HAMPSHIRE COUNTY COUNCIL

Decision Report

Committee:	Audit Committee
Date:	20 February 2020
Title:	Treasury Management Strategy Statement 2020/21 to 2022/23
Report From:	Deputy Chief Executive and Director of Corporate Resources

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Purpose of the report

1. The Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 (the CIPFA Code) requires authorities to determine their Treasury Management Strategy Statement (TMSS) before the start of each financial year.

2. This Strategy fulfils the County Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

3. The purpose of this report is therefore to present the Treasury Management Strategy Statement for 2020/21 to 2022/23.

Recommendations

4. That the Audit Committee notes the following recommendations that have been made to Cabinet:

5. That the Treasury Management Strategy for 2020/21 (and the remainder of 2019/20) be approved.

6. That authority is delegated to the Deputy Chief Executive and Director of Corporate Resources to manage the County Council's investments and borrowing according to the Treasury Management Strategy Statement as appropriate.

7. That £2m is transferred to the Investment Risk Reserve as part of the Revised Budget for 2019/20.

Introduction

8. In 2018 the Ministry of Housing, Communities & Local Government (MHCLG) produced new Investment Guidance including the requirement to produce an Investment Strategy.

9. The County Council's Capital and Investment Strategy sets out the Council's broad approach to investment, including its capital programme, how this is funded, and investments held for service purposes or for commercial profit (as reported to Cabinet and County Council in the Revenue Budget and Precept 2020/21 report on 3 February 2020 and 13 February 2020 respectively).

10. This Treasury Management Strategy (TMS) supports the Capital and Investment Strategy in setting out the arrangements for the management of the County Council's cash flows, borrowing and investments, and the associated risks.

11. The County Council has borrowed and invested sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the County Council's prudent financial management.

12. Treasury risk management at the County Council is conducted within the framework of the CIPFA Code which requires the County Council to approve a Treasury Management Strategy Statement (TMSS) before the start of each financial year. This Strategy fulfils the County Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

13. Investments held for service purposes or for commercial profit are considered separately in the Capital and Investment Strategy.

External Context

14. The following paragraphs explain the economic and financial background against which the TMS is being set.

Economic Background

15. The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the County Council's TMS for 2020/21.

16. Gross Domestic Product (GDP) growth rose by 0.4% in the third quarter of 2019 from -0.2% in the previous three months with the annual rate falling further below its trend rate to 1.1%. Looking ahead, the Bank of England forecasts economic growth to pick up during 2020 as Brexit related uncertainties dissipate and provide a boost to business investment helping GDP reach 1.6% in Quarter 4 2020, 1.8% in Quarter 4 2021 and 2.1% in Quarter 4 2022.

17. The headline rate of UK Consumer Price Inflation (CPI) remained the same in November 2019 at 1.5% year-on-year, although lower than highs of 2.1% in July and April 2019 and below the Bank of England target of 2%.

18. Labour market data continues to be positive with unemployment at 3.8%, the lowest level since 1975. The three month average annual growth rate for pay excluding bonuses rose to 3.5% in November 2019, providing some evidence that a shortage of labour is supporting wages. However, adjusting for inflation this means real wages were only up by 0.9% in October 2019 and only likely to have a moderate impact on household spending.

Credit Outlook

19. The recent Bank of England stress tests assessed all seven UK banking groups, with all seven passing the test. Major banks have steadily increased their capital for many years now, however the tests do not cover all banks and the Bank of England will seek to address issues with the tests in 2020, when Virgin Money / Clydesdale will be added to the testing group and separate tests will be included of ringfenced banks.

20. Looking forward, the potential for adverse Brexit outcomes and / or a global recession remain the major risks facing banks and building societies in 2020/21 and a cautious approach to bank deposits continues to be recommended by the County Council's treasury advisors.

Interest Rate Forecast

21. The Council's treasury management adviser Arlingclose is forecasting that the Bank Rate will remain at 0.75% until the end of 2022. The risks to this forecast are deemed to be significantly weighted to the downside, particularly given the need for greater clarity on Brexit and continuing global economic slowdown.

22. The Bank of England, having previously indicated interest rates may need to rise if a Brexit agreement was reached, stated in its November Monetary Policy Report and its Bank Rate decision (7 to 2 vote to hold rates) that the

Monetary Policy Committee (MPC) now believe this is less likely even in the event of a deal.

23. Gilt yields have risen but remain at low levels and only some very modest upward movement from current levels are expected based on Arlingclose's interest rate projections. The central case is for 10-year and 20-year gilt yields to rise to around 1.00% and 1.40% respectively over the time horizon, with broadly balanced risks to both the upside and downside. However, short-term volatility arising from both economic and political events over the period is a near certainty.

24. A more detailed economic and interest rate forecast provided by Arlingclose is attached at Annex A.

Balance Sheet Summary and Forecast

25. On 30 November 2019, the County Council held £308m of borrowing and £590m of investments. This is set out in further detail at Annex B. Forecast changes in these sums are shown in the balance sheet analysis in Table 1 below:

Table 1: Balance Sheet Summary and Forecast

	31/03/19 Actual £M	31/03/20 Estimate £M	31/03/21 Forecast £M	31/03/22 Forecast £M	31/03/23 Forecast £M
Capital Financing Requirement	781	794	824	822	793
Less: Other Long-term Liabilities					
- Street Lighting PFI	(104)	(100)	(96)	(91)	(86)
- Waste Management Contract	(53)	(50)	(46)	(42)	(38)
Borrowing CFR	**624**	**644**	**682**	**689**	**669**
Less: External Borrowing					
- Public Works Loan Board	(238)	(228)	(218)	(208)	(200)
- Other Loans (incl. LOBOs)	(45)	(41)	(41)	(41)	(41)
- Other Short-term Borrowing	(31)	(31)	(31)	(31)	(31)
Internal Borrowing	**310**	**344**	**392**	**409**	**397**
Less: Reserves and Balances	(669)	(591)	(625)	(656)	(670)
Less: Allowance for Working Capital	(210)	(210)	(210)	(210)	(210)
Resources for Investment	**(879)**	**(801)**	**(835)**	**(866)**	**(880)**
(Treasury Investments) / New Borrowing	**(569)**	**(457)**	**(443)**	**(457)**	**(483)**

26. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The County Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

27. It is forecast that the County Council will continue to take advantage of internal borrowing, which will increase through until 2021/22, whilst paying off Public Works Loan Board (PWLB) debt as maturities arise.

28. The County Council intends to pay employer's Local Government Pension Scheme (LGPS) pension contributions in advance in April 2020 for the three years covering 2020/21 to 2022/23, with the initial reduction in cash balances offset by not then making monthly pension contributions. The lower contribution rate being charged as a result of paying in advance will generate a saving for the County Council across the three-year period that is greater than the investment income foregone.

29. Reserves and balances are initially due to reduce over the forecast period due to the anticipated funding of the Capital Programme, repayment of external debt, and use of the Budget Bridging Reserve (BBR) and are then forecast to increase as part of the Council's Reserves Strategy.

30. These factors result in the profile for investment balances shown in Table 1.

31. CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the County Council's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the County Council expects to comply with this recommendation during 2020/21.

Borrowing Strategy

32. The County Council currently holds £308m of loans, a decrease of £1m on the previous year, as part of its strategy for funding previous years' Capital Programmes. The balance sheet forecast in Table 1 shows that the County Council does not expect to need to borrow in 2020/21. The County Council may however borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £780m.

Objectives

33. The County Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and

achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the County Council's long-term plans change is a secondary objective.

Strategy

34. Given the significant cuts to public expenditure and in particular to local government funding, the County Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, if the County Council does need to borrow, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

35. By internally borrowing, the County Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. If borrowing is required, the benefits of internal and short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the County Council with this 'cost of carry' and breakeven analysis.

36. The County Council has previously raised the majority of its long-term borrowing from the PWLB, but the Government increased the margin on PWLB rates by 100 basis points (1%) in October 2019 making it a relatively expensive way to meet borrowing needs.

37. Alternative options should the County Council need to borrow any long-term amounts include banks, pension funds and local authorities as well as the potential to issue bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code.

38. The County Council may also arrange forward starting loans during 2020/21, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

39. In addition, the County Council may borrow short-term loans (normally for up to one month) to cover unplanned cash flow shortages.

Sources

40. The approved sources of long-term and short-term borrowing are:

- PWLB and any successor body.
- Any institution approved for investments (see below).
- Any other bank or building society authorised to operate in the UK.
- Any other UK public sector body.
- UK public and private sector pension funds (except Hampshire Pension Fund).
- Capital market bond investors.
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues.

Other Sources of Debt Finance

41. In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- Leasing.
- Hire purchase.
- Private Finance Initiative (PFI).
- Sale and leaseback.

LOBOs

42. The County Council holds £20m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the County Council has the option to either accept the new rate or to repay the loan at no additional cost.

43. All of these loans have options during 2020/21, and although the County Council understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The County Council will take the option to repay LOBO loans at no cost if it has the opportunity to do so. Total borrowing via LOBO loans will be limited to the current level of £20m.

Short-term and Variable Rate Loans

44. These loans leave the Council exposed to the risk of short-term interest rate rises. This risk is monitored through the indicator on interest rate exposure in the treasury management indicators in this report.

Debt Rescheduling

45. The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The County Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

Investment Strategy

46. The County Council holds invested funds representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the County Council's investment balance has ranged between £569m and £677m, although lower levels are expected in the forthcoming year, as shown in Table 1.

47. The reduction in investment balances predicted for 2020/21 is largely the result of the intention to pay employer's pension contributions in advance in April 2020. This will be for the three years covering 2020/21 to 2022/23 for staff in the LGPS and will enable the County Council to make savings on pension contributions that outweigh the lost investment income. This can be done without impacting liquidity with the benefit of also reducing counterparty risk.

Objectives

48. The CIPFA Code requires the County Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The County Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

Negative Interest Rates

49. If the UK enters into a recession in 2020/21, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

Strategy

50. Given the increasing risk and very low returns from short-term unsecured bank investments, the County Council aims to continue to be diversified in more secure and/or higher yielding asset classes during 2020/21. This is especially the case for the estimated £340m that is available for longer-term investment.

51. Approximately 77% of the County Council's surplus cash is invested so that it is not subject to bail-in risk, as it is invested in local authorities, registered providers, pooled property, equity and multi-asset funds, and secured bank bonds.

52. Of the cash subject to bail-in risk, 17% is held in short-term notice accounts which are maturing before the end of the financial year, 56% is held in overnight money market funds and cash plus funds which are subject to a reduced risk of bail-in, and 27% is held in certificates of deposit which can be sold on the secondary market. This diversification is a continuation of the strategy adopted in 2015/16. Further detail is provided at Annex B.

Business Models

53. Under the new IFRS 9, the accounting for certain investments depends on the 'business model' for managing them. The County Council aims to achieve value from its internally managed treasury investments through a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

Investments Targeting Higher Returns

54. As set out in the Capital and Investment Strategy, the County Council agreed in 2019 to increase the amount of its cash balances earmarked for investments targeting higher yields of around 4% to £235m. Just over £201m of this allocation has now been invested, as shown in Annex B, with the remaining balance earmarked.

55. Without this allocation the weighted average return of the Council's cash investments based on investments held at 30 November 2019 would have been 0.97%; whereas the allocation to higher yielding investments has a weighted average return of 4.67% bringing the overall average return for the portfolio to 2.23%, as shown in the table below:

Table 2: Weighted Average Returns

	Cash Balance 30/11/2019	Weighted Average Return
	£M	%
Short-term and Long-term Cash Investments	388.5	0.97
Investments Targeting Higher Yields	201.1	4.67
Total	**589.6**	**2.23**

56. The latest estimated value of investment income is circa £13.5m for 2019/20. However, as these balances and returns do not remain constant over the course of a year the figures are indicative, and the actual returns will form part of the outturn report at the conclusion of the financial year.

57. The County Council's overall investment balances will fall during 2020/21 as a result of the early payment of LGPS pension contributions explained above. The amount earmarked to investments targeting higher yields, however, reflects the County Council's long-term stable balances, and there is therefore no requirement to change this allocation of £235m.

58. Higher yields can be accessed through long-term cash investments (although this is currently less the case as yields have declined) and investments in other assets than cash, such as pooled property, equities and bonds. Non-cash pooled investments must be viewed as long-term investments in order that monies are not withdrawn in the event of a fall in capital values to avoid crystallising a capital loss.

59. When the County Council began to specifically target higher returns from a proportion of its investments, it also established an Investment Risk Reserve to mitigate the risk of an irrecoverable fall in the value of these investments. It is recommended that a further £2.0m is added to this reserve in line with this strategy to further protect the County Council's funds. This is prudent given the additional amount to be targeted at higher yielding investments and will bring the total amount in the reserve to approaching £5.0m or just over 2.1% of the value of the investments.

60. At the current time, given the medium to long term nature of the investments, it is unlikely that a capital loss would ever be realised, since the County Council would avoid selling investments that realised a capital loss.

61. Going forward however, changes to IFRSs mean that capital gains and losses on investments need to be reflected in the revenue account on an

annual basis. There is currently a statutory override in place for local authorities that exempts them from complying with this requirement for the next four years. However, given the greater future risk in this area it is proposed to continue to contribute towards the Investment Risk Reserve to reach 2.5% of the total amount invested (in line with the recommendation of 2.5% for the general fund balance).

62. The County Council's investments in pooled property, equity and multi-asset funds are summarised in Table 3 below:

Table 3: Pooled Fund Investments Capital Value at 30 November 2019

Pooled Fund Investments	**Principal Invested £M**	**Market Value 30/11/19 £M**	**Capital Growth (per annum) %**
Pooled Property	77.0	77.7	0.22
Pooled Equity	52.0	52.7	0.43
Pooled Multi-asset	42.0	43.2	1.47
Total	**171.0**	**173.6**	**0.48**

63. In addition to the capital growth shown in Table 3, the County Council has achieved income returns averaging 4.67% per annum from these investments in pooled funds, resulting in a total return of 5.15% per annum.

64. Although money can usually be redeemed from the pooled funds at short notice, the County Council's intention is to hold them for at least the medium-term. Their performance and suitability in meeting the County Council's investment objectives are monitored regularly and discussed with Arlingclose.

Investment Limits

65. The maximum that will be lent to any one organisation (other than the UK Government) will be £50m. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, and investments in pooled funds, as they would not count against a limit for any single foreign country, since the risk is diversified over many countries.

Table 4: Investment Limits

	Cash Limit
Any single organisation, except the UK Central Government	£50m each
UK Central Government	Unlimited
Any group of organisations under the same ownership	£50m per group
Any group of pooled funds under the same management	£50m per manager
Registered Providers and Registered Social Landlords	£50m in total
Money Market Funds	50% in total
Real Estate Investment Trusts	£50m in total

Approved Counterparties

66. The County Council may invest its surplus funds with any of the counterparty types in Table 5, subject to the cash limits (per counterparty) and the time limits shown:

Table 5: Approved Investment Counterparties and Limits

Credit Rating	**Banks**		**Government**	**Corporates**	**Registered Providers**	
	Unsecured	**Secured**			**Unsecured**	**Secured**
UK Govt	N/A	N/A	£ Unlimited 30 years	N/A	N/A	N/A
AAA	£25m 5 years	£50m 20 years	£50m 30 years	£25m 20 years	£25m 20 years	£25m 20 years
AA+	£25m 5 years	£50m 10 years	£50m 25 years	£25m 10 years	£25m 10 years	£25m 10 years
AA	£25m 4 years	£50m 5 years	£50m 15 years	£25m 5 years	£25m 10 years	£25m 10 years
AA-	£25m 3 years	£50m 4 years	£50m 10 years	£25m 4 years	£25m 10 years	£25m 10 years
A+	£25m 2 years	£50m 3 years	£25m 5 years	£25m 3 years	£25m 5 years	£25m 5 years
A	£25m 13 months	£50m 2 years	£25m 5 years	£25m 2 years	£25m 5 years	£25m 5 years
A-	£25m 6 months	£50m 13 months	£25m 5 years	£25m 13 months	£25m 5 years	£25m 5 years
None	£25m 6 months	N/A	£50m 25 years	N/A(*)	£25m 5 years	£25m 5 years
Pooled Funds & Real Estate Investment Trusts	£50m per fund					

*See paragraph 72

This table must be read in conjunction with the notes below

Credit Rating

67. Investment limits are set by reference to the lowest published long-term credit rating from a selection of external rating agencies. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

Banks Unsecured

68. Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

Banks Secured

69. Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

Government

70. Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 30 years.

Corporates

71. Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent.

72. The County Council will not invest in an un-rated corporation except where it owns a significant or controlling interest in the corporation, in which case a limit of £35m will for an investment of up to 20 years will apply.

Registered Providers Secured and Unsecured

73. Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords. These bodies are tightly regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government, and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

Pooled Funds

74. Shares or units in diversified investment vehicles consisting of any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and / or have a notice period will be used for longer investment periods.

75. Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the County Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Depending on the type of pooled fund invested in, it may have to be classified as capital expenditure. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the County Council's investment objectives will be monitored regularly.

Real Estate Investment Trusts (REITs)

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

Operational Bank Accounts

77. The County Council may incur operational exposures, for example through current accounts, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be kept low. The County Council's operational bank account is with National Westminster and aims to keep the overnight balances held in current accounts positive, and as close to zero as possible. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the County Council maintaining operational continuity.

Risk Assessment and Credit Ratings

78. Credit ratings are obtained and monitored by the County Council's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

79. Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as “rating watch negative” or “credit watch negative”) so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

Other Information on the Security of Investments

80. The County Council understands that credit ratings are good but not perfect predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press and analysis from the County Council's treasury management adviser. No investments will be made with an organisation if

there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

81. When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the County Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the County Council's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office, or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

Liquidity Management

82. The County Council has due regard for its future cash flows when determining the maximum period for which funds may prudently be committed. Historic cash flows are analysed in addition to significant future cash movements, such as payroll, grant income and council tax precept. Limits on long-term investments are set by reference to the County Council's medium term financial position (summarised in Table 1) and forecast short-term balances.

Treasury Management Indicators

83. The County Council measures and manages its exposures to treasury management risks using the following indicators.

Interest Rate Exposures

84. The following indicator shows the sensitivity of the County Council's current investments and borrowing to a change in interest rates. Fixed rate investments maturing during the year are assumed to be variable for the remainder of the year.

Table 6: Interest Rate Risk Indicator

	30 November 2019	Impact of +/- 1% Interest Rate Change
Sums Subject to Variable Interest Rates		
Investment	£272.9m	+ / - £2.7m
Borrowing	(£23.3m)	+ / - £0.2m

Maturity Structure of Borrowing

85. This indicator is set to control the County Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

Table 7: Refinancing Rate Risk Indicator

	Upper	Lower
Under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	75%	0%
10 years and within 20 years	75%	0%
20 years and within 30 years	75%	0%
30 years and above	100%	0%

86. Time periods start on the first day of each financial year.

Principal Sums Invested for Periods Longer than a Year

87. The purpose of this indicator is to control the County Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

Table 8: Price Risk Indicator

	2020/21	2021/22	2022/23
Limit on principal invested beyond year end	£340m	£330m	£330m

Related Matters

88. The CIPFA Code requires the County Council to include the following in its TMSS.

Financial Derivatives

89. Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

90. The County Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the County Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

91. Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit. The use of financial derivatives is not planned as part of the implementation of the TMSS and any changes to this would be reported to Members in the first instance.

92. In line with the CIPFA Code, the County Council will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.

Investment Advisers

93. The County Council has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues. The quality of this service is controlled through quarterly review meetings with the Deputy Chief Executive and Director of Corporate Resources, her staff and Arlingclose.

Markets in Financial Instruments Directive

94. The County Council has opted up to professional client status with its providers of financial services, including advisers, brokers, and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the County Council’s treasury management activities, the Section 151 Officer believes this to be the most appropriate status

Annex A - Arlingclose Economic & Interest Rate Forecast January 2020

Underlying assumptions:

- The global economy has entered a period of weaker growth in response to political issues. The UK economy continues to experience slower growth due to both Brexit uncertainty and the downturn in global activity. In response, global and UK interest rate expectations are low.

- Some improvement in global economic data and a more positive outlook for US / China trade negotiations has prompted worst case economic scenarios to be pared back.

- The new Conservative UK government will progress with achieving Brexit on 31 January 2020. The more stable political environment will prompt a partial return in business and household confidence in the short term, but the subsequent limited Brexit transitionary period, which the government is seeking to enforce, will create additional economic uncertainty.

- UK economic growth has stalled in Quarter 4 and inflation is running below the target of 1.5%. The inflationary consequences of the relatively tight labour market have yet to manifest, while slower global growth should reduce the prospect of externally driven pressure, although escalating geopolitical turmoil could continue to push up oil prices.

- The first few months of 2020 will indicate whether the economy benefits from restored confidence. The Government will undertake substantial fiscal easing in 2020/21, which should help support growth in the event of a downturn in private sector activity.

- The weak outlook for the UK economy and current low inflation have placed pressure on the Monetary Policy Committee (MPC) to loosen monetary policy. Two MPC members voted for an immediate cut in the last two MPC meetings of 2019. The evolution of the economic data and political moves over the next few months will inform policy, but upside risks to the Bank Rate are very limited.

- Central bank actions and geopolitical risks will produce significant volatility in financial markets, including bond markets.

Forecast:

- We have maintained our Bank Rate forecast at 0.75% for the foreseeable future. Substantial risks to this forecast remain, arising primarily from the Government's policy around Brexit and the transitionary period.

- Arlingclose judges that the risks are weighted to the downside.

- Gilt yields remain low due to the soft UK and global economic outlooks. US monetary policy and UK government spending will be key influences alongside UK monetary policy.

- We expect gilt yields to remain at relatively low levels for the foreseeable future and judge the risks to be broadly balanced.

	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
Official Bank Rate													
Upside risk	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Case	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Downside risk	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
3-month money market rate													
Upside risk	0.10	0.10	0.25	0.25	0.25	0.25	0.25	0.25	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Downside risk	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
1yr money market rate													
Upside risk	0.10	0.20	0.20	0.20	0.20	0.20	0.20	0.25	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85
Downside risk	0.30	0.50	0.55	0.65	0.65	0.65	0.65	0.65	0.65	0.65	0.65	0.65	0.65
5yr gilt yield													
Upside risk	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.45	0.45	0.45
Arlingclose Central Case	0.50	0.50	0.55	0.55	0.55	0.60	0.60	0.65	0.65	0.70	0.75	0.75	0.75
Downside risk	0.35	0.50	0.55	0.55	0.55	0.60	0.60	0.65	0.65	0.70	0.75	0.75	0.75
10yr gilt yield													
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45
Arlingclose Central Case	0.75	0.80	0.80	0.85	0.85	0.90	0.90	0.95	0.95	1.00	1.05	1.10	1.10
Downside risk	0.40	0.40	0.40	0.40	0.45	0.45	0.45	0.45	0.50	0.50	0.50	0.50	0.50
20yr gilt yield													
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45
Arlingclose Central Case	1.20	1.25	1.25	1.25	1.30	1.30	1.30	1.35	1.35	1.35	1.40	1.40	1.40
Downside risk	0.40	0.40	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.50	0.50
50yr gilt yield													
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45
Arlingclose Central Case	1.20	1.25	1.25	1.25	1.30	1.30	1.30	1.35	1.35	1.35	1.40	1.40	1.40
Downside risk	0.40	0.40	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.50	0.50

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 1.80%
PWLB Local Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

Annex B - Existing Investment & Debt Portfolio Position at 30 November 2019

Investments	**Balance 30/11/2019 £M**	**Rate 30/11/2019 %**	**WAM (*) 30/11/2019 Years**
Short Term Investments			
- Banks and Building Societies:			
- Unsecured	41.0	0.86	0.16
- Secured	50.1	0.85	0.42
- Money Market Funds	43.2	0.73	0.00
- Local Authorities	146.0	0.92	0.38
- Registered Provider	0.0	0.00	0.00
- Cash Plus Funds	10.0	1.45	N/A
	290.3	**0.89**	**0.30**
Long Term Investments			
- Banks and Building Societies:			
- Secured	43.2	0.95	2.14
- Local Authorities	55.0	1.40	1.85
	98.2	**1.20**	**1.98**
Long Term Investments – high yielding strategy			
- Local Authorities			
- Fixed deposits	20.0	3.96	14.30
- Fixed bonds	10.0	3.78	14.11
- Pooled Funds			
- Pooled property**	77.0	4.14	N/A
- Pooled equity**	52.0	5.90	N/A
- Pooled multi-asset**	42.0	4.69	N/A
- Other	0.1	5.68	0.41
	201.1	**4.67**	**14.24**
Total Investments	**589.6**	**2.23**	**1.69**

* WAM - Weighted Average Maturity

** The rates provided for pooled fund investments are reflective of the average of the most recent dividend return as at 30 November 2019.

	£M	%
External Borrowing		
PWLB Fixed Rate	(232.1)	(4.71)
Other Loans (including LOBO Loans)	(44.8)	(4.08)
Other Short-term Borrowing	(31.0)	N/A)
Total External Borrowing	**(307.7)**	**(4.61)**
Other Long-Term Liabilities:		
Street Lighting PFI	(99.9)	
Waste Management Contract	(49.5)	
Total Other Long-Term Liabilities	**(149.4)**	
Total Gross External Debt	**(457.1)**	
Investments	**589.6**	**2.23**
Net (Debt) / Investments	**141.5**	

REQUIRED CORPORATE AND LEGAL INFORMATION:

Links to the Strategic Plan

This proposal does not link to the Strategic Plan but, nevertheless, requires a decision because it relates to the effective management of the County Council's cash balances

Other Significant Links

Links to previous Member decisions:	
Title Treasury Management Strategy Statement 2019/20 to 2021/22 Revenue Budget and Precept 2020/21	Date 21/2/2019 3/2/2020
Direct links to specific legislation or Government Directives	
Title	Date

Section 100 D - Local Government Act 1972 - background documents **The following documents discuss facts or matters on which this report, or an important part of it, is based and have been relied upon to a material extent in the preparation of this report. (NB: the list excludes published works and any documents which disclose exempt or confidential information as defined in the Act.)**

Document	Location
None	

EQUALITIES IMPACT ASSESSMENT:

1. Equality Duty

The County Council has a duty under Section 149 of the Equality Act 2010 ('the Act') to have due regard in the exercise of its functions to the need to:

- Eliminate discrimination, harassment and victimisation and any other conduct prohibited by or under the Act with regard to the protected characteristics as set out in section 4 of the Act (age, disability, gender reassignment, marriage and civil partnership, pregnancy and maternity, race, religion or belief, sex and sexual orientation);
- Advance equality of opportunity between persons who share a relevant protected characteristic within section 149(7) of the Act (age, disability, gender reassignment, pregnancy and maternity, race, religion or belief, sex and sexual orientation) and those who do not share it;
- Foster good relations between persons who share a relevant protected characteristic within section 149(7) of the Act (see above) and persons who do not share it.

Due regard in this context involves having due regard in particular to:

- The need to remove or minimise disadvantages suffered by persons sharing a relevant protected characteristic that are connected to that characteristic;
- Take steps to meet the needs of persons sharing a relevant protected characteristic that are different from the needs of persons who do not share it;
- Encourage persons sharing a relevant protected characteristic to participate in public life or in any other activity in which participation by such persons is disproportionally low.

2. Equalities Impact Assessment:

Equality objectives are not considered to be adversely affected by the proposals in this report which relates to the County Council's management of its cash investment balances.