TYNE & WEAR FIRE AND RESCUE AUTHORITY

Item 4

MEETING: 19TH MARCH 2018

SUBJECT: TREASURY MANAGEMENT POLICY AND STRATEGY 2018/2019, INCLUDING PRUDENTIAL 'TREASURY MANAGEMENT' INDICATORS FOR 2018/2019 TO 2020/2021

REPORT OF THE STRATEGIC FINANCE MANAGER

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1. Purpose of the Report

1.1 To provide the Authority with the proposed Treasury Management Policy and Strategy (including both borrowing and investment strategies) for 2018/2019 and the associated Prudential 'Treasury Management' Indicators for 2018/2019 to 2020/2021 for approval.

2. Treasury Management

2.1 Treasury management is defined as "the management of the authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

The Treasury Management function is a specialist service that is carried out by Sunderland City Council on behalf of the Authority.

2.2 **Statutory requirements**

The Local Government Act 2003 (the Act) and supporting regulations requires the Authority to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential (Treasury Management) indicators for the next three years to ensure that the Authority's capital investment plans are affordable, prudent and sustainable, these are set out in Appendix 1.

The Act also requires the Authority to adopt a Treasury Management Policy Statement (detailed in Appendix 2) and to set out its Treasury Management Strategy comprising the Authority's strategy for borrowing and the Authority's policies for managing its investments and giving priority to the security and liquidity of those investments (Appendix 3).

The Ministry of Housing, Communities & Local Government (formerly Department of Communities and Local Government) 'Guidance on Local Government Investments', is currently being updated and subject to a consultation with results planned to take effect from 1st April 2018. The Chartered Institute of Public Finance and Accountancy (CIPFA) updated its Treasury Management in the Public Services Code of Practice in December 2017 (previously updated November 2011). The Authority is statutorily required to have regard to this advice when setting its Treasury Management Policy Statement and Treasury Management Strategy and are taking proposed changes into account. Any variations considered necessary to the TMPS and TMSS resulting from the outcome of the consultation will be reported to future Authority meetings.

2.3 **CIPFA Code of Practice requirements**

The Authority continues to fully adopt and to re-affirm annually its adherence to the updated Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management.

The primary requirements of the Code include that:

1. The Authority will create and maintain, as the cornerstones for effective treasury management:
   - a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities;
   - suitable Treasury Management Practices (TMP's), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

   The content of the policy statement is detailed in Appendix 2 and the TMP's follow the recommendations contained in Sections 6 and 7 of the Code, subject only to minor variations where necessary to reflect the particular circumstances of the Authority and these do not result in the Authority materially deviating from the Code's key principles.

2. The Authority will receive reports on treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year ahead, a mid-year review and an annual report after its close, in the form prescribed in its TMP's.

3. The Authority delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to this Committee, and for the execution and administration of treasury management decisions to the Strategic Finance Manager, who acts in accordance with the organisation's Policy Statement, TMP's and CIPFA's Standard of Professional Practice on Treasury Management.

4. The Authority has previously nominated the Governance Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

Treasury Management Strategy for 2018/2019

2.4 The Treasury Management Strategy comprises a Borrowing and an Investment Strategy. These set out the Authority's policies for managing its borrowing and investments in 2018/2019.

2.5 There are no major changes being proposed to the overall Treasury Management Strategy in 2018/2019 which maintains the prudent approach adopted by the Authority in previous years. Particular areas that inform the strategy include the extent of potential borrowing included in the Authority's capital programme, the availability of borrowing, and the current and forecast world and UK economic positions, in particular forecasts relating to interest rates and security of investments.

2.6 The proposed Treasury Management Strategy Statement for 2018/2019 is set out in Appendix 3 and is based upon the views of the Strategic Finance Manager, supplemented with market data, market information and leading market forecasts and views provided by the Authority's treasury adviser, Link Asset Services.

2.7 The strategy is subject to regular review to ensure compliance to the agreed treasury management strategy and that the strategy adapts to changing financial markets as appropriate. The Authority's performance for 2017/2018 using the prudent treasury management strategy adopted shows that the current average rate of borrowing at 3.26% is low in comparison with other local authorities whilst the current rate earned on investments at 0.41% is higher than the current benchmark figure of 0.17%. Market conditions are also under constant review so that the Authority can take a view on the optimum time to carry out further borrowing or debt rescheduling.

3. **Recommendations**

3.1 The Authority is requested to approve the:

- Annual Treasury Management Policy and Strategy (including specifically the Annual Borrowing and Investment Strategies) for 2018/2019; and

- Prudential 'Treasury Management' Indicators for 2018/2019 to 2020/2021.

Appendix 1

Prudential 'Treasury Management' Indicators 2018/2019 to 2020/2021

The indicators below relate to Treasury Management (all indicators relating to capital financing have been removed for clarity and can be found in the Capital Programme 2018/2019 including Prudential Indicators for 2018/2019 to 2020/2021 report made to the Authority on 12th February 2018).

P5 In respect of its external debt, it is recommended that the Authority approves the following authorised limits for its total external debt (gross of investments) for the next three financial years, and agrees the continuation of the previously agreed limit for the current year since no change to this is necessary.

The limits separately identify borrowing from other long-term liabilities such as PFI schemes and finance leases. The Authority must approve these limits and have delegated authority to the Strategic Finance Manager, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long term liabilities, in accordance with option appraisal and best value for the Authority. Any such changes made will be reported to the Authority at the next meeting following the change. The figures below have been calculated by reference to the overall Authorised Limit for Sunderland City Council which covers all separate bodies, including the Fire and Rescue Authority, which is subject to the Prudential Code.

	Authorised Limit for External Debt			
	2017/2018	**2018/2019**	**2019/2020**	**2020/2021**
	£000	**£000**	**£000**	**£000**
Borrowing	21,626	**28,124**	31,389	32,649
Other long term liabilities	20,085	**19,089**	17,981	16,702
Total	41,711	**47,213**	49,370	49,351

The Strategic Finance Manager reports that the above authorised limits are consistent with the Authority's current commitments, existing plans and the proposals in this report on the Capital Programme for capital expenditure and financing, and with its approved treasury management policy statement and practices. The Strategic Finance Manager also confirms they are based on the estimate of most likely, prudent but not worst case scenario, with, in addition, sufficient headroom over and above this to allow for operational management, for example unusual cash movements. Risk analysis and risk management strategies have been taken into account, as have plans for capital expenditure, estimates of the Capital Financing Requirement and estimates of cash flow requirements for all purposes.

In taking its decisions on the Revenue Budget and Capital Programme for 2018/2019, the Authority must note that the authorised limit determined for

2018/2019 will be the statutory limit determined under section 3(1) of the Local Government Act 2003 and is set at £47.213 million.

P6 The Authority must also approve the following operational boundary for external debt for the same time period and agrees to the continuation of the previously agreed limit for the current year since no change to this is necessary. The proposed operational boundary for external debt is based on the same estimates as the authorised limit, but reflects directly the estimate of the most likely, prudent but not worst case scenario level, without the additional headroom included within the authorised limit to allow, for example, for unusual cash flow movements. It equates to the projected maximum external debt and represents a key management tool for in-year monitoring. Within the operational boundary, figures for borrowing and other long-term liabilities are separately identified.

The Authority has delegated authority to the Strategic Finance Manager, within the total operational boundary for any individual year, to effect movement between the separately agreed figures for borrowing and other long term liabilities, similar to the authorised limit set out in P5.

The operational boundary limit for 2018/19 will be £42.213 million and will be closely monitored and a report will be made to Authority if it is exceeded at any point, although it is not anticipated that there will be any issues in remaining within the operational limit for 2018/19.

Operational boundary for external debt

	2017/2018	**2018/2019**	2019/2020	2020/2021
	£000	**£000**	**£000**	**£000**
Borrowing	16,625	**23,124**	26,389	27,649
Other long term liabilities	20,085	**19,089**	17,981	16,702
Total	36,710	**42,213**	44,370	44,351

P7 The Authority's actual external debt at 31 March 2017 was £33.805 million (calculated on the basis that all Authority debt is classed as external), comprising £13.219 million borrowing and £20.586 million in respect of other long-term liabilities. The Authority is required to include an element for long-term liabilities relating to PFI schemes and finance leases in its calculation of the operational and authorised boundaries to allow flexibility over future financing. It should be noted that actual external debt is not directly comparable to the authorised limit and operational boundary, since the actual external debt reflects the position at a point in time and allowance needs to be made for cash flow variations.

P8 Sunderland City Council, on the Authority's behalf, is no longer required to formally indicate if it has adopted the CIPFA Code of Practice on Treasury Management. However the revised Code was adopted by the full Council on 3rd March 2010 and is re-affirmed annually. The Authority therefore takes assurance from this formal process each year.

The objective of the Prudential Code is to provide a clear framework for local authority capital finance that will ensure for individual local authorities that:

(a) capital expenditure plans are affordable;

(b) all external borrowing and other long term liabilities are within prudent and sustainable levels;

(c) treasury management and investment decisions are taken in accordance with professional good practice and in full understanding of the risks involved;

and that in taking decisions in relation to (a) to (c) above the local authority is:

(d) accountable, by providing a clear and transparent framework.

Furthermore, the framework established by the Code should be consistent with and support:

(e) local strategic planning;

(f) local asset management planning;

(g) proper options appraisal.

In exceptional circumstances the objective of the Code is to provide a framework that will demonstrate that where there is a danger of not ensuring the above, the Authority can take timely remedial action.

CIPFA Treasury Management in the Public Services Code of Practice - Indicators 2018/2019 to 2020/2021

P9 It is recommended that the Authority also adopts the proposed lead authority's upper limit on its fixed interest rate exposures of £350 million in 2018/2019, £365 million in 2019/2020 and £350 million in 2020/2021.

P10 It is further recommended that the Authority also adopts the proposed lead authority's upper limit on its variable interest rate exposures of £58 million in 2018/2019, £46 million in 2019/2020 and £53 million in 2020/2021.

P11 It is recommended that the Authority sets upper and lower limits for the maturity structure of its borrowings, consistent with Sunderland City Council's policy, as follows:

Amount of projected borrowing that is fixed rate maturing in each period expressed as a percentage of total projected borrowing that is fixed rate at the start of the period:

	Upper limit	Lower limit
Under 12 months	50%	0%
12 months and within 24 months	60%	0%
24 months and within 5 years	80%	0%
5 years and within 10 years	100%	0%
10 years and over	100%	0%

P12 A maximum maturity limit of £75 million is set for each financial year (2018/2019, 2019/2020 and 2020/2021) for long term investments (those over 365 days). This gives additional flexibility to the Authority in undertaking the Treasury Management function. It is proposed that the Authority funds may be invested within the limits set by Sunderland City Council as set out in the Annual Investment Strategy (Appendix 3).

Appendix 2

Treasury Management Policy Statement

In line with CIPFA recommendations, the Authority adopted the following Treasury Management Policy Statement, which defines the policies and objectives of its treasury management activities:

- The Authority defines its treasury management activities as: “The management of the Authority’s investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks”.

- The Authority regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation and any financial instruments entered into to manage these risks.

- The Authority acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

  The Authority has an agreed Borrowing and Investment Strategy, the high level policies of which are as follows:

  The basis of the agreed Borrowing Strategy is to:
  - continuously monitor prevailing interest rates and forecasts;
  - secure long-term funds to meet the Authority’s future borrowing requirement when market conditions are considered favourable;
  - use a benchmark financing rate of 3.50% for long term borrowing (i.e. all borrowing for a period of one year or more);
  - take advantage of debt rescheduling opportunities, as appropriate.

  The general policy objective for the Authority in considering potential investments is the prudent investment of its treasury balances.
  - the Authority’s investment priorities in order of importance are:
    1) The security of its capital
    2) The liquidity of its investments and then,
    3) The Authority aims to achieve the optimum yield on its investments but this is commensurate with the proper levels of security and liquidity

  - the Authority has a detailed Lending List and criteria must be observed when placing funds – these are determined using expert TM advice, view of money market conditions and using detailed rating agency information as well as using our own market intelligence.

- Limits are also placed on the amounts that can be invested with individual and grouped financial institutions based on the Lending List and detailed criteria which is regularly reviewed.

The Authority re-affirms its commitment to the above Treasury Management Policy Statement.

Appendix 3

Treasury Management Strategy Statement for 2018/2019

1. **Introduction**

1.1 The Local Government Act 2003 and subsequent guidance requires the Authority to set out its Treasury Management Strategy for Borrowing and to prepare an Annual Investment Strategy. This sets out the Authority's policies for managing both its borrowing and its investments, which gives priority to the security and liquidity of those investments.

The suggested strategy for 2018/2019 is set out below and is based upon the Strategic Finance Manager's views on interest rates, supplemented with leading market forecasts and other financial data available and advice provided by the Authority's treasury adviser, Link Asset Services.

1.2 The treasury management strategy covers:

A. Borrowing Policy and Strategy

- treasury limits for 2018/2019 to 2020/2021
- current treasury management position
- prudential and treasury management indicators for 2018/2019 to 2020/2021
- prospects for interest rates
- the borrowing strategy
- the borrowing requirement 2018/2019
- policy on borrowing in advance of need
- debt rescheduling

B. Annual Investment Policy and Strategy

- Investment policy and objectives
- the investment strategy
- investment types
- investment limits
- provision for credit related losses
- creditworthiness policy
- monitoring of credit ratings
- past performance and current position
- MiFID II
- outlook and proposed investment strategy
- external fund managers
- policy on use of external service providers

2. Borrowing Policy and Strategy

2.1 Treasury Limits for 2018/2019 to 2020/2021

It is a statutory duty under Section 3 of the Local Government Act 2003 and supporting regulations, for the Authority to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Affordable Borrowing Limit". In England and Wales the Authorised Limit represents the legislative limit specified in the Act.

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

Whilst termed an "Affordable Borrowing Limit", the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is set, on a rolling basis, for the forthcoming financial year and two successive financial years and details can be found in Appendix 1 (P5) of this report. The Authority must approve these limits and delegates authority to the Strategic Finance Manager, within the total limit for any individual year, to action movement between the separately agreed limits for borrowing and other long term liabilities where this would be appropriate. Any such changes made will be reported to the Authority at their next meeting following the change.

Also, the Authority must also approve the Operational Boundary Limits (P6) which are included in the Prudential Indicators set out in Appendix 1. This operational boundary represents a key management tool for in-year monitoring. Within the operational boundary, figures for borrowing and other long-term liabilities are separately identified and the Authority is also asked to delegate authority to the Strategic Finance Manager, within the total operational boundary for any individual year, to action movement between the separately agreed figures for borrowing and other long-term liabilities, in a similar fashion to the authorised limit.

2.2 Current Treasury Management Position

2.2.1 Interest Rates 2017/2018

The Bank of England's (BoE) Monetary Policy Committee (MPC) voted at its 2nd November 2017 meeting to increase the Bank Rate by 0.25% to 0.50%, the first increase since July 2007. This increase reverses the emergency cut made in August 2016 after the EU referendum and had been strongly signalled in advance at the September MPC meeting. The increase was made primarily to reduce inflationary pressures within the economy and had been priced into markets. The MPC also gave forward guidance that they expected to increase the Bank Rate very gradually and to a limited extent twice more in the next three years to reach 1.0% by 2020.

Link Asset Services, the Authority's treasury advisors, now predict that on current trends base rates will increase by 0.25% towards the end of 2018, 2019 and late summer 2020.

Economic and interest rate forecasting remains difficult, with Brexit and many other external factors influencing the UK. The above forecasts (and MPC decisions) will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. The MPC, having previously expressed concern over the apparent lack of significant progress in Brexit negotiations sounded more optimistic in December, noting that recent progress in negotiations had reduced the likelihood of a disorderly exit from the EU. However, developments regarding the UK withdrawal from the EU remain the most significant influence on, and source of uncertainty about, the economic outlook. Geopolitical developments throughout the world but particularly conflict in the Middle East and between the US and North Korea, could also have a major impact.

PWLB rates have remained at historically low levels in 2017/2018 and the expectation is still 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. This expected increase in bond yields has not happened as the action of central banks since the financial crash of 2008, in implementing substantial Quantitative Easing, added further impetus to this downward trend in bond yields and rising bond prices. 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 (Fed) 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.

US monetary policy has now started to refocus on countering the threat of rising inflationary pressures as stronger economic growth becomes more firmly established. The Fed 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 causing bond yields to rise. 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. A world economic recovery will likely see investors switching from the safe haven of bonds to equities.

It is likely that from time to time gilt yields, and therefore PWLB rates, will 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 over the next few years.

The government introduced a 0.20% discount on PWLB loans under the prudential borrowing regime in March 2012 for those authorities that provided 'improved information and transparency on their locally determined long-term borrowing and associated capital spending plans'. Sunderland City Council successfully applied to access PWLB loans at a discount of 0.20% and has been successful in extending its access to the PWLB certainty rate until 31st October 2018.

The following table shows the average PWLB rates for Quarters 1, 2 and 3 and the figures for Quarter 4 to 8th January 2018.

2017/2018	Qtr 1* (Apr - Jun) %	Qtr 2* (Jul - Sep) %	Qtr 3* (Oct – Dec) %	Qtr 4* (rates to 8th Jan 2018) %
7 days notice	0.11	0.11	0.28	0.28
1 year	0.87*	1.01*	1.18*	1.22*
5 year	1.23*	1.37*	1.58*	1.59*
10 year	1.89*	2.01*	2.13*	2.10*
25 year	2.60*	2.69*	2.73*	2.66*
50 year	2.34*	2.44*	2.44*	2.38*

*rates take account of the 0.2% discount to the PWLB rates available to eligible authorities that came into effect on 1st November 2012.

2.2.2 **Long Term Borrowing 2017/2018**

The Authority's strategy for 2017/2018 was to adopt a pragmatic approach in identifying the low points in the interest rate cycle at which to borrow and to respond to any changing circumstances to seek to secure benefit for the Authority. A benchmark financing rate of 3.50% for long-term borrowing was set in light of the views prevalent at the time the Treasury Management policy was set in March 2017.

Volatility in the financial markets in Quarters 1 and 2 continued in Quarter 3 leading to considerable movement of funds into gilts with a resulting fall in both gilt yields and PWLB rates. In line with discussions with the Authority's economic advisors, Sunderland City Council took advantage of the low borrowing rate troughs that have occurred and has taken out £10 million of new borrowing during the financial year as these rates were considered opportune. The new borrowing is summarised in the following table:

Duration	Date of the transaction	Start	Matures	Rate %	Loan Amount £m
48½ years	03/11/2017	07/11/2017	07/05/2066	2.41	10.0

Since taking out this new borrowing rates rose before falling to around the levels at which additional borrowing was taken out. The position is subject to large variations but the overall longer term expectation is for gilt yields and PWLB rates to rise, albeit gently. The Treasury Management team continues to closely monitor PWLB rates to assess the value of possible further new borrowing in line with future Capital Programme requirements.

The Borrowing Strategy for 2017/2018 made provision for debt rescheduling but due to the proactive approach taken by the Authority in earlier years, and because of the very low underlying rate of the Authority's long-term debt, it would be difficult to refinance long-term loans at interest rates lower than those already in place. Rates have not been sufficiently favourable for rescheduling in 2017/2018 so far and the Treasury Management team will continue to monitor market conditions and secure early redemption if appropriate opportunities should arise.

There are currently seven market Lender's Option / Borrower's Option (LOBO) loans totalling £39.5 million. The lender has the option to alter the rate on these loans at set intervals and these can either be accepted at the new rate or repaid without penalty. The following table shows the LOBO's that were subject to a potential rollover this financial year. No changes to loan rates have been received and none are expected for the outstanding rollover period LOBO's with Dexia Credit Local and so these arrangements will continue.

Roll Over Dates	Lender	Amount (£m)	Rate %	Roll Over Periods
27/01/2018	Dexia	5.0	4.32	Every 3 years
21/04/2017 & 21/10/2017	Barclays	5.0	4.50	Every 6 months
10/12/2017	Barclays	9.5	4.37	Every 3 years
Total		**19.5**		

2.2.3 Current Portfolio Position

The treasury portfolio position at 31st December 2017 for Sunderland City Council, which the Fire and Rescue Authority forms part of, comprised:

		Principal (£m)	Total (£m)	Average Rate (%)
Borrowing				
Fixed Rate Funding	PWLB	207.8		
	Market	39.6		
	Other	4.2	251.6	3.57
Variable Rate Funding	Temporary/ Other		27.6	0.41
Total Borrowing			**279.2**	**3.26**
Total Investments	In House-short term*		**143.9**	
Net Deficit			**135.3**	

*The total investments figure includes monies invested on behalf of ANEC which agreed with its member authorities that Sunderland City Council would invest its surplus funds.

Currently there is a deficit of £135.3m which represents the difference between gross debt and total investments and is significantly lower that the lead authority's capital financing requirement (capital borrowing need). This means that the capital borrowing need has not been fully funded with loan debt as cash supporting the lead authority's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and it also reduces counterparty risk. The net deficit position is expected to increase over the next few years as the lead authority and the Authority have to manage their finances with significantly less government funding. This is likely to impact in the form of increased borrowing and reductions to reserves, with the result that the net borrowing position will probably increase.

There are a number of risks and benefits associated with having both a large amount of debt whilst at the same time having a considerable amount of investments.

Benefits of having a high level of investments are;

- liquidity risk – having a large amount of investments means that the Authority is at less of a risk should money markets become restricted or borrowing less generally available, this mitigates against liquidity risk;
- interest is received on investments which helps the Authority to address its Strategic Priorities;
- of more importance, the Authority has greater freedom in the timing of its borrowing as it can afford to wait until the timing is right rather than be subject to the need to borrow at a time when interest rates are not advantageous.

Risks associated with holding a high level of investments are;

- the Counterparty risk – institutions cannot repay the Authority investments placed with them;
- interest rate risk – the rate of interest earned on the investments will be less than that paid on debt, thus causing a loss to the Authority.

The Authority has mitigated these risks by having a risk averse Treasury Management Investment Strategy and by detailed monitoring of counterparties through its borrowing and investment strategies and treasury management working practices and procedures.

2.3 **Prudential and Treasury Management Indicators for 2018/2019 – 2020/2021**

Prudential and Treasury Management Indicators (as set out in Appendix 1) are a requirement of the CIPFA Prudential Code and are relevant for the purposes of setting an integrated treasury management strategy and to ensure that treasury management decisions are taken in accordance with good professional practice.

The requirement for the Authority to indicate if it has adopted the CIPFA Code of Practice on Treasury Management has been removed in the revised 2017 edition of the Code. However this is still considered to be good practice. The original 2001 Code was adopted on 20th November 2002 and the revised code in 2011 was adopted in March 2012. The Authority re-affirms its full adherence to the latest 2017 edition of the Code and will continue to do so annually (as set out in Appendix 2).

2.4 **Prospects for Interest Rates**

The Authority's treasury advisors are Link Asset Services and part of their service is to assist the Authority to formulate a view on interest rates. A number of current City forecasts for short term (Bank Rate) and longer fixed interest rates are set out in Appendix 4. The following gives the Link Asset Services Bank Rate forecast for the current and next 3 financial years.

- 2017/2018 0.25% - 0.50%
- 2018/2019 0.50% - 0.75%
- 2019/2020 0.75% - 1.00%
- 2020/2021 1.00% - 1.25%

There are downside risks to these forecasts if economic growth were to fall significantly and upside risks if inflation is significantly higher than expected alongside a higher than expected level of economic growth or if world economic activity and US interest rates increase faster than anticipated. However it is clear that interest rates will remain at historically low levels into the medium term which will keep investment returns at very low levels and there will remain a cost of carry to any new borrowing due to incurring a revenue loss between borrowing costs and investment returns. A detailed view of the current economic background is contained within Appendix 5 to this report. The position will be closely monitored to ensure the Authority takes appropriate action as necessary under either scenario.

2.5 **Borrowing Strategy**

The treasury management function ensures that the Authority's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This involves both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury/prudential indicators, the current and projected debt positions and the annual investment strategy.

2.6 **Borrowing Requirement 2017/2018**

The borrowing requirement for Sunderland City Council, which the Fire and Rescue Authority forms part of, is as follows:

		2018/19 £m	2019/20 £m	2020/21 £m
1.	Capital Programme Borrowing	**86.0**	**25.3**	**17.9**
2.	Replacement borrowing (PWLB)	**5.0**	**5.0**	**4.0**
3.	Replacement LOBO	**20.0**	**10.0**	**19.5**
	TOTAL:	**111.0**	**40.3**	**41.4**

2.6.1 **Borrowing rates**

The Link Asset Services forecast in respect of interest rates for loans charged by the PWLB is as follows: -

Date	Bank Rate %	PWLB Borrowing Rates (including certainty rate adjustment) %		
		5 year	25 year	50 year
March 2018	0.50	1.60	2.90	2.60
June 2018	0.50	1.60	3.00	2.70
Sept 2018	0.50	1.70	3.00	2.80
Dec 2018	0.75	1.80	3.10	2.90
March 2019	0.75	1.80	3.10	2.90
June 2019	0.75	1.90	3.20	3.00
Sept 2019	0.75	1.90	3.20	3.00
Dec 2019	1.00	2.00	3.30	3.10
March 2020	1.00	2.10	3.40	3.20
June 2020	1.00	2.10	3.50	3.30
Sept 2020	1.25	2.20	3.50	3.30
Dec 2020	1.25	2.30	3.60	3.40
March 2021	1.25	2.30	3.60	3.40

A more detailed forecast from Link Asset Services is included in Appendix 4.

The main sensitivities of the forecast are likely to be;

- if it were felt that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in the US Federal Funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities, an increase in world economic activity or a sudden increase in UK inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate borrowing will be undertaken whilst interest rates are still lower than they will be in the next few years.

- if it were 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 a relapse into recession, an increase in Geopolitical risks abroad or a risk of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

In conjunction with the Authority's treasury advisers, the Authority monitors both the prevailing interest rates and the market forecasts. The Strategic Finance Manager, taking into account potential market volatility and the advice of the Authority's treasury adviser, considers a benchmark financing rate of 3.50% for any further long-term borrowing for 2018/2019 to be appropriate.

It is possible that a Municipal Bonds Agency, currently being set up by the Local Government Association, will be offering bonds to local authorities in the future. The rates offered by the new Agency will be assessed and use made of this new source of funding where it is considered advantageous.

Consideration will be also given to other options, including utilising some investment balances to fund the borrowing requirement in 2018/2019. This policy has served the Authority well over the last few years as investment returns continue to be low. As a result the Authority is currently maintaining a large under-borrowed position. This position will be carefully reviewed to avoid incurring higher borrowing costs over the long term whilst ensuring that financing is available to support capital expenditure plans. The need to adapt to changing circumstances and revisions to profiling of capital expenditure is required, and flexibility needs to be retained to adapt to any changes that may occur.

The Strategic Finance Manager, taking advice from the Authority's treasury advisers, will continue to monitor rates closely and whilst implementing the borrowing strategy, will adopt a pragmatic approach in identifying the low points in the interest rate cycle at which to borrow wherever possible, when applicable.

2.7 Policy on borrowing in advance of need

The Authority will not borrow more than or in advance of its needs purely to profit from treasury investments of the extra sums borrowed. Any decision to borrow in advance will be assessed within the relevant Capital Financing Requirement estimates, with regard to current policies, and will be considered carefully to ensure value for money can be demonstrated and that the Authority can ensure the security of such funds.

Risks associated with any borrowing in advance of activity will be subject to appraisal and any borrowing undertaken will be reported to the Authority as part of the agreed treasury management reporting arrangements.

2.8 Debt Rescheduling

The reasons for any rescheduling of debt will include:

- the generation of cash savings at minimum risk;
- in order to help fulfil the Treasury Management Strategy; and

- in order to enhance the balance of the long-term portfolio (by amending the maturity profile and/or the balance of volatility).

In previous years, debt rescheduling has achieved significant savings in interest charges and discounts and these interest savings have been secured for many years to come. However in 2007 the PWLB introduced a spread between the rates applied to new borrowing and repayment of debt which was compounded in 2010 by a considerable further widening of the difference between new borrowing and repayment rates and it has meant that PWLB debt restructuring is much less attractive than it was before both of these measures were introduced. Consideration will also be given to other options where interest savings may be achievable by using LOBO (Lenders Option Borrowers Option) loans and/or other market loans, in rescheduling exercises rather than solely using PWLB borrowing as the source of replacement financing but this would only be the case where this would represent best value to the Authority.

The latest interest rate projections for 2018/2019 show short-term borrowing rates will be cheaper than longer term rates and as such there may be potential for some opportunities to generate savings by switching from long-term debt to short-term debt. These potential 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, their short-term nature, and the likely cost of refinancing those short-term loans, once they mature, compared to the current rates of longer term debt in the existing debt portfolio.

The Authority is keeping a watching brief on market conditions in order to secure further debt rescheduling when, and if, appropriate opportunities arise. The timing of all borrowing and investment decisions inevitably includes an element of risk, as those decisions are based upon expectations of future interest rates. The policy to date has been very firmly one of risk spread and this prudent approach will be continued.

Any rescheduling undertaken will be reported to the Authority, as part of the agreed treasury management reporting arrangements.

3. Annual Investment Policy and Strategy

3.1 Investment Policy and Objectives

When considering its investment policy and objectives, the Authority has taken regard to the Ministry of Housing, Communities & Local Government (HCLG) Guidance on Local Government Investments (“the Guidance”), proposed new HCLG guidance that is currently being considered and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes (“the CIPFA TM Code”).

The Authority’s investment objectives are:-

(a) the security of capital, and
(b) the liquidity of its investments.

The Authority also aims to achieve the optimum return on its investments but this is commensurate with proper levels of security and liquidity.

In accordance with the above guidance from the HCLG and CIPFA, and in order to minimise the risk to investments, the Authority applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of risk. The risk appetite of the Authority is regarded as low in order to give priority to security of its investments.

The borrowing of monies for treasury management activities purely to invest or on-lend and make a return is unlawful and the Authority will not engage in such activity.

3.2 **Investment Strategy**

This Strategy sets out:

- the guidelines for choosing and placing investments;
- the maximum periods for which funds may be prudently committed in each class of investment;
- the amount or percentage limit to be invested in each class of investment;
- specified investments that the Authority will use;
- non-specified investments that the Authority will use, clarifying the greater risk implications, identifying the general type of investment that may be used and a limit to the overall amounts of various categories that can be held at any time.

3.3 **Investment Types**

The Authority is allowed to invest in two types of investment, namely Specified Investments and Non-specified Investments.

Specified Investments are sterling investments that are for a period of not more than one-year maturity, or those which could be for a longer period but where the Authority has the right to be repaid within 12 months if it wishes. These are placed with high rated counterparties and are considered low risk assets where the possibility of loss of principal or investment income is small. Within these bodies and in accordance with the Code, the Authority has set additional criteria to limit the time and amount of monies that will be invested with these bodies.

Non-specified Investments are any investments which are not classified as specified investments. As the Authority only uses investment grade high credit rated counterparties for treasury management investments this means in effect that any investments placed with those counterparties for a period over one year or more will be classed as Non-specified Investments.

The type of investments to be used by the in-house treasury management team will be limited to Certificates of Deposit, fixed term deposits, interest bearing accounts, Money Market Funds, Government debt instruments, floating rate notes, corporate bonds, municipal/local authority bonds, bond funds, gilt funds and gilt edged securities and will follow the criteria as set out in Appendix 6.

The Authority may make other type of investments (usually defined by regulation as capital expenditure) that are not part of treasury management activity. Treasury management investment activity covers those investments which arise from the Authority's cash flows and debt management activity, and ultimately represent balances which need to be invested until the cash is required for use in the course of business.

Investments that may be made for policy reasons outside of normal treasury management activities may include;

- service investments held clearly and explicitly in the course of the provision, and for the purposes of operational services, including regeneration. This may include loans to local enterprises as part of a wider strategy for local economic growth
- commercial investments which are taken for mainly financial reasons. These may include investments arising as part of business structures, such as shares and loans in subsidiaries or other outsourcing structures; or investments explicitly taken with the aim of making a financial surplus for the Authority. Commercial investments also include non-financial assets which are held primarily for financial benefit, such as investment properties.

The Strategic Finance Manager will maintain a schedule setting out a summary of existing material investments, subsidiaries, joint ventures and liabilities including financial guarantees and the Authority's risk exposure.

Investment objectives in relation to these types of investments will still be primarily security and liquidity but with the understanding that the liquidity for these types of investments may be less than those for treasury management activities and that these may be subject to higher levels of risk. When non-treasury management investments are considered due diligence will take place with all proposed investments being subjected to a detailed financial appraisal that will include financial sustainability of the investment and the identification of risk to both capital and returns. An assessment against loss will be carried out periodically and if the value of non-financial investments is no longer sufficient to provide security against loss mitigating actions will be taken. Decisions relating to non-treasury management investments will follow appropriate governance arrangements.

3.5 **Investment Limits**

One of the recommendations of the Code is that local authorities should set limits for the amounts of investments that can be placed with institutions by country, sector and group. These limits are applied in the lead authority's Counterparty criteria set out in Appendix 6.

The minimum amount of overall investments that will be held in short-term investments (less than one year) is £15 million. As the lead authority has decided to restrict most of its investments to term deposits, it will maintain liquidity by having a minimum of 30% of these short-term investments maturing within 6 months.

A maximum limit of £75 million is to be set for in-house non-specified investments over 365 days up to a maximum period of 2 years (excluding non-treasury management investments and all other investments defined as capital expenditure). This amount has been calculated by reference to total cash flows, including the potential use of earmarked reserves. The Strategic Finance Manager will monitor long-term investment rates and identify any investment opportunities if market conditions change.

3.6 Provision for Credit Related Losses

If any of the investments appear at risk of loss due to default (i.e. a credit-related loss and not one resulting from a fall in price due to movements in interest rates), then the lead authority will make revenue provision of an appropriate amount in accordance with proper accounting practice or any prevailing government regulations, if applicable. This position has not occurred and the lead authority mitigates this risk with its prudent investment policy.

3.7 Creditworthiness policy

The creditworthiness policy adopted by the Authority takes into account the credit ratings issued by all three credit rating agencies (Fitch, Moody's and Standard & Poor's). Credit rating information is supplied by Link Asset Services, our treasury advisors, on all active counterparties that comply with the Authority's counterparty criteria.

Following the financial crisis of 2008 it was recognised that investors, who largely remained unaffected through this period, should share the burden in future by making them forfeit part of their investment to "bail in" a bank before taxpayers are called upon. Regulatory changes that have been made in the banking sector are designed to see greater stability, lower risk and the removal of expectations of Government financial support should an institution fail.

To reflect this and commencing in 2015, in response to the evolving regulatory regime, the three credit rating agencies have carried out a wider reassessment of methodologies. In addition to the removal of implied government support, new methodologies are now taking into account additional factors, such as regulatory capital levels.

In keeping with the agencies' new methodologies, the rating element of our credit assessment process now focuses solely on the Short and Long Term ratings of an institution. The evolving regulatory environment, in tandem with the rating agencies' new methodologies also means that sovereign ratings are now of lesser importance in the assessment process. While this Authority understands the changes that have taken place, it will continue to specify a minimum sovereign rating of AA. This is due to the fact that the underlying domestic, and where appropriate, international, economic and wider political and social background will still have an influence on the ratings of a financial institution.

It is important to stress the ongoing regulatory changes made in the UK and the rest of Europe are designed to make the financial system sounder. In the majority of cases implied sovereign government support has effectively been withdrawn from banks. They are now expected to have sufficiently strong balance sheets to be able to withstand foreseeable adverse financial circumstances without government support. In many cases, the balance sheets of banks are now much more robust than they were before the 2008 financial crisis when they had higher ratings than now.

As with previous practice, ratings will not be the sole determinant of the quality of an institution and the Authority will continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Authority will engage with its advisors to monitor market pricing such as "credit default swaps" and overlay that information on top of the credit ratings provided.

Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

In summary the UK financial institutions have stregthened their Balance Sheets to better accommodate the impact of another financial crisis. As a result, government intervention would become limited if at all and Bail-In arrangements would apply if banks were to fail. This increases the risk of depositors but only to the extent the institution can not withstand the total losses.

Set out in Appendix 6 is the detailed criteria that will be used, subject to approval, in determining the level of investments that can be invested with each counterparty or institution. Where a counterparty is rated differently by any of the 3 rating agencies, the lowest rating will be used to determine the level of investment. If the Council's own banker, National Westminster Bank plc should fail to meet the minimum credit criteria to allow investments from the Authority then balances will be minimized as far as possible.

3.8 Monitoring of Credit Ratings

- All credit ratings are monitored on a daily basis. The Authority has access to all three credit ratings agencies and is alerted to changes through its use of Link Asset Services counterparty service.
- If a counterparty's rating is downgraded with the result that it no longer meets the Authority's minimum criteria, the Authority will cease to place funds with that counterparty.
- If a counterparty's rating is downgraded with the result that their rating is still sufficient for the counterparty to remain on the Approved Lending List, then the counterparty's authorised investment limit will be reviewed accordingly. A downgraded credit rating may result in the lowering of the counterparty's investment limit and vice versa. The detailed Lending List is set out in Appendix 7 for information.

Should the UK Government's AA sovereign rating be withdrawn the Authority's Investment Strategy and Lending List criteria will be reviewed and any changes necessary will be reported to the Authority.

3.9 Past Performance and Current Position

During 2017/2018 the Authority did not employ any external fund managers, all funds being managed by the in-house team. The performance of the fund managed by Sunderland City Council's in-house team is shown below compared to the relevant benchmarks and performance from the previous year:

	2016/17 Benchmark %	**2016/17 Return %**	**To date 2017/18 Benchmark %**	**To date 2017/18 %**
Performance	0.20	0.41	0.17	0.41

During 2018/2019 the Authority will continue to review the optimum arrangements for the investment of its funds whilst fully observing the investment strategy in place. The Authority uses the 7-day London Interbank Bid (LIBID) rate as a benchmark for its investments. Performance is significantly above the benchmark rate, whilst still adhering to the prudent policy agreed by the Authority, in what remains a very challenging market. The rate of return achieved by the Authority compared favourably according to our external Treasury Management advisors who have benchmarked our performance with other authorities.

3.10 MiFID II

New European Financial Directives known as MiFID II came into force on 3rd January 2018. These directives are designed to strengthen transparency and investor protection in financial markets across the EU. Under the directives each client is classed as either retail or professional. All Local Authorities are initially classified as de facto retail counterparties under MiFID II but with the option to ask to opt up to professional status subject to meeting qualitative and quantitative criteria. Financial Institutions dealing with a number of regulated products including direct investments such as Certificates of Deposit, Gilts, Corporate Bonds and investment funds (including Money Market Funds) will only be able to deal with professional clients. Sunderland City Council has opted up to professional client status with a number of financial institutions to allow access to specific products and will seek to opt up to with others where this is appropriate.

3.11 **Outlook and Proposed Investment Strategy**

Based on its cash flow forecasts, the Authority together with the City Council anticipates its fund balances in 2018/2019 are likely to range between £15 million and £150 million. This represents a cautious approach and provides for funding being received in excess of the level budgeted for, and also for unexpected and unplanned levels of capital underspending in the year or reprofiling of spend into future years. In 2017/2018 short-term interest rates have been materially below long-term rates and some investment balances have been used to fund some long-term borrowing requirements. It is likely that this will continue into 2018/2019 with investment balances being used to fund some long-term borrowing or used for debt rescheduling. Such funding is wholly dependent upon market conditions and will be assessed and reported to the Authority if and when the appropriate conditions arise.

The Authority is not committed to any investments which are due to commence in 2018/2019 (i.e. it has not agreed any forward deals).

Activities likely to have a significant effect on investment balances are:
- Capital expenditure during the financial year, (dependent upon timing), will affect cash flow and short term investment balances;
- Any reprofiling of capital expenditure from, and to, other financial years will also affect cash flow (no reprofiling has been taken into account in current estimates);
- Any unexpected capital receipts or other income;
- Timing of new long-term borrowing to fund capital expenditure;
- Possible funding of long-term borrowing from investment balances (dependent upon appropriate market conditions).

The Strategic Finance Manager, in conjunction with the Authority’s treasury adviser Link Asset Services, and taking into account the minimum amount to be maintained in short-term investments, will continue to monitor investment rates closely and to identify any appropriate investment opportunities that may arise.

It is proposed that delegated authority continues for the Strategic Finance Manager to vary the Lending List Criteria and Lending List itself should circumstances dictate, on the basis that changes be reported to the Authority retrospectively, in accordance with normal treasury management reporting procedures.

3.12 **External fund managers**

At present the lead authority does not use external fund managers.

Should the Authority appoint any external fund managers in the future, they will have to agree to strict investment limits and investment criteria prior to being appointed.

3.13 **Policy on the use of external service providers**

The Authority uses Link Asset Services as its external treasury management adviser. The Authority recognises that responsibility for treasury management decisions remains with the Authority at all times and will ensure that no undue reliance is 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 Authority will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented and subject to regular review.

4. **Scheme of delegation**

4.1 The Treasury Management Strategy Statement has been prepared in accordance with the revised Code. Accordingly, the Authority's Treasury Management Strategy (TMS) is approved annually by the Authority and now receives, as a minimum, a mid-year TMS report and an annual Treasury Management outturn report for the previous year by no later than the 30th September of the following year. In addition quarterly reports are made to the Authority and the Governance Committee and monitoring reports are reviewed by members in both executive and scrutiny functions respectively. The aim of these reporting arrangements is to ensure that those with ultimate responsibility for the treasury management function appreciate fully the implications of treasury management policies and activities, and that those implementing policies and executing transactions have properly fulfilled their responsibilities with regard to delegation and reporting.

The Authority has the following reporting arrangements in place in accordance with the requirements of the Code:-

Area of Responsibility	**Authority/ Committee/ Officer**	**Frequency**
Treasury Management Policy Statement	Full Authority	Reaffirmed annually and updated as appropriate

Area of Responsibility	Authority/ Committee/ Officer	Frequency
Treasury Management Strategy / Annual Investment Strategy	Full Authority	Annually before the start of the year
Treasury Management Strategy / Annual Investment Strategy – mid-year report	Full Authority	Mid-year
Treasury Management Strategy / Annual Investment Strategy – updates or revisions at other times	Full Authority	As appropriate
Annual Treasury Management Outturn Report	Full Authority	Annually by 30/09 after the end of the financial year
Treasury Management Monitoring Reports	Strategic Finance Manager	Monthly
Treasury Management Practices	Strategic Finance Manager	Annually
Scrutiny of Treasury Management Strategy	Governance Committee	Annually before Full Authority
Scrutiny of Treasury Management Performance	Governance Committee	Quarterly

5. The Treasury Management Role of the Section 151 Officer

5.1 The Strategic Finance Manager is the Authority's Section 151 Officer and has specific delegated responsibility in the Authority's Constitution to manage the borrowing, financing and investment requirements of the Authority in accordance with the Treasury Management Policy agreed by the Authority. This includes;

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

Appendix 4

Interest Rate Forecasts

Introduction

The data set out overleaf shows a variety of forecasts published by Link Asset Services and Capital Economics (an independent forecasting consultancy).

The forecast within this strategy statement has been drawn from these diverse sources and officers' own views.

1. Individual Rate Forecasts

PWLB rates and forecasts 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													
	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%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%
3 Month LIBID	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%	0.60%	0.80%	0.80%	0.80%	0.90%	1.00%	1.00%	1.10%	1.30%	1.30%	1.40%
12 Month LIBID	0.80%	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	1.60%	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	2.20%	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	2.90%	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	2.60%	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%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%
Capital Economics	0.50%	0.75%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	2.00%	2.00%	2.25%	2.25%	-
5yr PWLB Rate													
Link Asset Services	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%	2.10%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.65%	2.65%	2.90%	-
10yr PWLB Rate													
Link Asset Services	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	2.20%	2.40%	2.60%	2.80%	2.80%	2.80%	2.80%	2.80%	2.80%	3.05%	3.05%	3.30%	-
25yr PWLB Rate													
Link Asset Services	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	2.60%	2.90%	3.10%	3.30%	3.30%	3.30%	3.35%	3.35%	3.35%	3.60%	3.60%	3.80%	-
50yr PWLB Rate													
Link Asset Services	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	2.50%	2.70%	2.90%	2.90%	2.90%	3.05%	3.05%	3.15%	3.15%	3.40%	3.40%	3.65%	-

Survey of Economic Forecasts

HM Treasury November 2017
The current 2017 base rate forecasts are based from samples of both City and non-City forecasters included in the HM Treasury November 2017 report.

BANK RATE FORECASTS	Annual Average Bank Rate				
	Ave. 2017	Ave. 2018	Ave. 2019	Ave. 2020	Ave. 2021
Average	0.39%	0.65%	0.98%	1.41%	1.70%
Highest	0.50%	0.92%	1.50%	2.10%	1.50%
Lowest	0.29%	0.50%	0.50%	0.50%	0.50%

Source: HM Treasury: Forecasts for the UK Economy Nov. 2017 (No.366)

Appendix 5

Economic Background

1.1 United Kingdom Economy

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

While the Bank of England is expected to give forward guidance to prepare financial markets for gradual changes in policy, the Monetary Policy Committee (MPC) meeting of 14 September 2017 surprised forecasters by taking a more aggressive tone in terms of its words around warning that Bank Rate will need to rise soon. The Bank of England Inflation Reports during 2017 have clearly flagged up that it expected CPI inflation to peak at just under 3% in 2017, before falling back to near to its target rate of 2% in two years' time. The Bank revised its forecast for the peak to just over 3% at the 14 September meeting. The MPC focus in deciding that the base rate should increase to reduce inflation based on the view that an increase in rates would not damage the economy as 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. 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. The Bank was also concerned that the withdrawal of the UK from the EU would effectively lead to a *decrease* in such globalisation pressures in the UK, and so this would cause additional inflationary pressure over the next few years.

At its 2 November 2017 meeting, the MPC approved a 0.25% increase in Bank Base Rate. It also gave forward guidance that they expected to increase Bank Base Rate only twice more in the next three years to reach 1.0% by 2020. This is a relaxed rate of increase prediction for the Bank Base Rate in line with previous statements that the Bank Base Rate would only go up very gradually and to a limited extent.

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

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

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

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

- Bank of England takes action too quickly over the next three years to raise the Bank Base Rate and causes UK economic growth, and increases in inflation, to be weaker than currently anticipated.
- Geopolitical risks, especially North Korea, but also in Europe and the Middle East, could lead 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.
- Germany is still without an effective government 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 popularist 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
- The result of the October 2017 Austrian general election 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 obstacle 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.
- Rising protectionism under President Trump
- A sharp Chinese downturn and its impact on emerging market countries

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

- The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- UK inflation returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.
- The Fed causing a sudden shock in financial markets through misjudging the pace and strength of increases in its Federal Funds Rate and in the pace and strength of reversal of quantitative easing, which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead 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.

1.2 Global Outlook

World growth looks to be on an encouraging trend of stronger performance, rising earnings and falling levels of unemployment. In October the IMF upgraded forecasts 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 both the UK and US. This has led to many comments by economists that there appears to have been a fundamental shift downwards in the Phillips curve (this plots the correlation between levels of unemployment and inflation e.g. if the former is low the latter tends to be high). The cause of this is probably the combination of a shift towards flexible working, self-employment, falling union membership and a consequent reduction in union power and influence in the economy, and increasing globalisation and specialisation of individual countries, which has meant that labour in one country is in competition with labour in other countries which may be offering lower wage rates, increased productivity or a combination of the two. In addition, technology is probably also exerting downward pressure on wage rates and this is likely to grow with an accelerating movement towards automation, robots and artificial intelligence, leading to many repetitive tasks being taken over by machines or computers.
Globally, looking back on nearly ten years since the financial crash of 2008 when liquidity suddenly dried up in financial markets, it can be assessed that central banks' monetary policy measures to counter the sharp world recession were

successful. The key monetary policy measures they used were a combination of lowering central interest rates and flooding financial markets with liquidity, particularly through unconventional means such as Quantitative Easing (QE), where central banks bought large amounts of central government debt and smaller sums of other debt.

The key issue now is that this period of stimulating economic recovery and warding off the threat of deflation is coming towards its close and a new period has already started in the US, and more recently, in the UK, on reversing those measures i.e. by raising central rates and (for the US) reducing central banks' holdings of government and other debt. These measures are now required in order to stop the trend of an on-going reduction in spare capacity in the economy, and of unemployment falling to such low levels that the re-emergence of inflation is viewed as a major risk. It is, therefore, crucial that central banks get their timing right and do not cause shocks to market expectations that could destabilise financial markets. In particular, a key risk is that because QE-driven purchases of bonds drove up the price of government debt, and therefore caused a sharp drop in income yields, this then also encouraged investors into a search for yield and into investing in riskier assets such as equities. This resulted in bond markets and equity market prices both rising to historically high valuation levels simultaneously. This, therefore, makes both asset categories vulnerable to a sharp correction. It is important, therefore, that central banks only gradually unwind their holdings of bonds in order to prevent destabilising the financial markets. It is also likely that the timeframe for central banks unwinding their holdings of QE debt purchases will be over several years. They need to balance their timing to neither limit economic recovery by taking too rapid and too strong action, or, alternatively, letting inflation increase by taking action that was too slow and/or too weak. The potential for central banks to get this timing and strength of action wrong are now key risks.

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

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

- Some economists favour a shift to a lower inflation target of 1% to emphasise the need to keep inflation from rising to high levels. Alternatively, it is possible that a central bank could simply ignore the overall 2% inflation target in order to take action in raising rates sooner than might otherwise be expected.

- Other economists argue for a shift up in the inflation target to 3% in order to ensure that central banks place the emphasis on maintaining economic growth through adopting a slower pace of withdrawal of stimulus.
- In addition, there is a strong argument that central banks should target financial market stability. As mentioned previously, bond markets and equity markets could be vulnerable to a sharp correction. There has been much commentary, that since 2008, QE has caused massive distortions, imbalances and bubbles in asset prices, both financial and non-financial. Consequently, there are widespread concerns at the potential for such bubbles to be burst by exuberant central bank action. On the other hand, too slow or weak action would allow these imbalances and distortions to continue or to even inflate them further.
- Consumer debt levels are also at historically high levels due to the prolonged period of low cost of borrowing since the financial crash. In turn, this cheap borrowing has meant that other non-financial asset prices, particularly house prices, have been driven up to high levels when 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.

The Eurozone

Economic growth in the Eurozone (EZ), the UK's biggest trading partner, had been low 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 QE. 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). Despite providing massive monetary stimulus, the European Central Bank is still struggling to get inflation up to its 2% target and in October 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.

USA

Growth in the American economy was notably erratic and volatile in 2015 and 2016 with 2017 following that trend with quarter 1 coming in at only 1.2% but quarter 2 rebounding to 3.1% and quarter 3 coming in at 3.0%. 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. The Fed has started on a gradual upswing in rates three increases in 2017 with the rate now at 1.50%. There could then be another three increases in 2018 and 2019. 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.

Asia

Economic growth in China has been weakening over successive years, despite repeated rounds of central bank stimulus and medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems.

Elsewhere in Asia, GDP growth in Japan has been gradually improving during 2017 to reach 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. It is also making little progress on fundamental reform of the economy.

Lending List Criteria **Appendix 6**

Counterparty Criteria

The lead Authority takes into account not only the individual institution's credit ratings issued by all three credit rating agencies (Fitch, Moody's and Standard & Poor's), but also all available market data and intelligence, the level of government support and advice from its Treasury Management advisors.

Set out below are the criteria to be used in determining the level of funds that can be invested with each institution. Where an institution is rated differently by the rating agencies, the lowest rating will determine the level of investment.

Fitch / S&P's Long Term Rating	**Fitch Short Term Rating**	**S&P's Short Term Rating**	**Moody's Long Term Rating**	**Moody's Short Term Rating**	**Maximum Deposit £m**	**Maximum Duration**
AAA	F1+	A1+	Aaa	P-1	120	2 Years
AA+	F1+	A1+	Aa1	P-1	100	2 Years
AA	F1+	A1+	Aa2	P-1	80	2 Years
AA-	F1+ / F1	A1+ / A-1	Aa3	P-1	75	2 Years
A+	F1	A-1	A1	P-1	70	364 days
A	F1 / F2	A-1 / A-2	A2	P-1 / P-2	65	364 days
A-	F1 / F2	A-2	A3	P-1 / P-2	50	364 days
Local Authorities (limit for each local authority)					30	2 years
UK Government (including debt management office, gilts and treasury bills)					350	2 years
Money Market Funds Maximum amount to be invested in Money Market Funds is £120m with a maximum of £50m in any one fund.					120	Liquid Deposits
Local Authority controlled companies (# duration limited to 20 years in accordance with Capital Regulations)					40	# 20 years

Where the UK Government holds a shareholding in an institution the UK Government's credit rating of AA will be applied to that institution to determine the amount the lead authority can place with that institution for a maximum period of 2 years.

The Code of Practice for Treasury Management in the Public Services recommends that consideration should also be given to country, sector, and group limits in addition to the individual limits set out above, these new limits are as follows:

Appendix 6 (continued)

Country Limit
It is proposed that only countries with a minimum sovereign credit rating of AA+ by all three rating agencies will be considered for inclusion on the Approved Lending List.

It is also proposed to set a total limit of £100 million which can be invested in other countries provided they meet the above criteria. A separate limit of £350 million will be applied to the United Kingdom and is based on the fact that the government has shown that it has been willing to take action to protect the UK banking system.

Country	Limit £m
UK	350
Non UK	100

Sector Limit
The Code recommends a limit be set for each sector in which the Authority can place investments. These limits are set out below:

Sector	Limit £m
Central Government	350
Local Government	350
UK Banks	350
Money Market Funds	120
UK Building Societies	100
Foreign Banks	100

Group Limit
Where institutions are part of a group of companies e.g. Lloyds Banking Group, Santander and the RBS, then the total limit of investments that can be placed with that group of companies will be determined by the highest credit rating of a counterparty within that group, unless the government rating has been applied. This will apply provided that:

- the UK continues to have a sovereign credit rating of AA; and
- that market intelligence and professional advice is taken into account.

Proposed group limits are set out in Appendix 7

Approved Lending List **Appendix 7**

	Fitch		Moody's		Standard & Poor's			
	L Term	S Term	L Term	S Term	L Term	S Term	Limit £m	Max Deposit Period
UK	AA	-	Aa2	-	AA	-	350	2 years
Lloyds Banking Group							**Group Limit 65**	
Lloyds Bank Plc	A+	F1	Aa3	P-1	A	A-1	65	364 days
Bank of Scotland Plc	A+	F1	Aa3	P-1	A	A-1	65	364 days
Royal Bank of Scotland Group (See Note 1)							Group Limit 80	
Royal Bank of Scotland Group plc	BBB+	F2	Baa3	P-3	BBB-	A-3	80	2 years
The Royal Bank of Scotland Plc	BBB+	F2	A2	P-1	BBB+	A-2	80	2 years
National Westminster Bank Plc	BBB+	F2	A2	P-1	BBB+	A-2	80	2 years
Santander Group							**Group Limit 65**	
Santander UK plc	A	F1	Aa3	P-1	A	A-1	65	364 days
Barclays Bank plc	A	F1	A1	P-1	A	A-1	65	364 days
Clydesdale Bank *	BBB+	F2	Baa1	P-2	BBB+	A-2	0	
Co-Operative Bank Plc	B-	B	Caa2	NP	-	-	0	
Goldman Sachs International Bank	A	F1	A1	P-1	A+	A-1	65	364 days
HSBC Bank plc	AA-	F1+	Aa3	P-1	AA-	A-1+	75	2 years
Nationwide BS	A+	F1	Aa3	P-1	A	A-1	65	364 days
Standard Chartered Bank	A+	F1	A1	P-1	A	A-1	65	364 days
Top Building Societies (by asset value)								
Nationwide BS (see above)								
Coventry BS	A	F1	A2	P-1	-	-	65	364 days
Leeds BS	A-	F1	A3	P-2	-	-	50	364 days
Nottingham BS **	-	-	Baa1	P-2	-	-	0	
Principality BS **	BBB+	F2	Baa2	P-2	-	-	0	

	Fitch		Moody's		Standard & Poor's			
	L Term	S Term	L Term	S Term	L Term	S Term	Limit £m	Max Deposit Period
Skipton BS **	A-	F1	Baa1	P-2	-	-	0	
West Bromwich BS **	-	-	B1	NP	-	-	0	
Yorkshire BS **	A-	F1	A3	P-2	-	-	50	364 days
Money Market Funds							120	Liquid
Prime Rate Stirling Liquidity	AAA				AAA		50	Liquid
Insight Liquidity Fund	AAA		-		AAA		50	Liquid
Standard Life Investments Liquidity Fund	AAA		-		AAA		50	Liquid
Deutsche Managed Sterling Fund	AAA		Aaa		AAA		50	Liquid
Foreign Banks have a combined total limit of £100m								
Australia	AAA		Aaa		AAA		100	2 years
Australia and New Zealand Banking Group Ltd	AA-	F1+	Aa3	P-1	AA-	A-1+	75	2 years
Commonwealth Bank of Australia	AA-	F1+	Aa3	P-1	AA-	A-1+	75	2 years
National Australia Bank	AA-	F1+	Aa3	P-1	AA-	A-1+	75	2 years
Westpac Banking Corporation	AA-	F1+	Aa3	P-1	AA-	A-1+	75	2 years
Canada	AAA		Aaa		AAA		100	2 years
Bank of Nova Scotia	AA-	F1+	A1	P-1	A+	A-1	70	364 days
Royal Bank of Canada	AA	F1+	A1	P-1	AA-	A-1+	70	364 days
Toronto Dominion Bank	AA-	F1+	Aa2	P-1	AA-	A-1+	75	2 years
Finland	AA+		Aa1		AA+		100	2 years
OP Corporate Bank plc	-	-	Aa3	P-1	AA-	A-1+	75	2 years
Germany	AAA		Aaa		AAA		100	2 years
DZ Bank AG (Deutsche Zentral-Genossenschaftsbank)	AA-	F1+	Aa1	P-1	AA-	A-1+	75	2 years
Landwirtschaftliche Rentenbank	AAA	F1+	Aaa	P-1	AAA	A-1+	100	2 years
NRW Bank	AAA	F1+	Aa1	P-1	AA-	A-1+	75	2 years

	Fitch		Moody's		Standard & Poor's			
	L Term	S Term	L Term	S Term	L Term	S Term	Limit £m	Max Deposit Period
Netherlands	AAA		Aaa		AAA		100	2 years
Bank Nederlandse Gemeenten	AA+	F1+	Aaa	P-1	AAA	A-1+	100	2 years
Cooperatieve Centrale Raiffeisen Boerenleenbank BA (Rabobank Nederland)	AA-	F1+	Aa2	P-1	A+	A-1	70	364 days
Nederlandse Waterschapsbank N.V	-	-	Aaa	P-1	AAA	A-1+	100	2 years
Singapore	AAA		Aaa		AAA		100	2 years
DBS Bank Ltd	AA-	F1+	Aa1	P-1	AA-	A-1+	75	2 years
Oversea Chinese Banking Corporation Ltd	AA-	F1+	Aa1	P-1	AA-	A-1+	75	2 years
United Overseas Bank Ltd	AA-	F1+	Aa1	P-1	AA-	A-1+	75	2 years
Sweden	AAA		Aaa		AAA		100	2 years
Nordea Bank AB	AA-	F1+	Aa3	P-1	AA-	A-1+	75	2 years
Svenska Handelsbanken AB	AA	F1+	Aa2	P-1	AA-	A-1+	75	2 years
USA	AAA		Aaa		AA+		100	2 years
Bank of New York Mellon	AA	F1+	Aa1	P-1	AA-	A-1+	75	2 years
JP Morgan Chase Bank NA	AA-	F1+	Aa2	P-1	A+	A-1	70	364 days
Wells Fargo Bank NA	AA-	F1+	Aa1	P-1	AA-	A-1+	75	2 years

Notes

Note 1 **Nationalised / Part Nationalised**

The counterparties in this section will have the UK Government's AA rating applied to them thus giving them a credit limit of £80m.

* The Clydesdale Bank (under the UK section) is owned by National Australia Bank

** These will be revisited and used only if they meet the minimum criteria (ratings of A- and above)

Any bank which is incorporated in the United Kingdom and controlled by the Prudential Regulation Authority (PRA) is classed as a UK bank for the purposes of the Approved Lending List.