential borrowing has not been identified at the time of writing. There may also be a requirement to borrow for other new projects / opportunities, but this would need to be dependent on a viable business case which fully justifies the investment.

The Council's borrowing strategy will give consideration to new borrowing in the following order or priority;

- Internal borrowing;

  By running down cash balances and foregoing interest earned at historically low rates, as this is the cheapest form of borrowing, however, in view of the overall forecast for long term borrowing rates to increase over the next few years, consideration will also be given to weighing the short term advantage of internal borrowing against potential long term costs if the opportunity is missed for taking market loans at long term rates which will be higher in future years;

- External borrowing;

  - the PWLB Certainty Rate is available to the Council at 0.2% below the normal terms or;

  - borrowing from the money markets, most probably other local authorities since the 100bp increase (PWLB), depending on market conditions at the time.

There may however be an occasional need to borrow for liquidity purposes especially as the Council no longer has an overdraft facility. The facility was removed as banking costs made it very expensive and rather than incurring any costs for the facility, the treasury team

now maintain an approx. £200k balance in the account daily (earning interest at the bank of England base rate -10bp, currently 0.65%) to cover any potential issues.

The borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

3.4.2 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 treasury indicators and limits in Appendix 1 also shown below:

Maturity structure of fixed interest rate borrowing 2020/21			
	Actual at 31/03/20	**Lower**	**Upper**
Under 12 months	0%	0%	40%
12 months and within 24 months	20%	0%	40%
24 months and within 5 years	0%	0%	50%
5 years and within 10 years	20%	0%	60%
10 years and above	60%	0%	100%

The Council currently has no variable rate borrowing.

3.5 Policy of 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.

3.6 Debt Rescheduling

The only loans that the Council currently hold are those taken to fund the housing reform payment.

Rescheduling of current borrowing in our debt portfolio is unlikely to occur as the 100 bps increase in PWLB rates only applied to new borrowing rates and not to premature debt repayment rates.

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).

Should there be any rescheduling, it will be reported to Full Council at the earliest meeting following its action.

3.7 New financial institutions as a source of borrowing and / or types of borrowing

Following the decision by the PWLB on 9 October 2019 to increase their margin over gilt yields by 100 bps to 180 basis points on loans lent to local authorities, consideration will also need to be given to sourcing funding at cheaper rates from the following:

- Local authorities (primarily shorter dated maturities)
- Financial institutions (primarily insurance companies and pension funds but also some banks, out of spot or forward dates)
- Municipal Bonds Agency (no issuance at present but there is potential)

The degree which any of these options proves cheaper than PWLB Certainty Rate is still evolving at the time of writing but our advisors will keep us informed.

4 <u>Annual Investment Strategy</u>

4.1 Investment Policy – management of risk

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

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

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

The above guidance from the MHCLG and CIPFA place a high priority on the management of risk. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -

1. Minimum acceptable **credit criteria** are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.

2. **Other information:** 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 achieve this consideration 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.

3. **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.

4. This Council has defined the list of **types of investment instruments** that the treasury management team are authorised to use. There are two lists in appendix 6 under the categories of 'specified' and 'non-specified' investments.

   - **Specified investments;** (these are considered low risk assets where the possibility of loss of principal or investment income is small) are those with a high level of credit quality and subject to a maturity limit of one year.

   - **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use. Once an investment is classed as non-specified, it remains non-specified all the way through to maturity i.e. an 18month deposit would still be non-specified even if it has only 11 months left until maturity. A maximum of 30% will be in aggregate in non-specified investments.

5. This authority will set a limit for the amount of its investments which are invested for **longer than 365 days**, (Appendix 1).

6. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating**, (Appendix 8).

7. All investments will be denominated in **sterling**.

8. The Council may invest in investments that are termed "alternative investments". These include, but are not limited to, things such as renewable energy bonds (Solar farms). These are asset backed bonds, offering good returns, and will enable the Council to enter new markets, thus furthering the diversification of our investment portfolio with secured investments and enhancing yield. Any investments entered into of this type will be subject to a full due diligence review prior to investment. (Category 8, Appendix 6)

9. It is recommended that the Council may invest in diversified funds subject to due diligence. For example, CCLA, where £5M is invested in a property fund and up to £4M in a money market fund, offers a diversified fund, providing a return of approx. 3%. These funds would diversify the risk from the property fund. (Currently there are 37 authorities investing in this fund and £180M). (Category 12, Appendix 6). More details

on the CCLA diversified Investment fund are included in Appendix 11.

10. As a result of the change in accounting standards for 2019/20 under **IFRS 9,** this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, the Ministry of Housing, Communities and Local Government, [MHCLG], concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years commencing from 1 April 18.

However, this authority will also pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance. Regular monitoring of investment performance will be carried out during the year.

The Council does not strictly adhere to the advisor's suggested lending list and durations, but does take account of the advice offered before making any investment decisions. The Council will take advantage of attractive rates available from counterparties of high creditworthiness for longer periods while interest rates remain low and the forecast for a rate hike is not till March 2021 (25bp).

4.2 Creditworthiness policy

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

- 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.

The Council achieves a high credit quality by using a minimum rating criteria (where rated). It does not use the approach suggested by CIPFA of using the lowest common denominator method of selecting counterparties as some rating agencies are more aggressive in giving low ratings than others. The Council applies a majority rule where a counterparty would be removed immediately from the lending list if 2 or more rating agencies downgrade the counterparty below the minimum criteria. The Council's minimum criteria can be seen in Appendix 7.

Additional requirements under the Code require the Council to supplement credit rating information, which the Council achieves using the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising

credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard & 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.

All credit ratings are monitored weekly and the Council is alerted to changes to ratings of all three agencies through its use of the Link 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 Link 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 government support for banks and the credit ratings of that government support.

The current list of approved counterparties is included in Appendix 7. Lloyds being the incumbent bank, has no limit however the Council will only invest up to £11M in term deposits with them.

UK banks – ring fencing

The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as "ring-fencing". Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.

Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and "riskier" activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity's core activities are not adversely affected by the acts or omissions of other members of its group.

While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

4.3 Other limits

Due care will be taken to consider the exposure of the Council's total investment portfolio to non-specified investments, countries, groups and sectors.

Non-specified investment limit. The Council has determined that it will limit the maximum total exposure to non-specified investments as being £18M (20/21) of the total investment portfolio.

The Council has determined that it will only use approved counterparties from the UK and 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 7. This list will be added to or deducted from by officers should ratings change in accordance with this policy.

The exception to this policy is the UK, which is currently rated AA by all 3 rating agencies. If the UK's credit rating should fall below the minimum criteria set above, investment will continue to be made in UK financial institutions if after careful consideration it is deemed appropriate to do so.

The code recommends that Councils take country limits into consideration in order to spread risk. In practice most investments tend to be made in the UK due to the restricted number of quality counterparties available to the Council and it is not proposed to set country limits at this time.

The Council does not currently use sector limits e.g. banks v. building societies due to the limited number of quality counterparties available. The Council has a limit of between £4M and £12M (see Appendix 6 and 7 for investment categories) which can be invested with a single counterparty (or group) depending on the credit quality of the counterparty.

Every effort will be made to spread the maturity profile of investments to compensate for the lack of sector or country spreads (due to limited counterparties).

4.4 Investment Strategy

The Council does not utilise external fund managers, but reserves the option to do so in the future should this be deemed to be appropriate. Should consideration be given to exercising this option in the future, the relevant Committee will be advised of the reason for doing so.

The Council's funds are therefore all managed in-house although £5M is invested in a property fund run by CCLA (Churches, Charities and Local Authorities). The average level of funds available for investment purposes is currently £62M (as at 31 December 2019). These funds are partially cash-flow derived and there is a core balance of approximately

£49M which is available for investments over a year (maximum 5 years or 25 years for property funds). The core balance is comprised of funds that are available due to a number of factors including the setting aside of funds to repay the HRA loans (£3.5M) for when they become repayable, the Earmarked Reserves, Capital Receipt, General Fund and HRA balances which were £15.40M, £2.79M, £9.95M and £8.39M at 31 March 2019 respectively.

Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.

- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

The Council has the following spanning the financial year and there are no forward commitments (deals) for the financial year 2020/21;

- £5m invested in the CCLA property fund
- £1m invested in Lloyds Bank

Investment returns expectations.
On the assumption that the UK and EU agree a Brexit deal including the terms of trade by the end of 2020 or soon after, then Bank Rate is forecast to increase only slowly over the next few years to reach 1.00% by quarter 1 2023. Bank Rate forecasts for financial year ends (March) are:

- Q1 2021 0.75%
- Q1 2022 1.00%
- Q1 2023 1.25%

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

2019/20	0.75%
2020/21	1.00%
2021/22	1.00%
2022/23	1.50%
2023/24	1.50%
2024/25	1.75%
Later years	2.25%

- The overall balance of risks to economic growth in the UK is probably to the downside due to the weight of all the uncertainties over Brexit, as well as a softening

global economic picture.

- The balance of risks to increases in Bank Rate and shorter term PWLB rates are broadly similarly to the downside.
- In the event that a Brexit deal is agreed with the EU and approved by Parliament, the balance of risks to economic growth and to increases in Bank Rate is likely to change to the upside.

The Council's budgeted rate of return for 2020/21 is 1.26% based on 1.17% on funds that are already invested; 4.20% for the property fund (£5M); 0.89% for the remaining core balances; and 0.70% for short term cash flow derived balances. The total investment income budget for 2020/21 is £550,000. The budget is based on investments up to one year particularly in category's 4 & 7 and longer investments in Category 1, 2, 3 and 6. (Category 1 being the highest rated banks and 6 being part nationalised banks). Category 5; the Councils Bank (Lloyds) is a mixture of the above but also notice accounts (32 Day Notice and 95 Day Notice) enabling the Council to achieve slightly enhanced rates compared to Money Market Funds (MMFs).
The Council currently uses two types of Pooled Funds, Property Funds and MMFs. Pooled funds enable the Council to diversify the assets and the underlying risk in the investment portfolio and provide the potential for enhanced returns. In this strategy it will also add diversified funds that will offer returns around 3%, diversifying from Property fund. MMFs are used for short term of daily surplus of cash as they provide instant liquidity with high quality counterparties at a return comparable to (if not better than) other fixed deposits of short term duration. (0.65%-0.75%)

The MMFs are "triple A" rated, liquid, and are currently all LVNAV (Low Volatility net asset value). This is a change from the previous constant net asset value (CNAV) as a result of the MMF reform where typically for every pound of principal invested you got a pound back. It is not guaranteed, but LVNAV offers better protection than using the VNAV (Variable net asset value) MMFs.

LVNAV MMFs are permitted to maintain a constant dealing NAV provided that certain criteria are met, including that the market NAV of the fund does not deviate from the dealing NAV by more than 20 basis points.

Investment treasury indicator and limit - total principal funds invested for greater than 365 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 indicators and limits in appendix 1 (shown below):

Maximum principal sums invested > 365 days			
£m	**2020/21**	**2021/22**	**2022/23**
Principal sums invested > 365 days	18	15	10

For its cash flow generated balances, the Council will seek to utilise its interest bearing bank account, notice accounts, money market funds and short-dated deposits 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 LIBID uncompounded.

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.

4.7 Scheme of delegation

Please see Appendix 9.

4.8 Role of the section 151 officer

Please see Appendix 10.

Contact: Sian Southerton ext 37861 sian.southerton@arun.gov.uk

2. PROPOSAL(S):		
To approve all 3 recommendations.		
3. OPTIONS:		
The Treasury Management Strategy is legislative and under the Local Government act 2003 and therefore the only option is follow the proposal.		
4. CONSULTATION:		
Has consultation been undertaken with:	**YES**	**NO**
Relevant Town/Parish Council		√
Relevant District Ward Councillors		√
Other groups/persons (please specify)	√ Treasury Advisors	
5. ARE THERE ANY IMPLICATIONS IN RELATION TO THE FOLLOWING COUNCIL POLICIES: (Explain in more detail at 6 below)	**YES**	**NO**
Financial	√	
Legal		√
Human Rights/Equality Impact Assessment		√
Community Safety including Section 17 of Crime & Disorder Act		√
Sustainability		√
Asset Management/Property/Land		√
Technology		√
Other (please explain)		
6. IMPLICATIONS:		
Approval will enable the Council to comply with legislation and provide a Treasury Service		

7. REASON FOR THE DECISION:

Statutory and the limits set, safeguard the Council against financial losses.

8. BACKGROUND PAPERS:

- The Local Government Act 2003 (www.legislation.gov.uk/ukpga/2003/26/content)
- CIPFA'S Treasury Management in the Public Services: Code of Practice (2017)

(Link not available as copyright)

- The Prudential Code for Capital Finance in Local Authorities (2017)

Cipfa Treasury Management Guidance notes (2018) *(Link not available as copyright)*

- MHCLG's Guidance on Local Government Investments ("the Guidance")

Prudential and treasury indicators

APPENDIX 1

1. PRUDENTIAL INDICATORS	2018/19	2019/20	2020/21	2021/22	2022/23
Extract from budget and rent setting report	**Actual**	**Probable outturn**	**Original**	**Original**	**Original**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
Capital Expenditure					
Non – HRA	13,764	3,520	4,228	3,244	3,244
HRA	4,125	10,423	13,336	4,545	4,995
TOTAL	**17,889**	**13,943**	**17,564**	**7,789**	**8,239**
Ratio of financing costs to net revenue stream					
Non – HRA	-2.62%	-2.32	-2.17	-2.17	-2.17
HRA	33.11%	32.97	32.84	33.19	31.24
Capital Financing Requirement as at 31 March					
Non – HRA	-1,876	-4,009	-4,223	-4,442	-4,642
HRA	53,594	52,481	51,674	49,212	47,869
TOTAL	**51,718**	**48,472**	**47,451**	**44,770**	**43,227**
Annual change in Cap. Financing Requirement					
Non – HRA	1,718	-2,133	-214	-219	-200
HRA	-1,807	-1,113	-807	-2,462	-1,343
TOTAL	**-89**	**-3,246**	**-1,021**	**-2,681**	**-1,543**

2. TREASURY MANAGEMENT INDICATORS	2018/19	2019/20	2020/21	2021/22	2022/23
	Actual	Probable outturn	Original	Original	Original
	£'000	£'000	£'000	£'000	£'000
Authorised Limit for external debt					
Borrowing	63,000	61,000	60,000	60,000	51,000
Other long term liabilities	0	0	1,000	1,000	1,000
TOTAL	**63,000**	**61,000**	**61,000**	**61,000**	**52,000**
Operational Boundary for external debt					
Borrowing	60,000	58,000	57,000	57,000	48,000
other long term liabilities	0	0	1,000	1,000	1,000
TOTAL	**60,000**	**58,000**	**58,000**	**58,000**	**49,000**
Actual external debt	53,180	**44,320	*44,320	**44,320	35,460
Upper limit for total principal sums invested for over 365 days (£m)	**22**	**18**	**18**	**15**	**10**
-	- -	-	-		

*2020/21 potentially up to £9m of borrowing, therefore Authorsied limit and Operational boundary increased by the £9m to allow for this

** £8.86m of debt being repaid (28 March 2020 (shown in 19/20) & 2022 (not shown yet in 21/22)

Maturity structure of fixed rate borrowing - upper & Lower limits	**Actual at 31/03/20**	lower limit	upper limit
under 12 months	0%	0%	40%
12 months and within 24 months	20%	0%	40%
24 months and within 5 years	0%	0%	50%
5 years and within 10 years	20%	0%	60%
10 years and above	60%	0%	100%

APPENDIX 2

Minimum Revenue Provision Policy

1. Introduction

1.1 CLG's Guidance on Minimum Revenue Provision (issued in 2012 but currently out for consultation) places a duty on local authorities to make a prudent provision for debt redemption. Where the Council finances capital expenditure by debt it must set aside resources to repay that debt in later years. The amount charged to revenue for the repayment of this debt is known as the Minimum Revenue Provision (MRP). The MRP charge is the means by which capital expenditure which has been funded by borrowing is paid for by council tax payers.

1.2. From 2007/08 onwards there has been no statutory minimum and the requirement is simply for local authorities to make a prudent level of provision, and the government has instead issued statutory guidance, which local authorities are required to 'have regard to' when setting a prudent level of MRP. The guidance gives local authorities more freedom to determine what would be a prudent level of MRP.

1.3. The CLG guidance requires the authority to approve an annual MRP statement, and recommends 4 options for calculating a prudent amount of MRP, for approval by Full Council in advance of the year to which it applies. Any subsequent revisions to that policy should also be approved by Full Council.

2. Details of DCLG Guidance on MRP

2.1. The statutory guidance issued by DCLG sets out the broad aims of a prudent MRP Policy as being "to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of the grant." It then identifies four options for calculating MRP and recommends the circumstances in which each option should be used, but states that other approaches are not ruled out.

2.2. The four MRP options available are:

- **Option 1**: Regulatory Method - is the previous statutory method, which is calculated as 4% of the Council's General Fund Capital Financing Requirement, adjusted for smoothing factors from the transition to the prudential capital financing regime in 2003.

- **Option 2**: CFR Method - Option 2 differs from Option 1 only in that the smoothing factors are removed. Option 2 has been included by DCLG to provide a simpler calculation for those councils for whom it would have a minimal impact, but the draft guidance does not expect it to be used by councils for whom it would significantly increase MRP.

- **Option 3**: Asset Life Method – MRP is charged over the expected useful life of the asset either in equal instalments or using an annuity method whereby the MRP increases in later years.

- **Option 4**: Depreciation Method - MRP is charged over the expected life of the asset in accordance with depreciation accounting. This would mean that the rate at which the MRP is charged could increase (or, more rarely, decrease) from year to year.

  The guidance clearly states this does not preclude other prudent methods to provide for the repayment of debt principal.

2.3 Under the statutory guidance, it is recommended that local authorities use Options 3 or 4 for all prudential borrowing and for all borrowing to fund capitalised expenditure (such as capital grants to other bodies and capital expenditure on IT developments). Authorities may use any of the four options for MRP for their remaining borrowing to fund capital expenditure.

2.4. For balance sheet liabilities relating to finance leases and PFI schemes, the guidance recommends that one prudent approach would be for local authorities to make an MRP charge equal to the element of the annual rental which goes to write down the balance sheet liability. This would have the effect that the total impact on the bottom line would be equal to the actual rentals paid for the year. However the guidance also mentions that Option 3 could be used for this type of debt.

2.5 The guidance also allows authorities to take a MRP Holiday where assets do not become operational for perhaps 2 or 3 years or longer. It proposes that MRP would not be charged until the year following the one in which the asset became operational.

3. Details of Statute - Part 4 Section 23 b of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003

3.1 In deciding on the appropriate level of MRP to charge and the most appropriate method of financing the capital programme, the Council needs to have regard to the wider legislation regarding the use of capital receipts.

3.2 Statute gives local authorities the option to apply capital receipts to fund the payment of any liabilities relating to finance leases and PFI schemes. This is a reflection of the fact that such schemes are being treated in accounting terms as the acquisition of fixed assets, and the liability represents the amount being paid towards the purchase of the asset itself, rather than interest or service charges payable.

3.3 Local authorities may also use capital receipts to repay any borrowing that was incurred to fund capital expenditure in previous years.

4. 2018/19 MRP Policy

For 2018/19 it is recommended the Council adopt the following MRP policy:

- MRP will be charged utilising **option 3** for assets which have been funded from prudential borrowing.
- MRP will only be charged in the year following the asset becoming operational.
- If capital receipts are utilised to repay debt in year, the value of MRP chargeable will be reduced by the value of the receipts utilised.
- Whether an annuity or equal instalment method is adopted for option 3 will be dependent on the most financially beneficial method as determined by the Chief Financial Officer
- For PFI and Finance lease liabilities an MRP charge will be made to match the value of any liabilities that have not been funded from capital receipts.
- The Chief Finance Officer will determine annually the most prudent use of Capital Receipts, taking into account forecasts for future expenditure and the generation of further receipts.
- There is no requirement for the HRA to make debt repayments but it has opted to make voluntary repayments relating to debt inherited due to HRA self-financing settlement and provision has been made within the business plan to show that it can pay down the remaining debt over the life of the business plan.
- Any major revisions to this policy will be presented to Full Council for approval.

INVESTMENTS at 31st December 2019

Appendix 3

Type of Investment/Deposit	Reference no.	Counterparty	Issue Date	Maturity Date	Nominal	Current Interest Rate
Fixed Term Deposit	723	DBS	08/07/2019	08/01/2020	£2,000,000.00	0.8200
Fixed Term Deposit	712	Goldman Sachs	12/04/2019	13/01/2020	£1,000,000.00	0.9900
Fixed Term Deposit	706	Close Brothers	04/03/2019	03/03/2020	£1,000,000.00	1.2500
Fixed Term Deposit	707	Qatar National Bank	06/03/2019	04/03/2020	£1,000,000.00	1.4200
Fixed Term Deposit	713	Yorkshire Building Society	24/04/2019	05/03/2020	£1,000,000.00	0.9800
Fixed Term Deposit	714	Goldman Sachs	01/05/2019	09/03/2020	£3,000,000.00	1.0200
Fixed Term Deposit	708	Close Brothers	18/03/2019	16/03/2020	£1,000,000.00	1.2500
Fixed Term Deposit	709	Qatar National Bank	27/03/2019	25/03/2020	£1,000,000.00	1.3900
Fixed Term Deposit	718	Goldman Sachs	19/06/2019	27/03/2020	£1,000,000.00	0.9650
Fixed Term Deposit	715	Goldman Sachs	07/05/2019	30/03/2020	£2,000,000.00	1.0100
Fixed Term Deposit	733	DBS	08/10/2019	06/04/2020	£2,000,000.00	0.8600
Fixed Term Deposit	734	Qatar National Bank	14/10/2019	06/04/2020	£2,000,000.00	1.1100
Fixed Term Deposit	737	DBS	31/10/2019	06/04/2020	£2,000,000.00	0.8700
Fixed Term Deposit	740	Qatar National Bank	05/12/2019	06/04/2020	£1,000,000.00	1.0300
Fixed Term Deposit	728	Goldman Sachs	16/08/2019	06/04/2020	£1,000,000.00	0.9150
Fixed Term Deposit	729	Santander UK Plc	16/08/2019	06/04/2020	£1,000,000.00	0.9800
Fixed Term Deposit	742	DBS	23/12/2019	06/04/2020	£1,000,000.00	0.8300
Fixed Term Deposit	711	Qatar National Bank	12/04/2019	09/04/2020	£1,000,000.00	1.2900
Fixed Term Deposit	710	Close Brothers	10/04/2019	14/04/2020	£1,000,000.00	1.2500
Fixed Term Deposit	735	DBS	28/10/2019	28/04/2020	£2,000,000.00	0.8600
Fixed Term Deposit	727	Skipton	01/08/2019	01/05/2020	£1,000,000.00	0.9200
Fixed Term Deposit	717	Qatar National Bank	04/06/2019	02/06/2020	£1,000,000.00	1.2700
Fixed Term Deposit	716	Lloyds	04/06/2019	04/06/2020	£2,000,000.00	1.2500
Fixed Term Deposit	719	Goldman Sachs	21/06/2019	19/06/2020	£1,000,000.00	0.9950
Fixed Term Deposit	721	Lloyds	26/06/2019	26/06/2020	£1,000,000.00	1.2500
Fixed Term Deposit	722	Lloyds	08/07/2019	06/07/2020	£2,000,000.00	1.2500
Fixed Term Deposit	725	Skipton	26/07/2019	24/07/2020	£1,000,000.00	0.9500
Fixed Term Deposit	724	Lloyds	26/07/2019	27/07/2020	£1,000,000.00	1.2500
Fixed Term Deposit	726	Lloyds	01/08/2019	30/07/2020	£1,000,000.00	1.2500
Fixed Term Deposit	731	Qatar National Bank	30/08/2018	01/09/2020	£2,000,000.00	1.2300
Fixed Term Deposit	732	Close Brothers	04/09/2019	04/09/2020	£1,000,000.00	1.1000
Fixed Term Deposit	738	Goldman	07/11/2019	05/11/2020	£2,000,000.00	1.0150
Fixed Term Deposit	739	Qatar National Bank	19/11/2019	17/11/2020	£2,000,000.00	1.2800
Fixed Term Deposit	741	Close Brothers	20/12/2019	18/12/2020	£1,000,000.00	1.2000
Fixed Term Deposit	736	Liverpool CC	20/12/2019	18/12/2020	£2,000,000.00	1.0000
Fixed Term Deposit	743	DBS	27/12/2019	31/03/2020	£3,000,000.00	0.8200
Fixed Term Deposit	730	Lloyds	16/08/2019	06/04/2021	£1,000,000.00	1.1200
Notice Account	44445	Lloyds Bank PLC - 95DN			£6,000,000.00	1.10
Property Fund	140000	CCLA (Churches, Charities and LA's)			£5,000,000.00	4.30
Money Market Fund	110000	Federated			£4,000,000.00	0.73
Money Market Fund	100500	CCLA (Churches, Charities and LA's)			£4,000,000.00	0.73
Money Market Fund	1300000	Aberdeen Std			£1,030,000.00	0.68
					£73,030,000.00	

Interest Rate Forecast 2020- 2023

APPENDIX 4

PWLB rates and forecast shown below have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012.

Bank Rate	Now	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Link Asset Services	**0.75%**	0.75%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.25%
Capital Economics	**0.75%**	0.75%	0.75%	0.75%	0.75%	0.75%	-	-	-	-	-	-		-	-

5yr PWLB Rate	Now	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Link Asset Services	**2.37%**	2.30%	2.40%	2.40%	2.50%	2.50%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.20%	3.20%
Capital Economics	**2.37%**	2.30%	2.40%	2.50%	2.50%	2.60%	-	-	-	-	-	-		-	-

10yr PWLB Rate	Now	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Link Asset Services	**2.57%**	2.60%	2.70%	2.70%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.50%
Capital Economics	**2.57%**	2.60%	2.60%	2.70%	2.80%	2.80%	-	-	-	-	-		-	-	-

25yr PWLB Rate	Now	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Link Asset Services	**3.12%**	3.20%	3.30%	3.40%	3.40%	3.50%	3.60%	3.70%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.10%
Capital Economics	**3.12%**	3.00%	3.10%	3.20%	3.20%	3.30%	-	-	-	-	-	-	-	-	-

50yr PWLB Rate	Now	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Link Asset Services	**2.94%**	3.10%	3.20%	3.30%	3.30%	3.40%	3.50%	3.60%	3.60%	3.70%	3.80%	3.90%	3.90%	4.00%	4.00%
Capital Economics	**2.94%**	3.00%	3.00%	3.10%	3.20%	3.20%	-	-	-	-	-	-		-	-

5.3 ECONOMIC BACKGROUND

UK. Brexit. 2019 has been a year of upheaval on the political front as Theresa May resigned as Prime Minister to be replaced by Boris Johnson on a platform of the UK leaving the EU on 31 October 2019, with or without a deal. However, MPs blocked leaving on that date and the EU agreed an extension to 31 January 2020. In late October, MPs approved an outline of a Brexit deal to enable the UK to leave the EU on 31 January. Now that the Conservative Government has gained a large overall majority in the **general election** on 12 December, this outline deal will be passed by Parliament by that date. However, there will still be much uncertainty as the detail of a trade deal will need to be negotiated by the current end of the transition period in December 2020, which the Prime Minister has pledged he will not extend. This could prove to be an unrealistically short timetable for such major negotiations that leaves open two possibilities; one, the need for an extension of negotiations, probably two years, or, a no deal Brexit in December 2020.

GDP growth has taken a hit from Brexit uncertainty during 2019; quarter three 2019 surprised on the upside by coming in at +0.4% q/q, +1.1% y/y. However, the peak of Brexit uncertainty during the final quarter appears to have suppressed quarterly growth to probably around zero. The economy is likely to tread water in 2020, with tepid growth around about 1% until there is more certainty after the trade deal deadline is passed.

While the Bank of England went through the routine of producing another **quarterly Inflation Report,** (now renamed the Monetary Policy Report), on 7 November, it is very questionable how much all the writing and numbers were worth when faced with the uncertainties of where the UK will be after the general election. The Bank made a change in their Brexit assumptions to now include a deal being eventually passed. Possibly the biggest message that was worth taking note of from the Monetary Policy Report, was an increase in concerns among MPC members around weak global economic growth and the potential for Brexit uncertainties to become entrenched and so delay UK economic recovery. Consequently, the MPC voted 7-2 to maintain Bank Rate at 0.75% but two members were sufficiently concerned to vote for an immediate Bank Rate cut to 0.5%. The MPC warned that if global growth does not pick up or Brexit uncertainties intensify, then a rate cut was now more likely. Conversely, if risks do recede, then a more rapid recovery of growth will require gradual and limited rate rises. The speed of recovery will depend on the extent to which uncertainty dissipates over the final terms for trade between the UK and EU and by how much global growth rates pick up. The Bank revised its inflation forecasts down – to 1.25% in 2019, 1.5% in 2020, and 2.0% in 2021; hence, the MPC views inflation as causing little concern in the near future.

The **MPC meeting of 19 December** repeated the previous month's vote of 7-2 to keep Bank Rate on hold. Their key view was that there was currently 'no evidence about the extent to which policy uncertainties among companies and

households had declined' i.e. they were going to sit on their hands and see how the economy goes in the next few months. The two members who voted for a cut were concerned that the labour market was faltering. On the other hand, there was a clear warning in the minutes that the MPC were concerned that "domestic unit labour costs have continued to grow at rates above those consistent with meeting the inflation target in the medium term".

If economic growth were to weaken considerably, the MPC has relatively little room to make a big impact with Bank Rate still only at 0.75%. It would therefore, probably suggest that it would be up to the Chancellor to provide help to support growth by way of a **fiscal boost** by e.g. tax cuts, increases in the annual expenditure budgets of government departments and services and expenditure on infrastructure projects, to boost the economy. The Government has already made moves in this direction and it made significant promises in its election manifesto to increase government spending by up to £20bn p.a., (this would add about 1% to GDP growth rates), by investing primarily in infrastructure. This is likely to be announced in the next Budget, probably in February 2020. The Chancellor has also amended the fiscal rules in November to allow for an increase in government expenditure.

As for **inflation** itself, CPI has been hovering around the Bank of England's target of 2% during 2019, but fell again in both October and November to a three-year low of 1.5%. It is likely to remain close to or under 2% over the next two years and so, it does not pose any immediate concern to the MPC at the current time. However, if there was a hard or no deal Brexit, inflation could rise towards 4%, primarily because of imported inflation on the back of a weakening pound.

With regard to the **labour market,** growth in numbers employed has been quite resilient through 2019 until the three months to September where it fell by 58,000. However, there was an encouraging pick up again in the three months to October to growth of 24,000, which showed that the labour market was not about to head into a major downturn. The unemployment rate held steady at a 44-year low of 3.8% on the Independent Labour Organisation measure in October. Wage inflation has been steadily falling from a high point of 3.9% in July to 3.5% in October (3-month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 2.0%. As the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. The other message from the fall in wage growth is that employers are beginning to find it easier to hire suitable staff, indicating that supply pressure in the labour market is easing.

USA. President Trump's massive easing of fiscal policy in 2018 fuelled a temporary boost in consumption in that year which generated an upturn in the rate of growth to a robust 2.9% y/y. **Growth** in 2019 has been falling after a strong start in quarter 1 at 3.1%, (annualised rate), to 2.0% in quarter 2 and then 2.1% in quarter 3. The economy looks likely to have maintained a growth rate similar to quarter 3 into quarter 4; fears of a recession have largely dissipated. The strong growth in employment numbers during 2018 has weakened during 2019, indicating that the economy had been cooling, while inflationary pressures

were also weakening. However, CPI inflation rose from 1.8% to 2.1% in November, a one year high, but this was singularly caused by a rise in gasoline prices.

The Fed finished its series of increases in rates to 2.25 – 2.50% in December 2018. In July 2019, it cut rates by 0.25% as a 'midterm adjustment' but flagged up that this was not intended to be seen as the start of a series of cuts to ward off a downturn in growth. It also ended its programme of quantitative tightening in August, (reducing its holdings of treasuries etc.). It then cut rates by 0.25% again in September and by another 0.25% in its October meeting to 1.50 – 1.75%.. At its September meeting it also said it was going to **start buying Treasuries again**, although this was not to be seen as a resumption of quantitative easing but rather an exercise to relieve liquidity pressures in the repo market. Despite those protestations, this still means that the Fed is again expanding its balance sheet holdings of government debt. In the first month, it will buy $60bn, whereas it had been reducing its balance sheet by $50bn per month during 2019. As it will be buying only short-term (under 12 months) Treasury bills, it is technically correct that this is not quantitative easing (which is purchase of long term debt). The Fed left rates unchanged in December. However, the accompanying statement was more optimistic about the future course of the economy so this would indicate that further cuts are unlikely.

Investor confidence has been badly rattled by the progressive ramping up of increases in tariffs President Trump has made on Chinese imports and China has responded with increases in tariffs on American imports. This **trade war** is seen as depressing US, Chinese and world growth. In the EU, it is also particularly impacting Germany as exports of goods and services are equivalent to 46% of total GDP. It will also impact developing countries dependent on exporting commodities to China.
However, in November / December, progress has been made on agreeing a phase one deal between the US and China to roll back some of the tariffs; this gives some hope of resolving this dispute.

EUROZONE. Growth has been slowing from +1.8 % during 2018 to around half of that in 2019. Growth was +0.4% q/q (+1.2% y/y) in quarter 1, +0.2% q/q (+1.2% y/y) in quarter 2 and then +0.2% q/q, +1.1% in quarter 3; there appears to be little upside potential in the near future. German GDP growth has been struggling to stay in positive territory in 2019 and fell by -0.1% in quarter 2; industrial production was down 4% y/y in June with car production down 10% y/y. Germany would be particularly vulnerable to a no deal Brexit depressing exports further and if President Trump imposes tariffs on EU produced cars.

The European Central Bank (ECB) ended its programme of quantitative easing purchases of debt in December 2018, which then meant that the central banks in the US, UK and EU had all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by quantitative easing purchases of debt. However, the downturn in EZ growth in the second half of 2018 and into 2019, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it aims to keep it near to 2%), has prompted the ECB to take new measures to stimulate growth. At its March meeting it said that it expected to

leave interest rates at their present levels “at least through the end of 2019”, but that was of little help to boosting growth in the near term. Consequently, it announced a **third round of TLTROs**; this provides banks with cheap borrowing every three months from September 2019 until March 2021 that means that, although they will have only a two-year maturity, the Bank was making funds available until 2023, two years later than under its previous policy. As with the last round, the new TLTROs will include an incentive to encourage bank lending, and they will be capped at 30% of a bank’s eligible loans. However, since then, the downturn in EZ and world growth has gathered momentum; at its meeting on 12 September it cut its deposit rate further into negative territory, from -0.4% to -0.5%, and announced a **resumption of quantitative easing purchases of debt for an unlimited period.** At its October meeting it said these purchases would start in November at €20bn per month - a relatively small amount compared to the previous buying programme. It also increased the maturity of the third round of TLTROs from two to three years. However, it is doubtful whether this loosening of monetary policy will have much impact on growth and, unsurprisingly, the ECB stated that governments would need to help stimulate growth by ‘growth friendly’ fiscal policy.

There were no policy changes in the December meeting, which was chaired for the first time by the new President of the ECB, Christine Lagarde. However, the outlook continued to be down beat about the economy; this makes it likely there will be further monetary policy stimulus to come in 2020. She did also announce a thorough review of how the ECB conducts monetary policy, including the price stability target. This review is likely to take all of 2020.

On the political front, Austria, Spain and Italy have been in the throes of **forming coalition governments** with some unlikely combinations of parties i.e. this raises questions around their likely endurance. The latest results of German state elections has put further pressure on the frail German CDU/SDP coalition government and on the current leadership of the CDU. The results of the Spanish general election in November have not helped the prospects of forming a stable coalition.

CHINA. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and shadow banking systems. In addition, there still needs to be a greater switch from investment in industrial capacity, property construction and infrastructure to consumer goods production.

JAPAN - has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

WORLD GROWTH. Until recent years, world growth has been boosted by increasing **globalisation** i.e. countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and

growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last thirty years, which now accounts for nearly 20% of total world GDP, has unbalanced the world economy. The Chinese government has targeted achieving major world positions in specific key sectors and products, especially high tech areas and production of rare earth minerals used in high tech products. It is achieving this by massive financial support, (i.e. subsidies), to state owned firms, government directions to other firms, technology theft, restrictions on market access by foreign firms and informal targets for the domestic market share of Chinese producers in the selected sectors. This is regarded as being unfair competition that is putting western firms at an unfair disadvantage or even putting some out of business. It is also regarded with suspicion on the political front as China is an authoritarian country that is not averse to using economic and military power for political advantage. The current trade war between the US and China therefore needs to be seen against that backdrop. It is, therefore, likely that we are heading into a period where there will be a **reversal of world globalisation and a decoupling of western countries** from dependence on China to supply products. This is likely to produce a backdrop in the coming years of weak global growth and so weak inflation. **Central banks are, therefore, likely to come under more pressure to support growth by looser monetary policy measures and this will militate against central banks increasing interest rates**.

The trade war between the US and China is a major concern to **financial markets** due to the synchronised general weakening of growth in the major economies of the world, compounded by fears that there could even be a recession looming up in the US, though this is probably overblown. These concerns resulted in **government bond yields** in the developed world falling significantly during 2019. If there were a major worldwide downturn in growth, central banks in most of the major economies will have limited ammunition available, in terms of monetary policy measures, when rates are already very low in most countries, (apart from the US). There are also concerns about how much distortion of financial markets has already occurred with the current levels of quantitative easing purchases of debt by central banks and the use of negative central bank rates in some countries. The latest PMI survey statistics of economic health for the US, UK, EU and China have all been predicting a downturn in growth; this confirms investor sentiment that the outlook for growth during the year ahead is weak.

INTEREST RATE FORECASTS

The interest rate forecasts provided by Link Asset Services in paragraph 3.3 are **predicated on an assumption of an agreement being reached on Brexit between the UK and the EU.** On this basis, while GDP growth is likely to be subdued in 2019 and 2020 due to all the uncertainties around Brexit depressing consumer and business confidence, an agreement on the detailed terms of a trade deal is likely to lead to a boost to the rate of growth in subsequent years. This could, in turn, increase inflationary pressures in the economy and so cause the Bank of England to resume a series of gentle increases in Bank Rate. Just how fast, and how far, those increases will occur and rise to, will be data dependent. The forecasts in this report assume a modest recovery in the rate and

timing of stronger growth and in the corresponding response by the Bank in raising rates.

- In the event of an **orderly non-agreement exit in December 2020**, it is likely that the Bank of England would take action to cut Bank Rate from 0.75% in order to help economic growth deal with the adverse effects of this situation. This is also likely to cause short to medium term gilt yields to fall.
- If there were a **disorderly Brexit**, then any cut in Bank Rate would be likely to last for a longer period and also depress short and medium gilt yields correspondingly. Quantitative easing could also be restarted by the Bank of England. It is also possible that the government could act to protect economic growth by implementing fiscal stimulus.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably even, but dependent on a successful outcome of negotiations on a trade deal.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates are broadly similarly to the downside.
- In the event that a Brexit deal was agreed with the EU and approved by Parliament, the balance of risks to economic growth and to increases in Bank Rate is likely to change to the upside.

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

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- **Brexit** – if it were to cause significant economic disruption and a major downturn in the rate of growth.
- **Bank of England** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the **Eurozone sovereign debt crisis.** In 2018, Italy was a major concern due to having a populist coalition government which made a lot of anti-austerity and anti-EU noise. However, in September 2019 there was a major change in the coalition governing Italy which has brought to power a much more EU friendly government; this has eased the pressure on Italian bonds. Only time will tell whether this new coalition based on an unlikely alliance of two very different parties will endure.
- Weak capitalisation of some **European banks**, particularly Italian banks.

- **German minority government.** In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. The CDU has done badly in recent state elections but the SPD has done particularly badly and this has raised a major question mark over continuing to support the CDU. Angela Merkel has stepped down from being the CDU party leader but she intends to remain as Chancellor until 2021.
- **Other minority EU governments.** Austria, Finland, Sweden, Spain, Portugal, Netherlands and Belgium also have vulnerable minority governments dependent on coalitions which could prove fragile.
- **Austria, the Czech Republic, Poland and Hungary** now form a strongly anti-immigration bloc within the EU. There has also been rising anti-immigration sentiment in Germany and France.
- In October 2019, the IMF issued a report on the World Economic Outlook which flagged up a synchronised slowdown in world growth. However, it also flagged up that there was **potential for a rerun of the 2008 financial crisis**, but his time centred on the huge debt binge accumulated by corporations during the decade of low interest rates. This now means that there are corporates who would be unable to cover basic interest costs on **some $19trn of corporate debt in major western economies,** if world growth was to dip further than just a minor cooling. This debt is mainly held by the shadow banking sector i.e. pension funds, insurers, hedge funds, asset managers etc., who, when there is $15trn of corporate and government debt now yielding negative interest rates, have been searching for higher returns in riskier assets. Much of this debt is only marginally above investment grade so any rating downgrade could force some holders into a fire sale, which would then depress prices further and so set off a spiral down. The IMF's answer is to suggest imposing higher capital charges on lending to corporates and for central banks to regulate the investment operations of the shadow banking sector. In October 2019, the deputy Governor of the Bank of England also flagged up the dangers of banks and the shadow banking sector lending to corporates, especially highly leveraged corporates, which had risen back up to near pre-2008 levels.
- **Geopolitical risks,** for example in North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

Upside risks to current forecasts for UK gilt yields and PWLB rates

- **Brexit** – if agreement was reached all round that removed all threats of economic and political disruption between the EU and the UK.
- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- **UK inflation,** whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

Specified and Non-Specified Investments **APPENDIX 6**

	specified	non-specified	Minimum Credit Criteria Fitch (and equivalent) / Minimum Criteria	Maximum Investment per Institution	Max. maturity period
Term deposits – Local Authorities **(category 1)**	✓	✓	--	£12M	5 years
Term deposits – banks and building societies **(category 1)**	✓	✓	Short-term F1+ Long-term AA-	£12M	5 years
Term deposits – banks and building societies **(category 2)**	✓	✓	Short-term F1 Long-term A+	£11M	3 years
Term deposits – banks and building societies **(category 3)**	✓	✓	Short-term F1 Long-term A-	£8M	2 years
Term deposits – building societies **(Category 4)**	✓	✓	Assets in Excess of £10 billion	£4M	1 year
Council's bank (for term deposits use appropriate category 1 to 3) **(category 5)**	✓	✓	n/a	No limit *Although category limit for term deposits*	As category 1 to 3
Term deposits – UK part nationalised banks **(category 6)**	✓	✓	Short-term F3 Long term BBB-	£11M	3 years
Callable deposits	✓	✓	As category 1,2,3,4,5 and 6	As category 1,2,3,4,5 and 6	As category 1,2,3,4,5 and 6
Forward deposits	✓	✓	As category 1,2,3,4,5 and 6	As category 1,2,3,4,5 and 6	As category 1,2,3,4,5 and 6
Alternative Investments – Asset Backed Bonds **(Category 8)**		✓	--	£4M	25 years
Debt Management Agency Deposit Facility **(category 9)**	✓	✓	--	No limit	Liquid

Bonds Issued by multilateral development banks **(category 10)**		✓	Long term AAA	£4M	5 years
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)					
Money Market Funds (CNAV, LVNAV & VNAV) Government Liquidity Fund **(Category 7)**	✓		AAA	£4M	liquid
Multi-Asset Funds **(Category 12 –** diversified funds**)**		✓	--	£6M	10 - 15 years
Property funds **(Category 11)**		✓	--	£6M	25 years

Part nationalised banks in the UK have credit ratings which do not conform to the credit criteria usually used by local authorities to identify banks which are of high creditworthiness. In particular, as they are no longer separate institutions in their own right, however, these institutions have effectively taken on the creditworthiness of the Government itself i.e. deposits made with them are effectively being made to the Government. It is therefore proposed to continue to keep the category of UK part nationalised banks for both specified and unspecified investments (category 6).

APPENDIX 7

LIST OF AUTHORISED COUNTERPARTIES

Category 1 - Limit of £12 million for each institution - Maximum investment period - 5 Years

		Long Term	Short Term
Min Criteria	**Fitch**	**AA-**	**F1+**
	Moody	**Aa3**	**P-1**
	S&P	**AA-**	**A-1+**

All Local Authorities

DBS Bank Ltd (SING)
HSBC Bank plc (UK)
Oversea-Chinese Banking Corp Ltd (SING)
Svenska Handelsbanken (SW)
United Overseas Bank Ltd (SING)
First Abu Dhabi Bank (U.A.E)

Category 2 - Limit of £11 million for each institution - Maximum investment period - 3 Years

		Long Term	Short Term
Min Criteria			
	Fitch	**A+**	**F1**
	Moody	**A1**	**P-2**
	S&P	**A+**	**A-1**

Goldman Sachs International Bank (UK)
Bank of Nova Scotia (CAN)
Standard Charted Bank (UK)
Qatar National Bank (Qatar)
National Westminster Bank PLC (RFB) (UK)
Royal Bank of Scotland PLC (RFB) (UK)

Category 3 - Limit of £8 million for each institution - Maximum investment period - 2 Years

		Long Term	Short Term
Min Criteria	**Fitch**	**A-**	**F1**
	Moody	**A3**	**P-2**
	S&P	**A-**	**A-1**

Barclays Bank plc (RFB & NRFB) (UK)
Nationwide Building Society (UK)
Santander (UK)
Close Brothers (UK)

Category 4 - Limit of £4 million for each institution - Maximum Investment period - 1 year
Building Society with Assets greater than £10 billion

Coventry Building Society (UK)
Skipton Building Society (UK)
Yorkshire Building Society (UK)

Category 5 - Council's Bank
NO LIMIT - appropriate category 1 to 3 (Max of £11M term deposit)

Lloyds Bank Plc (RFB)
Lloyds Bank Corporate Markets Plc (NRFB)
Bank of Scotland PLC (RFB)

Category 6 - Limit of £11 million for each institution - Maximum investment period - 3 Years
banks effectively nationalised by UK government

		Long Term	Short Term
Min Criteria	**Fitch**	**BBB-**	**F3**
	Moody	**Baa3**	**P-3**
	S&P	**BBB-**	**A-3**

National Westminster Bank plc (RFB) (UK)
Royal Bank of Scotland plc (RFB) (UK)

Category 7 - Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)

- Money Market Funds (MMF's), (CNAV, LVNAV, VNAV) & Enh
- Government Liquidity Funds

Limit of £4million for each institution

	Fitch	NAV
Aberdeen Standard (GBP)	AAA	LVNAV
CCLA Public sector deposit fund (PSDF)	AAA	LVNAV
Deutsche Banking Group	AAA	LVNAV
Federated Investors Ltd	AAA	LVNAV
Fidelity (GBP)	AAA	LVNAV
Northern Trust	AAA	

Category 8 - Alternative Investments (Asset Backed Bonds) - 25 Years
Maximum investment £4 million

Category 9 - Debt Management Office
Debt management Account - NO LIMIT (UK Govt)

Category 10 - Bonds issued by multilateral development banks - 5 Years
Maximum investment £4 million AAA

Category 11 – Property Funds - 25 Years
Maximum investment £6 million

CCLA

Category 12 - Multi-Asset Funds - 15 Years
Maximum investment £6 million

CCLA - Diversified Income Fund

Appendix 8

Approved countries for investments

This list is based on those countries which have sovereign ratings of AA- or higher, 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 Link Asset Services credit worthiness service.

Based on a majority rule of available ratings.

AAA

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland
- U.S.A. (S&P AA+)

AA+

- Finland

AA

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

AA-

- Belgium (S&P AA)
- Qatar

APPENDIX 9

Treasury management scheme of delegation

(i) Full Council

- approval of annual strategy
- budget consideration and approval approval of the division of responsibilities;
- approving the selection of external service providers and agreeing terms of appointment.
- receiving and reviewing monitoring and outturn reports on treasury management

(ii) Cabinet Member for Corporate Governance

- approval of amendments to the annual treasury management strategy once approved by Full Council between its review in consultation with the Group Head of Corporate Support.

(iii) Audit and Governance Committee (responsibility for scrutiny)

- reviewing the treasury management policy and procedures and making recommendations to Full Council (the responsible body).
- Scrutiny of annual strategy prior to adoption by Full Council
- Scrutiny of monitoring and outturn reports
- receiving and reviewing reports on treasury management policies, practices and activities

APPENDIX 10

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.
- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long-term timeframe
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority
- ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing
- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long-term liabilities
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees
- ensuring that members are adequately informed and understand the risk exposures taken on by an authority
- ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above
- creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed.

APPENDIX 11

CCLA – Diversified Income Fund

Performance

CCLA AUTHORISED CONTRACTUAL SCHEME
Prices & Dividend Yields

CCLA

End of	Dec-19	Nov-19	Oct-19	Sep-19	Aug-19	Jul-19	Jun-19	May-19	Apr-19	Mar-19	Feb-19	Jan-19
Diversified Income Fund												
Fund Size £m	179.77	177.50	177.09	172.23	168.02	165.75	155.50	154.31	148.06	143.91	136.56	130.80
Class 1 Price £	1.6302	1.6232	1.6091	1.6104	1.6176	1.6149	1.5968	1.5938	1.5807	1.5574	1.5432	1.5339
Dividend on XD Date £	0.0119			0.0119			0.0148			0.0123		
Dividend - Last 12 Months £	0.0508	0.0511	0.0511	0.0511	0.0512	0.0512	0.0512	0.0505	0.0505	0.0505	0.0502	0.0502
Dividend Yield on Price %	3.12	3.15	3.18	3.18	3.16	3.17	3.21	3.17	3.19	3.24	3.25	3.27
Class 2 Price £	1.5700	1.5634	1.5498	1.5511	1.5581	1.5554	1.5380	1.5354	1.5226	1.5002	1.4866	1.4777
Dividend on XD Date £	0.0115			0.0115			0.0145			0.0119		
Dividend - Last 12 Months £	0.0494	0.0496	0.0496	0.0496	0.0499	0.0499	0.0499	0.0488	0.0488	0.0488	0.0485	0.0485
Dividend Yield on Price %	3.15	3.17	3.20	3.20	3.20	3.21	3.24	3.18	3.21	3.25	3.26	3.28
Class 3 Price £	1.5793	1.5725	1.5589	1.5601	1.5671	1.5644	1.5470	1.5443	1.5313	1.5088	1.4950	1.4860
Dividend on XD Date £	0.0114			0.0115			0.0145			0.0118		
Dividend - Last 12 Months £	0.0491	0.0494	0.0494	0.0494	0.0496	0.0496	0.0496	0.0484	0.0484	0.0484	0.0481	0.0481
Dividend Yield on Price %*	3.11	3.14	3.17	3.17	3.17	3.17	3.21	3.14	3.16	3.21	3.22	3.24

Class 1 launch date: 02 December 2016
Class 2 launch date: 24 March 2017
Class 3 launch date: 01 December 2017

The units of the ACS and the income from them can fall as well as rise and an investor may not get back the amount originally invested. Past performance is no guarantee of future returns. The units are intended only for long-term investment and are not suitable for money liable to be spent in the near future. Units are realisable daily.

Source: CCLA

Background

The fund was set up at the back of 2016 and would only be suitable for long-term investment purposes. The fund is an Advanced Collective Scheme which is understood to meet UCITs, (Collective Investment in Transferable Securities), so would be deemed revenue in structure.