Allerdale borough council

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Treasury Management Strategy Statement & Investment Strategy

Minimum Revenue Provision Policy

2018/2019

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1. Introduction

1.1 Background

1.1.1 For public sector organisations, the Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as "the management of the organisation'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".

1.1.2 This definition expects a 'best value' approach in which authorities should seek to minimise the cost of borrowing (or maximise the returns from investment), subject to the over-riding management of risks, with risk limitation being more important than return (yield).

1.1.3 The statutory framework for treasury management and capital finance within local authorities is laid out in a series of legislations, statutory guidance and codes of practice, the key elements of which are:

- The Local Government Act 2003 - ('the 2003 Act')
- The Local Authorities (Capital Finance and Accounting)(England) Regulations 2003 (as amended) - ('the 2003 Regulations')
- Ministry of Housing, Communities & Local Government (MHCLG) (formerly the Department for Communities & Local Government) Guidance on Local Government Investments - third edition (February 2018)
- MHCLG guidance on Minimum Revenue Provision - fourth edition (February 2018)
- The Prudential Code for Capital Finance in Local Authorities - 2017 Edition - ('the Prudential Code')
- The Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes 2017 Edition - ('the Treasury Management Code').

1.1.4 Consistent with the definition of treasury management set out in paragraph 1.1.1 the Treasury Management and Investment strategies contained in this document are focused on borrowing and investments in financial instruments forming part of the Council's treasury management activity. Investments in financial and non-financial assets (for example investment property, loans supporting service outcomes and investments in subsidiaries and joint ventures) made for policy reasons, rather than for treasury management purposes, are dealt with in the Council's Capital Strategy.

1.2 Reporting requirements

1.2.1 Provisions contained in the Local Government Act 2003, statutory guidance and regulations issued by the Ministry of Housing, Communities & Local Government and Codes of Practice issued by CIPFA in relation to treasury management and capital finance, require local authorities to prepare and approve, before the start of each financial year:

- a Treasury Management Strategy Statement (TMSS) and Investment Strategy setting out its proposed treasury management activities for the year and policies for the prudent management of its investments
- a statement of its policy on making Minimum Revenue Provision (MRP) indicating how, in the forthcoming financial year, the duty to make prudent MRP will be discharged
- a set of prescribed prudential and treasury indicators for the forthcoming and following years - including the Council's Authorised Borrowing Limit - demonstrating that its capital expenditure plans are affordable and that external borrowing is within prudent and sustainable levels.

1.2.2 The Treasury Management Code also requires authorities to ensure the Full Council receives:

- a mid-year report providing:
  - an update on the economic environment and interest rate forecasts underlying the adopted strategies
  - details of variations (if any) from agreed policies/practices contained in the approved Treasury Management and Investment Strategies
  - details of investing and borrowing activities undertaken
  - confirmation of compliance with treasury and prudential indicators
- after the year-end, an annual report on the performance of the treasury management function, on the risk implications of decisions taken and the transactions executed in the past year, and on any circumstances of non-compliance with the Council's treasury management policy statement.

1.2.3 This document - prepared in accordance with the statutory framework and codes of practice referred to above - sets out the Council's:

- Treasury Management Strategy Statement (TMSS) and Investment Strategy for 2018-/19
- Minimum revenue provision (MRP) policy statement for 2018/19
- Prudential and treasury indicators for the three year period 2018/19 to 2020/21.

1.2.4 The TMSS and Investment Strategy, MRP policy and the prudential and treasury indicators must be approved by Full Council prior to the commencement of the financial year to which they relate.

1.2.5 To enable the Audit Committee to fulfil its responsibilities for ensuring effective scrutiny of treasury management strategy and policies, the Council's Treasury Management Practices (TMPs) require treasury management reports - including this report - to be submitted to the Audit Committee prior to their consideration by Full Council.

2. Treasury Management Strategy Statement

2.1 Current treasury position

2.1.1 The Council's treasury portfolio position at 31 December 2017 is summarised in table 1. Table 1 also shows a comparison of the Council's actual external debt (borrowing) postion with its underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

Table 1: Investment and borrowing

	At 31 Dec 2017 £000	At 31 Mar 2017 £000	At 31 Dec 2016 £000	At 31 Mar 2016 £000
Investments				
Specified Investments:				
Term, call & notice accounts	1,527	2,419	4,334	3,216
Money Market Funds	11,545	5,655	11,391	6,351
Non-specified investments:				
Equities	11	11	11	11
Total investments	**13,083**	**8,085**	**15,736**	**9,578**
Borrowing				
PWLB	13,465	13,607	13,693	13,829
Other borrowing	85	85	94	94
Other long-term liabilities	0	0	0	0
Total (gross) debt	**13,550**	**13,692**	**13,787**	**13,923**
Capital Financing Requirement	18,245	18,674	18,375	17,449
(Under)/Over borrowing	(4,695)	(4,982)	(4,588)	(3,526)

2.2 Treasury Indicators: limits on borrowing and lending activity

2.2.1 The Local Government Act 2003 requires a local authority to create and keep under review, limits on how much money it can afford to borrow by way of loans and other forms of credit (for example finance leases). The processes authorities must follow in setting these limits (the 'Authorised Limit for external debt') are set out in the Prudential Code which authorities must 'have regard to'. An authority is free to vary its affordable borrowing limit - subject to approval by Full Council – provided there is good reason for doing so. However breach of the Affordable Borrowing Limit is prohibited by the 2003 Act and any borrowing above the affordable borrowing limit is ultra-vires.

2.2.2 In addition to the Authorised Limit, the Prudential and Treasury Management Codes and accompanying sector guidance, include a number of other key treasury management indicators designed to ensure the Council operates its treasury activities within well-defined limits. These include:

- setting an operational boundary for external debt based on the expectations of the most likely maximum external debt for the year and reflecting the authority's plans for capital expenditure, estimated capital financing requirement (CFR) and cash flow requirements for the year for all purposes
- ensuring that 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 current and the following two financial years.
- placing upper limits on the total of principal sums invested for over 365 days
- placing upper and lower limits on the maturity structure of its borrowing.

2.2.3 Details of the Council's prudential and treasury indicators are set out in section 5 of this report.

2.3 Prospects for interest rates

2.3.1 The Council has appointed Link Asset Services (formerly operating as Capita Asset Services) as its treasury advisor. Part of their service is to assist the Council to formulate a view on interest rates. Link Asset Services undertook its latest review of interest rate forecasts in November 2017. These latest forecasts take into account the Bank of England quarterly Inflation Report for November 2017 and the decisions and forward guidance issued by Bank's Monetary Policy Committee at its meeting on 2 November 2017.

Table 2: Forecast interest rates 2018-2021

Quarter ending	Bank Rate	PWLB Borrowing Rates[1]			
	%	5 year %	10 year %	25 year %	50 year %
6 Feb 2018	0.50	1.83	2.33	2.76	2.45
Mar 2018	0.50	1.60	2.20	2.90	2.60
Jun 2018	0.50	1.60	2.30	3.00	2.70
Sep 2018	0.50	1.70	2.40	3.00	2.80
Dec 2018	0.75	1.80	2.40	3.10	2.90
Mar 2019	0.75	1.80	2.50	3.10	2.90
Jun 2019	0.75	1.90	2.60	3.20	3.00
Sept 2019	0.75	1.90	2.60	3.20	3.00
Dec 2019	1.00	2.00	2.70	3.30	3.10
Mar 2020	1.00	2.10	2.70	3.40	3.20
Jun 2020	1.00	2.10	2.80	3.50	3.30
Sept 2020	1.25	2.20	2.90	3.50	3.30
Dec 2020	1.25	2.30	2.90	3.60	3.40
Mar 2021	1.25	2.30	3.00	3.60	3.40

[1]Certainty rates are calculated by subtracting 0.2% from the standard new loan rates. Certainty rates apply to authorities who have provided MHCLG with required information on their plans for long-term borrowing and associated capital spending.

2.3.2 These forecasts are based on the PWLB Certainty Rate (standard new loan rate minus 20 basis points) which has been accessible to most authorities since 2012. It includes three further increase in the Bank Rate starting in quarter 4 (October to December) of 2018, together with a gradual increased in PWLB borrowing rates over the forecast period.

2.3.3 As expected, the Bank of England Monetary Policy Committee (MPC) delivered a 0.25% increase in the Bank Rate at its meeting on 2 November. This removed the emergency cut made in August 2016 after the EU referendum. The MPC also gave forward guidance that they expected to increase the Bank Rate only twice more by 0.25% by 2020 to end at 1.00%. The Link Asset Services forecast above includes increases in the Bank Rate of 0.25% in November 2018, November 2019 and August 2020.

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

2.3.5 The overall balance of risks to economic recovery in the UK is probably to the downside, particularly given with the current level of uncertainty over the final terms of Brexit.

2.3.6 In line with the base rate forecasts, investment returns are likely to remain low during 2018/19 and beyond. As a consequence there will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.

2.3.7 Borrowing interest rates increased sharply following the result of the general election in June 2017. Further increases occurred after the September MPC meeting when financial markets reacted by accelerating their expectations for the timing of Bank Rate increases. However, apart from these movements there has been little general trend in rates during the current financial year (2017/18).

2.3.8 From time to time, gilt yields – and therefore PWLB rates - can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis and emerging market developments. Such volatility could occur at any time during the forecast period.

2.3.9 The overall longer run trend, however, is for gilt yields and PWLB rates to rise, albeit gently. It has long been expected that, at some point, there would be a more protracted move from bonds to equities after a historic long-term trend, over about the last 25 years, of falling bond yields. The action of central banks since the financial crash of 2008, in implementing substantial

Quantitative Easing (QE), added further impetus to this downward trend in bond yields and rising bond prices.

2.3.10 Quantitative Easing has also directly led to a rise in equity values as investors searched for higher returns and took on riskier assets. The sharp rise in bond yields since the US Presidential election in November 2016 has called into question whether the previous trend may go into reverse, especially now the Federal Reserve has taken the lead in reversing monetary policy by starting, in October 2017, a policy of not fully reinvesting proceeds from bonds that it holds when they mature.

2.3.11 Until 2015, monetary policy was focused on providing stimulus to economic growth but has since started to refocus on countering the threat of rising inflationary pressures as stronger economic growth becomes more firmly established. The Federal Reserve has started raising interest rates and this trend is expected to continue during 2018 and 2019. These increases will make holding US bonds much less attractive and cause their prices to fall, and therefore bond yields to rise.

2.3.12 Rising bond yields in the US are likely to exert some upward pressure on bond yields in the UK and other developed economies. However, the degree of that upward pressure is likely to be dampened by how strong or weak the prospects for economic growth and rising inflation are in each country, and on the degree of progress towards the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

2.3.13 In addition to the above uncertainties, downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- the pace of Bank of England monetary policy action over the next three years causing weaker UK economic growth and increases in inflation than currently anticipated
- geopolitical risks in Asia (especially North Korea), Europe and the Middle East, leading to increasing safe haven flows
- a resurgence of the Eurozone sovereign debt crisis, possibly Italy, due to its high level of government debt, low rate of economic growth and vulnerable banking system
- weak capitalisation of some European banks
- the result of the October 2017 Austrian general election – which has resulted in a strongly anti-immigrant coalition government . In addition, the Czech ANO party became the largest party in the October 2017 general election on a platform of being strongly against EU migrant quotas and refugee policies. Both developments could provide major impetus to other, particularly former Communist bloc countries, to coalesce to create a major block to progress on EU integration and centralisation of EU policy. This, in turn, could spill over into impacting the Euro, EU financial policy and financial markets.

- the absence of an effective government in Germany after the inconclusive result of the general election in October. In addition, Italy is to hold a general election on 4 March and the anti EU populist Five Star party is currently in the lead in the polls, although it is unlikely to get a working majority on its own. Both situations could pose major challenges to the overall leadership and direction of the EU as a whole and of the individual respective countries. Hungary will hold a general election in April 2018.
- rising protectionism under President Trump
- a sharp Chinese downturn and its impact on emerging market countries.

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

- the pace and strength of increases in the Bank Rate is too slow allowing inflationary pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in the Bank Rate faster than currently expected
- UK inflation returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields
- the pace and strength of increases in the Federal Reserve Funds Rate and reversal of Quantitative Easing, causing a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities, leading to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.

2.3.15 A more detailed commentary on the economic background underpinning current interest rate forecasts is included in Appendix B.

2.4 Borrowing strategy

2.4.1 The Council is currently maintaining an under-borrowed position (see table 1). This means that the capital borrowing need (the Capital Financing Requirement - CFR), has not been fully funded with loan debt. By utilising cash supporting the Council's reserves and favourable in-year cash flow the Council has been able to avoid the need to borrow up to the level of the CFR.

2.4.2 This has allowed the Council to minimise borrowing costs and reduce treasury risk by reducing its external investment balances. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered. The Council will continue with this policy during 2018/19 to the extent permitted by its liquidity requirements and the effective management of its interest rate exposures.

2.4.3 Against this background and the risks within the economic forecast, caution will be adopted with the 2018/19 treasury operations. Treasury staff will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- if it was felt that there was a significant risk of a sharp fall in long and short-term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long-term borrowing will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.
- if it was felt that there was a significant risk of a much sharper rise in long and short-term rates than that currently forecast, (e.g. due an acceleration in the rate of increase in central rates in the USA and UK, a greater than expected increase in global economic activity or a sudden increase in inflation risks), then the portfolio position will be re-appraised with the likely action being that fixed rate funding will be drawn whilst interest rates are still lower than they will be in the next few years.

2.4.4 Any decisions taken in this regard will be reported to members at the next available opportunity.

2.4.5 The Council manages interest rate exposures through the prudent use of its approved instruments, methods and techniques, primarily to create stability and certainty of costs and revenues, but at the same time retaining a sufficient degree of flexibility to take advantage of unexpected, potentially advantageous changes in the level or structure of interest rates.

2.4.6 Interest rate cash flow risk (the risk that fluctuations in the levels of interest rates create an unexpected or unbudgeted burden on the organisation’s finances) associated with the Councils long term borrowing will be managed principally by borrowing at fixed rates.

2.5 Policy on borrowing in advance of need

2.5.1 The Local Government Act 2003 allows local authorities to borrow or invest for ‘‘any purpose relevant to its functions, under any enactment’’, or “for the purpose of the prudent management of its financial affairs”. This allows the temporary investment of funds borrowed for the purposes of expenditure in the near future.

2.5.2 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.

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

2.6 Debt rescheduling

2.6.1 Debt rescheduling includes the premature repayment of loans and the replacement of existing loans with new loans on different terms (repayment method, loan period, interest rate). The reasons for rescheduling include:

- aligning long-term cash flow projections and debt levels in order to redistribute the burden of debt financing costs between years of account
- generating savings in risk adjusted interest costs
- rebalancing the interest rate structure of the debt portfolio to reduce exposures to interest rate risk
- changing the size and/or maturity profile of the debt portfolio to reduce refinancing risk exposures and/or align the debt maturity profile with the underlying need to borrow for capital purposes (the capital financing requirement).

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

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

2.6.4 The economic environment and consequent structure of interest rates has limited the rescheduling opportunities during recent years. Whilst this situation is likely to remain during 2018/19 the Council will continue to monitor interest rate structures for opportunities to reschedule debt in order to generate savings and/or rebalance risks within the loan portfolio. All rescheduling will be reported to the Audit Committee and Full Council at the earliest meeting following its action.

2.7 Policy on the use of derivatives

2.7.1 The Council will only use derivatives for the management of risk and for the prudent management of its financial affairs. Transactions involving standalone derivative products such as forward rate agreements, interest rate swaps and options (interest rate caps, floors and collars) require authorisation by the Head of Financial Services and will only be entered into:

- after seeking proper advice to ensure the product is fully understood including how underlying risks are affected and the additional risks that may result from its use (for example credit exposure to derivative counterparties)
- after seeking confirmation that the Council has legal power to enter into the transaction

- where use of the product can be shown to reduce the overall level of financial risks the Council is exposed to (after taking into consideration additional risks that may result from use of the derivative instrument)
- after ensuring treasury staff have received training to ensure competent use of the product.

2.7.2 Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria outlined in section 3 below. The current value of any amount due from a derivative counterparty will count against the counterparty limits set out in paragraph 3.5.1.

2.8 Training

2.8.1 CIPFA's Treasury Management Code of Practice and Cross-Sectoral Guidance Notes require the responsible officer (the Head of Financial Services) to ensure that:

- all staff involved in the treasury management function (including statutory officers) are fully equipped to undertake the duties and responsibilities allocated to them
- members tasked with treasury management responsibilities, including those responsible for scrutiny, have access to training relevant to their needs and responsibilities.

2.8.2 In complying with these requirements the Council regularly reviews the training needs of officers and members and training will be arranged as required to ensure that officers and members have the requisite skills and knowledge.

2.9 Treasury management advisors

2.9.1 The Council currently uses Link Asset Services as its external treasury management advisors. They provide a range of services to the Council including:

- technical support on treasury matters and capital finance issues
- economic and interest rate analysis
- debt services including advice on the timing of borrowing
- debt rescheduling advice
- generic investment advice on interest rates, timing and investment instruments
- credit ratings and creditworthiness information.

2.9.2 The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers. It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value is assessed are properly agreed and documented, and subjected to regular review.

2.9.3 In 2017 Link Asset Services were re-appointed for an initial period of three years (2017-2020) following a competitive tendering exercise. The Council retains the option to extend this contract for a further year.

3. Annual Investment Strategy

3.1 Investment policy - objectives

3.1.1 The Council's investment policy has regard to the MHCLG's Guidance on Local Government Investments ('MHCLG Investment Guidance') (third edition) and CIPFA's Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes 2017 Edition ('the Treasury Management Code').

3.1.2 Accordingly, the Council's primary policy objectives in relation to its treasury investment activity are to ensure:

- first, the security of principal sums invested (i.e. to protect the capital sum invested from loss)
- second, that appropriate levels of liquidity are maintained – (i.e. ensuring funds invested are available to meet expenditure when needed).

3.1.3 The Council will aim to achieve the optimum return on its investments (yield) commensurate with the proper levels of security and liquidity. However, yield will only determine investment decisions when deciding between two or more investments satisfying security and liquidity objectives.

3.2 Creditworthiness policy (credit risk management)

3.2.1 Ensuring the security of principal sums invested is achieved through active management of the Council's credit risk exposures. This includes placing restrictions and limits on:

- the counterparties with whom investments may be placed based on the creditworthiness of the counterparty (section 3.3)
- the types of investment instruments that may be used (section 3.4)
- the amount invested with any single institution or group of institutions on the Council's list of approved counterparties (section 3.5)
- the duration of individual investment instruments depending on the financial standing (creditworthiness) of the counterparty (section 3.6).

3.3 Approved investment counterparties

3.3.1 Counterparties with whom investments may be placed are restricted to financial institutions and other bodies of high credit quality. High credit quality financial institutions and other bodies are defined by the Council as those with a minimum long-term rating across all three of the main credit ratings agencies (Fitch, Moody's and Standard & Poor's) of A- or equivalent (AA+ or equivalent for non-UK sovereigns).

3.3.2 The minimum rating criteria applied by the Council uses the lowest common denominator method of selecting counterparties and applying limits. This means the Council's minimum criteria will apply to the lowest available rating for any institution. For example, if an institution is rated by two agencies, one rating meets the Council's criteria, the other does not, the institution will fall outside the lending criteria and will be excluded from the list of approved counterparties.

3.3.3 Whilst credit ratings remain a key source of information they are not the sole determinant of the Council's assessment of the credit quality of potential counterparties. Before making investment decisions reference will also be made to:

- ratings outlooks (indicating the likely direction of an issuer's rating over the medium term)
- credit watches and watchlists (indicating that downgrading or upgrading of the credit rating could be imminent)
- sovereign ratings and support mechanisms
- credit default swap (CDS) spreads (indicating perceived market sentiment regarding the credit risk associated with a particular institution and an early warning of potential creditworthiness problems which may only belatedly lead to actual changes in credit ratings).

3.3.4 This information is fully integrated into the creditworthiness methodology used by the Council's treasury advisors,Link Asset Services to produce its colour coded ratings assessment to indicate the relative creditworthiness of potential counterparties. Information provided by this ratings assessment is used by the Council to determine the maximum duration of individual investment instruments (see section 3.6).

3.3.5 Other information sources used to assess the suitability of potential investment counterparties include the financial press, share price and other information pertaining to the banking sector and the economic and political environments in which these institutions operate. Regardless of the credit rating assigned to an institution if this additional information casts doubt over its financial standing then that institution will be removed immediately from the Council's counterparty lending list.

3.3.6 Credit ratings and creditworthiness information is supplied to the Council by Link Asset Services and monitored weekly. The Council is also alerted by email when there is an amendment by any of the agencies to the credit rating of an institution. If as a result of downgrade, a counterparty no longer meets the Council's minimum credit ratings criteria, it will be removed immediately from the Council's counterparty (dealing) list. Notification of rating changes, rating watches and rating outlooks is provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating watch applying to a counterparty, currently at the minimum Council criteria, will result in the counterparty being suspended from use, with all others being reviewed in light of market conditions. Link Asset Services also provide the Council with information relating to movements in credit default swap spreads against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

3.4 Approved instruments

3.4.1 The types of investment instruments that may be used by the Council - subject to the counterparty and maturity limits set out in sections 3.5 and 3.6 - are shown in table 3. Permitted instruments are categorised as either "Specified" or "Non-Specified" investments - as defined in MHCLGs Investment Guidance - to distinguish those (specified) investment instruments offering relatively high security and high liquidity from those with higher credit risk (non-specified investments). All investments will be in sterling.

Table 3: Permitted investment instruments - specified & non-specified

Investment	Specified	Non-Specified
Term deposits, call and notice accounts with banks & building societies	✓	✓
Term deposits with UK local authorities	✓	✓
Certificates of deposit with banks & building societies	✓	✓
Gilts issued by the UK Debt Management Office (DMO)	✓	✓
Treasury Bills (T-bills) issued by the UK DMO	✓	
Bonds issued by Multilateral Development Banks	✓	✓
Local Authority Bills	✓	×
Commercial Paper	✓	×
Corporate Bonds	✓	✓
AAA rated Money Market Funds (with 60-day Weighted Average Maturity (WAM))[CNNAV, VNAV, LVNAV]	✓	×
Other Money Market & Collective Investment Schemes	✓	✓
Debt Management Account Deposit Facility	✓	×
Equity investments		✓

3.4.2 A specified (treasury management) investment - offering high security and high liquidity - is defined as an investment that is:

(a) denominated in sterling with any payments or repayments payable only in sterling

(b) not a long-term investment (i.e. the authority has a contractual right to repayment within 12 months of acquisition)

(c) not defined as capital expenditure under regulations (e.g. acquisition of share capital)

(d) made with a body or in an investment scheme of high credit quality (as defined by the Council in paragraph 3.3.1) or with the UK Government, a local authority or a parish council or community council.

3.4.3 Non-specified investments refer to any (treasury management) investments not meeting the definition of 'specified investments'. The Council currently holds a limited quantity of non-specified investments (unquoted equity shares). These account for less than 1% of the Council's investment portfolio. No additional non-specified investments are planned during 2018/19 and all new investments made in 2018/19 will be subject to a maximum maturity of 365 days.

3.4.4 Non-specified investments will only be made with prior approval by the Head of Financial Services and will only be undertaken:

- following external credit assessment and due diligence to assess the financial strength and creditworthiness of the counterparty, and
- after taking such professional advice as is considered necessary to inform the decision to invest.

3.4.5 In the event that the credit rating of the Council's banker falls below the minimum credit criteria referred to above, the Council will continue to use the bank for transactional purposes but will seek to minimise balances as far as is possible.

3.5 Limits on principal sums invested

3.5.1 With the exception of funds placed with HM Treasury's Debt Management Office (DMO) the maximum amount that may be placed with any institution or group of institutions that are part of the same banking group is £4 million. For funds placed with the DMO's Account Deposit Facility the limit is £12m (subject to maximum maturity of 3 weeks for all sums in excess of £4m).

3.6 Limits on investment maturities

3.6.1 To ensure that access to cash to meet forecast liquidity is not impaired, decisions regarding the maturity of investments instruments must be taken having regard to cash flow requirements. The maturity of investment instruments is also subject to the maximum maturity periods set out below (table 4). These are established to ensure that access to cash is not unduly restricted and to reduce the risk of being locked into an investment whilst the creditworthiness of the counterparty is deteriorating.

3.6.2 The maximum period for which funds may prudently be committed by the Council is determined using the Creditworthiness service provided by Link Asset Services. This combines credit ratings information provided by the three main credit rating agencies - Fitch, Moody's and Standard & Poor's - with ratings outlooks and credit watches in a weighted scoring system. This is combined with an overlay of credit default swap (CDS) spreads to produce a colour rating to indicate the relative creditworthiness of the counterparty. These colour codes are used to determine the maximum duration for investments made with individual counterparties.

3.6.3 In the current economic climate it is considered appropriate to keep investment terms short to cover cash flow needs, but also to seek out value available in periods of up to 12 months with high credit quality institutions using Link's creditworthiness approach. Using this approach the Council will use the following duration bands - shown in table 4 - subject to a maximum maturity of 365 days (from the date of acquisition).

Table 4: Upper limits on investment maturities

Colour rating	Maximum duration (term to maturity)
Yellow	5 years- restricted to 12 months (see paragraph 3.6.3)
Purple	2 years - restricted to 12 months (see paragraph 3.6.3)
Orange	12 months
Red	6 months
Green	100 days
No colour	0 months (counterparty not to be used)

3.7 Reporting arrangements

3.7.1 The Treasury Management and Prudential Codes require the Council to report regularly on its treasury management activities including its performance against all forward-looking prudential and treasury management indicators set out in section 5 below. In meeting the recommended reporting requirements of the Treasury Management Code (outlined in section 1.2 above) the Head of Financial Services will, in addition to this report, submit to the Audit Committee and Full Council:

- a mid-year review of the Council's treasury management activities covering the six months to 30 September 2018, and
- an annual treasury report after the year-end.

The annual report will be submitted as soon as reasonably practicable after the end of the financial year, but in any case no later than 30 September 2019.

3.7.2 A summary of treasury management activities will also be included in the quarterly finance reports submitted to the Council's Executive.

4. Minimum revenue provision (MRP) policy statement

4.1 Regulation 27 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 ('the 2003 Regulations') requires local authorities to 'charge to a revenue account a minimum revenue provision (MRP) for that year'. The minimum revenue provision is an annual amount required to be set aside from the General Fund to meet the capital cost of expenditure funded by borrowing or credit arrangements, that is, capital expenditure that has not been financed from grants, revenue contributions or capital receipts.

4.2 Regulation 27 also allows authorities to charge to a revenue account any amount, in addition to the MRP, in respect of the financing of capital expenditure incurred in the current financial year or any financial year before the current year (voluntary revenue provision - VRP).

4.3 The calculation of MRP is covered in regulation 28 of the 2003 Regulations. From 31 March 2008, Regulation 28, as amended by Regulation 4(1) of the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 ('the 2008 Regulations'), requires each authority to:

> 'determine for the current financial year an amount of minimum revenue provision which it considers to be prudent.'

4.4 The 2003 Regulations (as amended) are accompanied by statutory guidance on minimum revenue provision, issued by the Ministry of Housing, Communities & Local Government (MHCLG) under section 21(1A) of the Local Government Act 2003 ('the 2003 Act'). The latest version of this guidance (version four) was issued by MHCLG in February 2018. It replaces the previous version issued in 2012.

4.5 The updated MRP guidance is applicable from 1 April 2019, although early adoption is encouraged. This is with the exception of those changes relating to guidance on changing methods for calculating MRP, which apply from 1 April 2018. The Authority has elected to adopt the requirements of the updated MRP guidance, in full, with effect from 1 April 2018.

4.6 In meeting the requirement to 'make prudent provision', the 2003 Act requires local authorities to 'have regard to' this guidance. This means that an authority must consider what the statutory guidance says. It does not mean that a local authority is obligated to follow the guidance. However, if an authority does decide to depart from the guidance, it must be able to show good reasons for doing so.

4.7 The current version of regulation 28 was implemented by the 2008 regulations. It came into force on 31 March 2008 and along with the first edition of MHCLG's statutory guidance on MRP, is effective for 2007/08 and later years. The current version of regulation 28 provides flexibility in how they calculate MRP. Before this change regulation 28 set out detailed formula - based on an authority's capital financing requirement - which authorities were required to follow when calculating MRP.

4.8 Neither the 2003 Regulations nor the statutory guidance define the term "prudent provision". The statutory guidance does however establish the broad aim of making prudent provision, which is to ensure that revenue is put aside to cover the underlying need to borrow for capital purposes (the capital financing requirement) over a period:

- commensurate with the period over which the capital expenditure provides benefits, or
- for historic borrowing originally supported by grant income rolled into Revenue Support Grant (RSG), over the period implicit in the determination of that original grant funding.

4.9 The MHCLG guidance outlines four possible 'options' as methods of calculating a prudent amount of MRP. However, approaches other than the four listed in the guidance are not ruled out provided they are consistent with the statutory duty to make a prudent provision. This provides authorities with wide discretion in determining MRP. The statutory guidance also includes specific recommendations on the calculation of MRP in respect of finance leases, on-balance PFI contracts and investment properties.

4.10 The four options for calculating MRP outlined in the MHCLG guidance, and restrictions on their use, are summarised in table 5.

Table 5: Options for prudent provision of MRP

Option	Method of calculation	Applicability and limits on use
'Option 1 Regulatory method'	Apply the statutory formula set out in the 2003 Regulations (as amended) before it was revoked by the 2008 Regulations	May only be used in relation to: ▪ Supported capital expenditure for RSG purposes incurred before 1 April 2008. ▪ Supported capital expenditure for RSG purposes incurred on or after 1 April 2008.
'Option 2 CFR method'	Multiply the (non-housing) Capital Financing Requirement at the end of the preceding financial year by 4%.	May only be used in relation to: ▪ Supported capital expenditure incurred before 1 April 2008. ▪ Supported capital expenditure for RSG purposes incurred on or after 1 April 2008.
'Option 3 Asset life method'	Amortise expenditure financed by borrowing or credit arrangement over the estimated useful life of the relevant assets using either the equal instalment or annuity method.	Must be used for capital expenditure incurred on or after 1 April 2008 that does not form part of the Authority's supported capital expenditure. This includes all expenditure capitalised under regulations or direction on or after 1 April 2008 falling outside the scope of 'Option 1'. May be used in relation to any capital expenditure whether or not supported and whenever incurred.
'Option 4 Depreciation method'	Charge MRP to revenue based on proper accounting practices for depreciation as they apply to the relevant assets. This includes any amount for impairment chargeable to the Income & Expenditure Account.	Must be used for capital expenditure incurred on or after 1 April 2008 that does not form part of the Authority's supported capital expenditure. May be used in relation to any capital expenditure whether or not supported and whenever incurred.

4.11 Where capital expenditure on an asset is financed wholly or partly by borrowing or credit arrangements, authorities applying 'Option 3' should calculate MRP by reference to the estimated useful life of the asset. Two main variants of this option exist: (i) the equal instalment method and (ii) the annuity method.

4.12 Both variations allow authorities to make additional voluntary revenue provision (VRP) or to finance expenditure through other methods of repayment (e.g. the application of capital receipts) during the repayment period. In such cases appropriate adjustments should be made to the calculation of MRP. Where an authority uses Options 3 or 4, the CFR for the purposes of Options 1 and 2 is reduced by the amount of the relevant expenditure and cumulative provision for MRP made under Options 3 and 4.

Policy adopted for 2018/19

4.13 Having regard to the statutory guidance on minimum revenue provision issued by MHCLG and the 'options' for calculating MRP set out in that guidance, the Council will calculate MRP:

- for all capital expenditure funded from borrowing incurred before 1 April 2008 and for all supported capital expenditure funded from borrowing incurred on or after 1 April 2008, based on 4% of the non-housing Capital Financing Requirement at the end of the preceding financial year (Option 2- CFR method)
- for unsupported capital funded from borrowing expenditure incurred on or after 1 April 2008 by applying Option 3 - Asset life method - using either the equal instalments or annuity method
- for credit arrangements, such as on balance sheet leasing arrangements (finance leases), by charging an amount (MRP) equal to the element of the rent/charge that goes to write down the balance sheet liability.

4.14 In applying 'Option 3':

- MRP should normally begin in the financial year following the one in which the expenditure was incurred. However, in accordance with the statutory guidance, commencement of MRP may be deferred until the financial year following the one in which the asset becomes operational
- the estimated useful lives of assets used to calculate MRP should not exceed a maximum of 50 years except as otherwise permitted by the guidance
- if no life can reasonably be attributed to an asset, such as freehold land, the estimated useful life should be taken to be a maximum of 50 years
- for expenditure capitalised by virtue of a capitalisation direction or regulation 25(1) of the 2003 regulations, the 'asset' life should equate to the value specified in the statutory guidance.

5. Prudential and treasury indicators 2018-19 – 2020-21

5.1 Indicators required by the Prudential Code

5.1.1 The Prudential Code requires local authorities to self-regulate the affordability, prudence and sustainability of their capital expenditure and borrowing plans, by setting estimates and limits, and by publishing actuals for a range of prudential indicators. It also requires them to ensure their treasury management practices are carried out in accordance with good professional practice.

5.1.2 The prudential and treasury indicators required by the Prudential Code, the Treasury Management Code and accompanying sector guidance issued by CIPFA, are designed to support and record local decision making. They are not designed to be comparative performance indicators and should not be used for this purpose. The prudential and treasury indicators for the forthcoming and following years must be set before the beginning of the forthcoming year. They may be revised at any time, following due process, and must be reviewed, and revised if appropriate, for the current year when the prudential indicators are set for the following year.

Estimates of capital expenditure

5.1.3 The estimate of capital expenditure indicator summarises the Council's capital expenditure plans for the forthcoming year and the following two financial years. Estimates of capital expenditure include both those agreed previously and those forming part of the current (2018/19) budget cycle.

5.1.4 Capital expenditure is defined as in section 16 of the Local Government Act 2003 and includes all expenditure capitalised in accordance with proper practices together with any items capitalised in accordance with regulation 25 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (as amended), or by virtue of a capitalisation direction issued under section 16(2) of the 2003 Act. Estimates of capital expenditure include any capital expenditure that it is estimated might (depending on option appraisals) or will be dealt with as other long-term liabilities.

Table 6: **Capital expenditure**

Planned expenditure	2017/18 Approved[1] £000	2017/18 Revised[2] £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000
Approved in 2017/18 (& prior years)	9,401	5,935	15,266	2,190	40
Budget proposals 2018/19 – 2020/21			(673)	150	2,000
Total expenditure	**9,401**	**5,935**	**14,593**	**2,340**	**2,040**

[1] Approved capital programme for 2017/18; [2] Updated to reflect revised carry forward of budget from 2016/17 and additional capital bids included in the revised capital budget for 2017/18.

5.1.5 Table 7 shows how these capital expenditure plans will be financed through the application of capital and revenue resources. Any excess of capital expenditure over resources applied (unfinanced expenditure) will result in a corresponding increase in the underlying need for borrowing (the capital financing requirement).

Table 7: Financing of capital expenditure

	2017/2018		Estimate		
	Approved £000	Revised £000	2018/19 £000	2019/20 £000	2020/21 £000
Total expenditure					
Financed by:					
Capital receipts	0	280	0	0	0
Capital grants	7,426	2,090	9,043	1,033	1,000
Revenue/Reserves	0	973	20	0	0
Total financed	**7,426**	**3,343**	**9,063**	**1,033**	**1,000**
Unfinanced expenditure:					
Supported borrowing[1]	0	0	0	0	0
Unsupported borrowing	1,975	2,592	5,530	1,307	1,040
Financed & unfinanced	**9,401**	**5,935**	**14,593**	**2,340**	**2,040**

[1] Following the Spending Review 2010 there have been no new supported borrowing allocations since 2010/11 (although the level of assumed outstanding debt is still included in the calculation of formula grant allocations). This form of financial support has been discontinued from 2011/12.

Estimates of Capital Financing Requirement

5.1.6 The Capital Financing Requirement (CFR) is a measure of an authority's underlying need to borrow for capital purposes. It represents the historic cost of capital expenditure that has yet to be financed by setting aside resources (grants, contributions, capital receipts or direct revenue financing). It does not necessarily correspond with an authority's actual borrowing position. The level of external debt will be determined in accordance with an authority's treasury management strategy and practices and authorities should not associate borrowing with particular items of expenditure unless required to do so by legislation or official guidance.

5.1.7 Capital expenditure that is not financed up-front through the application of capital grants, contributions, capital receipts or a direct charge to revenue will increase the Capital Financing Requirement. Charging the minimum revenue provision or a voluntary revenue provision against the general fund will reduce the CFR. The CFR includes items of capital expenditure included in the Council's balance sheet associated with other long term liabilities, such as assets held on finance leases, but excluding the underlying liability.

5.1.8 Table 8 sets out estimates of the Council's capital financing requirement at the end of 2018/19 and the following two financial years.

Table 8: Capital financing requirement

	2017/18		Estimate		
	Approved £000	Revised £000	2018/19 £000	2019/20 £000	2020/21 £000
CFR at 1 April	19,637	18,674	20,643	25,460	25,825
CFR at 31 March	20,967	20,643	25,460	25,825	25,843
Movement in CFR	**1,330**	**1,969**	**4,817**	**365**	**18**
Represented by:					
Unfinanced expenditure	1,975	2,592	5,530	1,307	1,040
Less MRP/VRP	(645)	(623)	(713)	(942)	(1,022)
Movement in CFR	**1,330**	**1,969**	**4,817**	**365**	**18**

Gross debt and the capital financing requirement (CFR)

5.1.9 A fundamental provision of the Prudential Code and a key indicator of prudence is that over the medium term, debt will only be for a capital purpose. To ensure this is the case, the Prudential Code requires that gross external debt should not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.

5.1.10 This requirement allows some flexibility for limited early borrowing for future years but ensures that borrowing is not undertaken for revenue purposes. If in any of these years there is a reduction in the CFR, this reduction is ignored in estimating the cumulative increase in the CFR used for comparison with gross external debt. Gross debt refers to the sum of borrowing and other long-term liabilities (credit arrangements).

Table 9: Gross debt & the CFR 2018/19

	£000	Limit 2018/19 £000
Forecast CFR at 31 March 2018		20,643
Estimated additional CFR for:		
2018/19 (see table 8)	4,817	
2019/20 (see table 8)	365	
2020/21 (see table 8)	18	5,200
Limit		25,843
Gross Debt 2018/19 (maximum)		
Estimated gross debt at 31 March 2018 - existing borrowing	13,464	
Estimated (maximum) net additional borrowing - 2017/18	3,930	
Estimated (maximum) net additional borrowing – 2018/19	5,440	
Estimated gross debt 2018/19		22,834
Excess of CFR over gross debt		3,009

5.1.11 At 31 December 2017 the Council was under-borrowed against its capital financing requirement by approximately £4.7m. The Council does not anticpate any difficulties in complying with this indicator during 2018/19 or the following two financial years.

Authorised limit for external debt

5.1.12 The Authorised Borrowing Limit represents the statutory limit on borrowing determined under section 3 of the Local Government Act 2003 (Affordable Limit). It imposes an upper limit on the Council's gross external debt (excluding investments), separately identifying borrowing (external loans) from other long-term liabilities (for example finance lease liabilities). Breach of the Affordable Borrowing Limit is prohibited by section 2(1)(a) of the Local Government Act 2003.

5.1.13 The Authorised Borrowing Limit is set with reference to the Council's capital expenditure plans, capital financing requirement (or underlying borrowing requirement) and the potential need to borrow to meet temporary revenue borrowing requirements pending the receipt of amounts due to the Council. The Affordable Borrowing Limit also includes headroom over and above the Operational Boundary (see below) to accommodate any unusual or unforeseen cash movements. The indicator separately identifies limits for borrowing and other long-term liabilities.

Table 10: Authorised Limit for External Debt

	2017/18 Limit £000	2018/19 Limit £000	2019/20[a] Limit £000	2020/21[a] Limit £000
Borrowing	25,000	28,000	29,000	29,000
Other long-term liabilities	0	0	0	0
Total	25,000	28,000	29,000	29,000

a: From 2019/20 the Code of practice on Local authority Accounting is expected to adopt IFRS 16 Leases. Pending confirmation of this change the impact on the other long-term liabilities component of the Authorised Limit for External Debt is not reflected in the reported limits

Operational boundary for external debt

5.1.14 The Operational Boundary represents the limit beyond which (gross) external debt is not expected to exceed. It is based on expectations of the maximum external debt of a local authority according to probable events (that is the most likely (prudent) but not worst case scenario) and is consistent with the maximum level of external debt projected by these estimates. The Operational Boundary links directly to the Council's plans for capital expenditure, estimates of the capital financing requirement and cash flow requirements for the year for all purposes but without the additional headroom included within the Authorised Limit. The indicator separately identifies limits for borrowing and other long-term liabilities.

Table 11: Operational boundary for external debt

	2017/18 Limit £000	2018/19 Limit £000	2019/20 Limit £000	2020/21 Limit £000
Borrowing	23,000	26,000	27,000	27,000
Other long-term liabilities	0	0	0	0
Total	23,000	26,000	27,000	27,000

a: From 2019/20 the Code of practice on Local authority Accounting is expected to adopt IFRS 16 Leases. Pending confirmation of this change the impact on the other long-term liabilities component of the Operational Boundary for External Debt is not reflected in the reported limits

5.1.15 Provided that the total Authorised Limit and total Operational Boundary for a year is unchanged, the Head of Financial Services has delegated authority to make changes to the separately identifiable limits for borrowing and other long-term liabilities. Any movement between these separate totals will be reported to the next meetings of the Audit Committee and Full Council.

Estimates of the ratio of financing costs to net revenue stream

5.1.16 This indicator of affordability highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs (net of interest and investment income).

5.1.17 Estimates of financing costs comprise the aggregate of the following amounts included in the Council's original and revised budgets:

- interest charged to the General Fund with respect to borrowing
- interest payable under finance leases and any other long-term liabilities
- premiums and discounts from debt restructuring charged or credited to the amount to be met from government grants and local taxpayers
- interest and investment income
- amounts payable or receivable in respect of financial derivatives
- minimum revenue provision plus any additional voluntary contributions
- any amounts for depreciation/impairment charged to the amount to be met from government grants and local taxpayers.

5.1.18 Estimates for net revenue stream for current and future years are taken from the Council's estimates of the amounts to be met from government grants and local taxpayers, using the equivalent figures from the original and revised budgets.

Table 12: Ratio of Financing Costs to Net Revenue Stream

	2017/18 Approved %	2017/18 Revised %	2018/19 Estimate %	2019/20 Estimate %	2020/21 Estimate %
Ratio	10.3	9.5	11.9	14.8	17.8

5.2 Indicators required by the Treasury Management Code

5.2.1 In addition to the indicators required by the Prudential Code there are also a number of treasury indicators required by the Treasury Management Code and accompanying sector guidance. These are:

- upper and lower limits to the maturity structure of its borrowing
- upper limits on the total of principal sums invested over 365 days.

5.2.2 These treasury management indicators specify ranges (rather than targets) designed to limit the Council's exposure to liquidity and refinancing risks.

Upper and lower limits to the maturity structure of borrowing

5.2.3 This indicator highlights potential exposures to refinancing risk arising from concentrations of debt falling due for refinancing, and is designed to facilitate reductions in the Council's exposure to refinancing at times of volatile or high interest rates.

5.2.4 It is calculated as the amount of projected borrowing maturing in each period as a percentage of total projected borrowing. The maturity of borrowing is determined by reference to the earliest date on which the lender can require payment.

Table 13: Lower/upper limits on % borrowing maturing in each period

	31.3.17 Actual %	31.3.18 forecast %	2017/18 Lower limit %	2017/18 Upper limit %	2018/19 Lower limit %	2018/19 Upper limit %
Under 12 months	1.89	1.97	0	20	0	20
12 months to 2 years	1.71	1.79	0	20	0	20
2 years to 5 years	5.44	5.71	0	20	0	20
5 years to 10 years	10.41	11.00	0	30	0	30
10 years to 20 years	17.20	16.30	0	40	0	40
20 years to 30 years	4.69	3.58	0	40	0	40
30 years to 40 years	51.33	59.65	0	80	0	80
40 years to 45 years	7.33	0	0	80	0	80

Upper limits on total principal invested for periods of more than 365 days

5.2.5 A local authority that invests, or plans to invest, for periods of more than 365 days is required to set an upper limit for each forward financial year period for the maturing of such investments. The purpose of these limits for principal sums invested for periods longer than 365 days is for the local authority to contain its exposure to the possibility of loss that might arise as a result of its having to seek early repayment or redemption of principal sums invested.

Table 14: Upper limit on total principal invested for periods of more than 365 days

	2017/18 Approved £000	2018/19 Limit £000	2019/20 Limit £000	2020/21 Limit £000
Principal sums invested > 365 days	20	20	20	20

5.2.6 For its cash flow generated balances, the Council will seek to utilise its call and notice accounts, money market funds and short-dated deposits (overnight to 6 months). The Council will not invest for periods of more than 365 days during 2018/19.

6. Appendices

A. Interest Rate Forecasts 2018 - 2021

B. Economic Background

C. Credit Ratings

Appendix A: Interest Rate Forecasts 2018 – 2021

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

Link Asset Services Interest Rate View	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate View	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.00%	1.25%	1.25%
3 Month LIBID	0.40%	0.40%	0.40%	0.40%	0.60%	0.60%	0.60%	0.70%	0.90%	0.90%	1.00%	1.20%	1.20%	1.20%
6 Month LIBID	0.50%	0.50%	0.50%	0.60%	0.80%	0.80%	0.80%	0.90%	1.00%	1.00%	1.10%	1.30%	1.30%	1.40%
12 Month LIBID	0.70%	0.80%	0.80%	0.90%	1.00%	1.00%	1.10%	1.10%	1.30%	1.30%	1.40%	1.50%	1.50%	1.60%
5yr PWLB Rate	1.50%	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
10yr PWLB Rate	2.10%	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
25yr PWLB Rate	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.50%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%
Bank Rate														
Link Asset Services	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%
Capital Economics	0.50%	0.50%	0.75%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	-	-	-	-	-
5yr PWLB Rate														
Link Asset Services	1.50%	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
Capital Economics	1.70%	1.90%	2.30%	2.60%	2.90%	2.90%	2.90%	2.90%	2.90%	-	-	-	-	-
10yr PWLB Rate														
Link Asset Services	2.10%	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
Capital Economics	2.30%	2.60%	2.80%	3.10%	3.30%	3.30%	3.30%	3.30%	3.30%	-	-	-	-	-
25yr PWLB Rate														
Link Asset Services	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
Capital Economics	2.95%	3.15%	3.45%	3.65%	3.90%	3.90%	3.90%	3.90%	3.90%	-	-	-	-	-
50yr PWLB Rate														
Link Asset Services	2.50%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%
Capital Economics	2.80%	3.10%	3.30%	3.60%	3.80%	3.80%	3.80%	3.80%	3.80%	-	-	-	-	-

Appendix B: Economic Background

UK Economy

B.1 After the UK surprised on the upside with strong economic growth in 2016, growth in 2017 has confounded pessimistic forecasts of weak growth by coming in at 1.8%, only marginally down on the 1.9% rate for 2016.; In 2017, quarter 1 came in at only +0.3% (+1.8% y/y), quarter 2 +0.3% (+1.5% y/y), quarter 3 +0.4% (+1.5% y/y) and Q4 +0.5% (+1.5% y/y).

B.2 Underpinning this growth was the strong performance of the manufacturing sector which showed a 1.3% increase in Q4 and +3.1% y/y. This level of performance was helped by an increase in exports due to the lower value of sterling over the last year and robust economic growth in our main trade partners, the EU and US. It is also notable that there has been a progressive acceleration in total GDP growth during the year which gives ground for optimism looking forward into 2018.

B.3 While the Bank of England is expected to give forward guidance to prepare financial markets for gradual changes in policy, the Monetary Policy Committee, (MPC), meeting of 14 September 2017, surprised financial markets and forecasters by suddenly switching to a much more aggressive tone in terms of its words around warning that the Bank Rate will need to rise soon. The Bank of England Inflation Reports during 2017 have clearly flagged up that it expected CPI inflation to peak at just under 3% in 2017 – as the past depreciation of sterling and increases in energy prices pass through to consumer prices - before falling back to near to its target rate of 2% in two years' time.

B.4 The Bank revised its forecast for the peak to just over 3% at the 14 September meeting. (Inflation actually came in at 3.1% in November the highest since March 2012 before falling to 3.0% in Decenber). However this marginal revision in the Bank's forecast can hardly justify why the MPC became so aggressive with its wording. Instead the focus was on an emerging view that with unemployment having already fallen to only 4.3%, the lowest level since 1975, and improvements in productivity being so weak, the amount of spare capacity in the economy was significantly diminishing towards a point at which they now needed to take action.

B.5 In addition, the MPC took a more tolerant view of low wage inflation as this now looks like a common factor in nearly all western economies as a result of automation and globalisation. This means that UK labour faces competition from overseas labour for example through outsourcing work to third world countries, which in turn depresses the negotioatiing power of UK labour. However, the Bank was also concerned that the withdrawal of the UK from the EU would effectively lead to a decrease in such globalisation pressures in the UK, and so this would cause additional inflationary pressure over the next few years.

B.6 At its 2 November meeting, the MPC duly delivered a 0.25% increase in the Bank Rate. It also gave forward guidance that they expected to increase the

Bank Rate only twice more in the next three years to reach 1.0% by 2020. This is, therefore, not quite the 'one and done' scenario but is, nevertheless, a very relaxed rate of increase prediction in the Bank Rate and in line with previous statements that the Bank Rate would only go up very gradually and to a limited extent.

B.7 Some forecasters are however flagging up that they expect growth to accelerate significantly towards the end of 2017 and then into 2018. This view is based primarily on an anticipated fall in inflation, (as the effect the depreciation of sterling following the EU referendum drops out of the CPI statistics), which will bring to an end the negative impact on consumer spending power. In addition, a strong export performance will compensate for weak services sector growth. If this scenario was to materialise, then the likelihood is that the MPC would accelerate its pace of increases in the Bank Rate during 2018 and onwards.

B.8 It is also worth noting the contradiction within the Bank of England between action in 2016 and in 2017 by two of its committees. After the shock result of the EU referendum, the MPC voted in August 2016 for emergency action to cut the Bank Rate from 0.50% to 0.25%, restarting £70bn of QE purchases, and also providing UK banks with £100bn of cheap financing. The aim of this was to lower borrowing costs, stimulate demand for borrowing and thereby increase expenditure and demand in the economy.

B.9 The MPC felt this was necessary in order to ward off their expectation that there would be a sharp slowdown in economic growth. Instead, the economy grew robustly, although the Governor of the Bank of England strongly maintained that this was because the MPC took that action. However, other commentators regard this emergency action by the MPC as being proven by events to be a mistake.

B.10 In 2017, we then had the Financial Policy Committee (FPC) of the Bank of England taking action in June and September over its concerns that cheap borrowing rates, and easy availability of consumer credit, had resulted in too rapid a rate of growth in consumer borrowing and in the size of total borrowing, especially of unsecured borrowing. It therefore took punitive action to clamp down on the ability of the main banks to extend such credit. Indeed, a PWC report in October 2017 warned that credit card, car and personal loans and student debt will hit the equivalent of an average of £12,500 per household by 2020.

B.11 However, averages belie wide variations in levels of debt with much higher exposure being biased towards younger people, especially the 25 to 34 year old band, reflecting their lower levels of real income and asset ownership.

B.12 One key area of risk is that consumers may have become used to cheap rates since 2008 for borrowing, especially for mortgages. It is a major concern that some consumers may have over extended their borrowing and have become complacent about interest rates going up after the Bank Rate had been unchanged at 0.50% since March 2009 until falling further to 0.25% in August 2016. This is why forward guidance from the Bank of England continues to emphasise slow and gradual increases in the Bank Rate in the coming years. However, consumer borrowing is a particularly vulnerable area in terms of the MPC getting the pace and strength of Bank Rate increases right - without causing a sudden shock to consumer demand, confidence and thereby to the pace of economic growth.

B.13 Moreover, while there is so much uncertainty around the Brexit negotiations, consumer confidence, and business confidence to spend on investing, it is far too early to be confident about how the next two to three years will actually pan out.

USA

B.14 Growth in the American economy was notably erratic and volatile in 2015 and 2016. 2017 started erratically with quarter 1 coming in at an annualised rate of only 1.2%, quarter 2 at 3.1%, quarter 3, 3.2% and Q4, 2.6%. This gave an overall figure for annual growth in 2017 of 2.6%, an acceleration from 1.5% in 2016. Unemployment in the US has also fallen to the lowest level for many years, reaching 4.1%, while wage inflation pressures, and inflationary pressures in general, have been building.

B.15 The Federal Reserve (the Fed.) has started on a gradual upswing in rates with five increases in all and four increases since December 2016. A rise of 25 basis points in December 2017 lifted the central rate to 1.25 – 1.50%. Forward guidance signalled there could then be another four increases in 2018. At its September meeting, the Fed said it would start in October to gradually unwind its $4.5 trillion balance sheet holdings of bonds and mortgage backed securities by reducing its reinvestment of maturing holdings.

Eurozone

B.16 Economic growth in the Eurozone (EZ), (the UK's biggest trading partner), had been lack lustre for several years after the financial crisis despite the ECB eventually cutting its main rate to -0.4% and embarking on a massive programme of Quantitative Easing. However, growth picked up in 2016 and has now gathered substantial strength and momentum thanks to this stimulus. GDP growth was 0.6% in quarter 1 (2.0% y/y), 0.7% in quarter 2 (2.3% y/y) and +0.6% in quarter 3 (2.5% y/y).

B.17 However, despite providing massive monetary stimulus, the European Central Bank is still struggling to get inflation up to its 2% target and in December inflation was 1.4%. It is therefore unlikely to start on an upswing in rates until possibly 2019. It has, however, announced that it will slow down its monthly QE purchases of debt from €60bn to €30bn from January 2018 and continue to at least September 2018.

Asia

B.18 Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus. This has, in turn, been denting economic growth in emerging market countries dependent on exporting raw materials to China. Medium term risks have also been increasing. These include a dangerous build up in the level of credit compared to the size of GDP and a need to address the level of non-performing loans in the banking and credit systems. In addition, major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property and address the level of non-performing loans in the banking and credit systems.

B.19 GDP growth in Japan has been gradually improving during 2017 reaching an annual figure of 2.1% in quarter 3. However it is still struggling to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. The Japanese government is also making little progress on fundamental reforms of the economy.

Global Outlook

B.20 World growth looks to be on an encouraging trend of stronger performance, rising earnings and falling levels of unemployment. In October 2017, the IMF upgraded its forecast for world growth from 3.2% to 3.6% for 2017 and 3.7% for 2018. In addition, inflation prospects are generally muted and it is particularly notable that wage inflation has been subdued despite unemployment falling to historically very low levels in the UK and US.

Central bank monetary policy measures

B.21 Following the financial crash of 2008, when liquidity suddenly dried up in financial markets, central bank sought to counter the recessionary impact of this through a combination of lowering central interest rates and flooding financial markets with liquidity, particularly through unconventional means such as Quantitative Easing (QE) where central banks bought large amounts of central government debt and smaller sums of other debt.

B.22 The key issue now is that the period of stimulating economic recovery and warding off the threat of deflation is coming towards its close and a new period has already started in the US, and more recently, in the UK, on reversing those measures i.e. by raising central rates and (for the US) reducing central banks' holdings of government and other debt.

B.23. These measures are now required in order to stop the trend of an on-going reduction in spare capacity in the economy, and of unemployment falling to such low levels that the re-emergence of inflation is viewed as a major risk. It is, therefore, crucial that central banks get their timing right and do not cause shocks to market expectations that could destabilise financial markets. In particular, a key risk is that because QE-driven purchases of bonds drove up the price of government debt, and therefore caused a sharp drop in income yields, this then also encouraged investors into a search for yield and into investing in riskier assets such as equities.

B.24 This resulted in bond and equity market prices rising to historically high valuation levels simultaneously. This, therefore, makes both asset categories vulnerable to a sharp correction. It is important, therefore, that central banks only gradually unwind their holdings of bonds in order to prevent destabilising the financial markets. It is also likely that the timeframe for central banks unwinding their holdings of QE debt purchases will be over several years. They need to balance their timing to avoid damaging economic growth by taking too rapid and/or too strong action, or, alternatively, letting inflation run away by taking action that was too slow and/or too weak. The potential for central banks to get this timing and strength of action wrong are now key risks.

B.25 There is also a potential key question over whether economic growth has become too dependent on strong central bank stimulus and whether it will maintain its momentum against a backdrop of rising interest rates and the reversal of QE. In the UK, a key vulnerability is the low level of productivity growth, which may be the main driver for increases in wages; and decreasing consumer disposable income, which is important in the context of consumer expenditure primarily underpinning UK GDP growth.

B.26 A further question that has come to the fore is whether an inflation target for central banks of 2%, is now realistic given the shift down in inflation pressures from internally generated inflation, (i.e. wage inflation feeding through into the national economy). Some economists favour a shift to a lower inflation target of 1% to emphasise the need to keep the lid on inflation. Alternatively, it is possible that a central bank could simply 'look through' tepid wage inflation, (i.e. ignore the overall 2% inflation target), in order to take action in raising rates sooner than might otherwise be expected.

B.27 However, other economists would argue for a shift up in the inflation target to 3% in order to ensure that central banks place the emphasis on maintaining economic growth through adopting a slower pace of withdrawal of stimulus. In addition, there is a strong argument that central banks should target financial market stability. As mentioned previously, bond markets and equity markets could be vulnerable to a sharp correction. There has been much commentary that, since 2008, QE has caused massive distortions, imbalances and bubbles in asset prices, both financial and non-financial. Consequently, there are widespread concerns over the potential for such bubbles to be burst by exuberant central bank action. On the other hand, too slow or weak action would allow these imbalances and distortions to continue or to even inflate them further.

B.28 Consumer debt levels are also at historically high levels due to the prolonged period of low cost of borrowing since the financial crash. In turn, this cheap borrowing has meant other non-financial asset prices, particularly house prices, have been driven up to very high levels, especially compared to income levels. Any sharp downturn in the availability of credit, or increase in the cost of credit, could potentially destabilise the housing market and generate a sharp downturn in house prices. This could then have a destabilising effect on consumer confidence, consumer expenditure and GDP growth. However, no central bank would accept that it ought to have responsibility for specifically targeting house prices.

Appendix C: Credit Ratings

International long-term credit ratings

Fitch	Moody's	Standard & Poor's	Definition	Permitted counter-party
Investment Grade				
AAA	Aaa	AAA	Highest quality/Best quality/Extremely strong	Yes
AA	Aa	AA	Very high quality/High quality/Very strong	Yes
A	A	A	High quality/Upper medium grade/Strong	Yes*
BBB	Baa	BBB	Good quality/Medium grade/Adequate	No
Non-investment/speculative grade				
BB	Ba	BB	Speculative/Lower medium grade/Speculative – Less vulnerable	No
B	B	B	Highly speculative/Low grade/More vulnerable	No
CCC	Caa	CCC	Poor quality/Currently vulnerable	No
CC	Ca	CC	High default risk/Highly speculative/Currently highly vulnerable	No
C	C	C	High default risk/Extremely poor/Imminent default	No
D		D	In default	No

*except non UK sovereigns

Note: Fitch Ratings and Standard and Poor's ratings from 'AA' to 'CCC' may be modified by the addition of a plus (+) or minus (-) sign to show relative standing within the major rating categories. Moody's append numerical modifiers 1, 2, and 3 to each generic rating classification from Aa through Caa to denote relative status.