TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY 2019/20 TO 2021/22

REPORT OF:	Head of Corporate Resources
Contact Officer:	Peter Stuart
	Email: peter.stuart@midsussex.gov.uk Tel: 01444 477315

Wards Affected:	All
Key Decision:	No
Report to:	Audit Committee
	25th February 2019

Purpose of Report

1. This report sets out the Council's investment and borrowing strategy for the forthcoming three years and reports the counterparty list with which investments may be made. It also sets out the Prudential Limits that provide the parameters for approved future lending and borrowing, including the incidental cost of so doing.

Summary

2. The purchase of the Orchard Shopping Centre head lease in November 2016 necessitated borrowing of £22m from other Local Authorities. £10m was repaid in 2017 and £5m was repaid in November 2018, using the cash flow generated by matured fixed term deposits.

3. Lending is restricted to the same counterparties and within the same limits as in the previous strategy approved in March 2018 except for the following amendments:

   (i) removal of the sovereign credit rating from UK investments, which was approved together with the half year treasury management report in November 2018;

   (ii) addition of the CCLA Public Sector Deposit Fund to the list of specified Money Market Funds, approved with the Annual Review in August 2018;

   (iii) addition of the JP Morgan GBP Liquidity LVNAV Fund to the list of specified Money Market Funds;

   (iv) amendment to the specified banks to include only the ring fenced entities, where appropriate, approved with the Annual Review in August 2018;

   (v) the list of Building Societies has been updated to add those which have increased their assets to over £1 billion (Leek United and Newbury).

Recommendations

4. The Committee is recommended to propose that Council agree:

   (i) the proposed Treasury Management Strategy Statement (TMSS) for 2019/20 and the following two years, including the additions to specified investments listed above;
   (ii) the Annual Investment Strategy (AIS) and the Minimum Revenue Provision Statement (MRP) as contained in Sections 4 and 2.3 respectively of the report;
   (iii) the Prudential Indicators contained within this report.

Background

5. The Council applies and upholds the Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code"). CIPFA has defined 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."

6. The Code requires local authorities to produce an annual Treasury Management Strategy Statement (TMSS), which documents the Council's approach to capital financing and investments for the forthcoming financial year (2019/20) and the following two years. This report fulfils that requirement.

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

8. Additionally, the Act and its subsequent Investment Guidance require the Council to set out its treasury management strategy for borrowing, and to prepare an Annual Investment Strategy (AIS). The Council's borrowing position is reported in Section 3, with arrangements for making Minimum Revenue Provision (MRP) for repayment of debt explained in Section 2.3. The AIS is contained in Section 4 of this report, and describes the Council's policies for managing its investments, and for giving priority to the security and liquidity of those investments.

9. Statute requires that the AIS, MRP Statement, and Prudential Indicators are approved by full Council before the start of the new financial year.

Policy Context

10. Providing transparency and approval of the strategies contained in this report is an important part of the Council's statutory role. Treasury Management has become increasingly topical given the nature of the world's financial markets in recent years, and Members are expected to have a basic understanding of how the Council uses its reserves and cash flows which are in the stewardship of the Head of Corporate Resources.

Other Options Considered

11. None – this report is statutorily required.

Financial Implications

12. This report has no quantifiable financial implications. Interest payable and interest receivable arising from treasury management operations, and annual revenue provisions for repayment of debt, form part of the revenue budget but are not required to support the provision of services.

Risk Management Implications

13. This report has no specific implications for the risk profile of the Authority.

Equality and Customer Service Implications

14. None.

Background Papers

- Treasury Management Strategy Statement & Annual Investment Strategy 2018/19 to 2020/21 (March 2018)
- Annual Review of Treasury Management 2017-18 (July 2018)
- Review of Treasury Management Activity 1 April – 30 September 2018 (Nov. 2018)
- Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes (CIPFA)
- The Prudential Code for Capital Finance in Local Authorities (CIPFA, December 2017)
- MHCLG Investment Guidance (Revised for April 2018) and MRP Guidance
- Link Asset Services report template (January 2019)

Treasury Management Strategy Statement & Annual Investment 2019/20 to 2021/22

1. INTRODUCTION

Background

1. The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

2. The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

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

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

5. Revised reporting is required for the 2019/20 reporting cycle due to revisions of the MHCLG Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code. The primary reporting changes include the introduction of a capital strategy, to provide a longer-term focus to the capital plans, and greater reporting requirements surrounding any commercial activity undertaken under the Localism Act 2011. The capital strategy is being reported separately.

Reporting requirements

<u>Capital Strategy</u>

6. The CIPFA revised 2017 Prudential and Treasury Management Codes require, for 2019-20, all local authorities to prepare an additional report, a capital strategy report, which will provide the following:

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

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

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

- The corporate governance arrangements for these types of activities;
- Any service objectives relating to the investments;
- The expected income, costs and resulting contribution;
- The debt related to the activity and the associated interest costs;
- The payback period (MRP policy);
- For non-loan type investments, the cost against the current market value;
- The risks associated with each activity.

9. Where a physical asset is being bought, details of market research, advisers used, (and their monitoring), ongoing costs and investment requirements and any credit information will be disclosed, including the ability to sell the asset and realise the investment cash.

10. Where the Council has borrowed to fund any non-treasury investment, there should also be an explanation of why borrowing was required and why the MHCLG Investment Guidance and CIPFA Prudential Code have not been adhered to. If any non-treasury investment sustains a loss during the final accounts and audit process, the strategy and revenue implications will be reported through the same procedure as the capital strategy.

Treasury Management reporting

11. The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals:

a. **Prudential and treasury indicators and treasury strategy** (this report) - the first, and most important report covers:

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

12. The approval of the Treasury Management Strategy and Annual Investment Strategy is the function of the Council, however the Head of Corporate Resources shall also report to the Audit Committee on treasury management activity performance as follows:

b. **A mid year treasury management report** – This will update Members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision. The report will be submitted as soon after 30 September as practically possible.

c. **An annual treasury report** – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy. The report will be submitted no later than 30 September after the financial year end.

Scrutiny

13. The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Audit Committee, which may make recommendations regarding any aspects of treasury management policy and practices it considers appropriate in fulfilment of its scrutiny role. Such recommendations, as may be made shall be incorporated within the above named reports and submitted to meetings of the Council for consideration at the next available opportunity.

14. The Council's Scheme of Delegations is set out in Appendix E.

Treasury Management Strategy for 2019/20

15. The strategy for 2019/20 covers two main areas:

Capital issues
- the capital expenditure plans and the associated prudential indicators;
- the minimum revenue provision (MRP) policy.

Treasury management issues
- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

16. These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, MHCLG MRP Guidance, the CIPFA Treasury Management Code and MHCLG Investment Guidance.

Training

17. The CIPFA Code requires the responsible officer to ensure that Members with responsibility for treasury management receive adequate training. This especially applies to Members responsible for scrutiny. During 2019/20 appropriate mandatory treasury management training will be provided to the Audit Committee by. The training needs of the treasury management officers at Adur District Council, who provide the shared treasury service to Mid Sussex District Council, are periodically reviewed. Officers attend courses provided by appropriate trainers such as CIPFA and Link Asset Services.

External Service Providers

18. The Council obtains treasury management services under a Shared Services Arrangement (SSA) from the in-house treasury management team formed out of the partnership working between Adur District and Worthing Borough Councils. The operation for all three Councils' treasury management is based at Worthing Town Hall, utilising similar banking arrangements.

19. The SSA is provided under a Service Level Agreement (SLA) that commenced in October 2016 and which defines the respective roles of the client and provider authorities for a period of three years. In making this arrangement the Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that reliance beyond the terms and arrangements specified in the SLA is not placed upon the shared service providers. The SSA uses Link Asset Services as its external treasury management advisors.

20. The Council will ensure that the terms of the appointment of the shared services providers, and the methods by which their value will be assessed, are properly agreed and documented and subjected to regular review.

2. THE CAPITAL PRUDENTIAL INDICATORS 2019/20 – 2021/22

21. The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the Prudential Indicators, which are designed to assist Members' overview and confirm capital expenditure plans.

Capital expenditure

22. This Prudential Indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts:

Capital expenditure	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
	£m	£m	£m	£m	£m
General Fund	3.477	13.533	2.426	2.389	1.455

23. The above financing need excludes other long term liabilities, such as leasing arrangements which already include borrowing instruments.

24. The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

Capital expenditure	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
	£m	£m	£m	£m	£m
Total	3.477	13.533	2.426	2.389	1.455
Financed by:					
Capital receipts	0.000	1.269	0.000	0.000	0.000
Capital grants, Contributions & S106 receipts	1.500	3.017	1.084	1.983	0.900
General Reserves, Specific Reserves & Revenue Contributions	1.977	9.247	1.342	0.406	0.555
Net financing need for the year	0.000	0.000	0.000	0.000	0.000

The Council's borrowing need (the Capital Financing Requirement)

25. The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and so its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR. The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the indebtedness in line with each asset's life

26. The CFR includes any other long term liabilities (e.g. finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has one finance lease recognised in 2018 and ending in 2028.

27. The Council is asked to approve the CFR projections below:

Capital Financing Requirement	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
	£m	£m	£m	£m	£m
Total CFR at 31/03	25.357	27.947	7.437	6.915	6.381
Movement in CFR	(0.379)	2.590	(20.510)	(0.522)	(0.534)
Movement in CFR represented by:					
Net financing need for the year (above)	0.000	3.088	(20.000)	0.000	0.000
Less MRP and other financing movements	(0.379)	(0.498)	(0.510)	(0.522)	(0.534)
Movement in CFR	(0.379)	2.590	(20.510)	(0.522)	(0.534)

Minimum revenue provision (MRP) policy statement

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

29. MHCLG regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. A variety of options is provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement:

30. The Council's policy for MRP relating to unfunded capital expenditure is to provide for MRP on an annuity basis over the life of the loans (except as detailed below for the Orchard Shopping Centre). As an annuity is a fixed annual sum comprising interest and principal, the MRP for repayment of debt will increase each year over the asset life as the proportion of interest calculated on the principal outstanding reduces as the debt is repaid.

31. The purchase of the Orchard Shopping Centre head lease in November 2016 increased the Capital Financing Requirement. However, as the Council is forecasting possible capital receipts of over £20m in 2019/20, MRP will only be provided on the balance of nearly £5m. This will be done on a level basis of £100,000 per year.

32. Repayments included in finance leases are applied as MRP.

3. BORROWING

33. The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the the relevant professional codes, so that sufficient cash is available to meet this service activity and the Council's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

Current portfolio position

34. The overall treasury management portfolio as at 31 March 2018 and for the position as at 31 December 2018 are shown below for both borrowing and investments.

	Principal at 31.03.18 £m	Actual 31.03.2018 %	Principal at 31.12.18 £m	Actual 31.12.2018 %
External Borrowing				
PWLB	(0.698)	5%	(0.635)	6%
Other Borrowing	(12.000)	95%	(7.000)	67%
Finance lease	(0.000)		(2.886)	27%
TOTAL BORROWING	**(12.698)**	100%	**(10.521)**	100%
Treasury Investments:				
Local Authority Property Fund	5.851	16%	5.851	15%
In-house:				
Banks	6.000	16%	9.010	24%
Building societies - unrated	12.000	32%	10.000	26%
Building societies - rated	8.000	21%	6.000	16%
Local authorities	4.000	11%	2.000	5%
Money market funds	1.550	4%	5.130	14%
TOTAL INVESTMENTS	**37.401**	100%	**37.991**	100%
NET INVESTMENTS	**24.703**		**27.470**	

35. The Council's forward projections for borrowing are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

External Debt	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
	£m	£m	£m	£m	£m
Debt at 1 April	22.819	12.698	7.571	7.437	5.298
Expected change in Debt	(10.121)	(5.127)	(0.134)	(2.139)	(5.146)
Other long-term liabilities (OLTL)	0.158	0.000	2.817	2.541	2.258
Expected change in OLTL	(0.158)	2.817	(0.276)	(0.283)	(0.288)
Actual gross debt at 31 March	12.698	10.388	9.978	7.556	2.122
The Capital Financing Requirement	25.357	27.947	7.437	6.915	6.381
Under/(over) borrowing	12.659	17.559	(2.541)	(0.641)	4.259

36. The Council's debt comprises one loan from the Public Works Loan Board (PWLB), which matures on 1 March 2023 and 2 loans with other local authorities, totalling £7m, with remaining lives of between 1 and 3 years, to fund the purchase of the Orchard Shopping Centre head lease. The local authority loans are at rates lower than those that were available from the PWLB, ranging from 1.0% to 1.1% (average rate), and they will be repaid using capital receipts and maturing investments. The "other long term liability" is in respect of capital assets acquired by finance leases.

37. Within the range of Prudential Indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2019/20 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes.

38. The Head of Corporate Resources reports that the Council complied with this Prudential Indicator in the current year. The respective timings of capital receipts and repayment of debt results in a projected over borrowing position in the subsequent two years. However this is due to the Council's ability to fund its capital expenditure from grants and other resources and is not an indication of imprudent borrowing. In addition, both the CFR and the outstanding debt are small relative to the size of the Council's budget. This view takes into account current commitments, existing plans, and the proposals in this report.

Treasury Indicators: limits to borrowing activity

39. **The operational boundary** - This is the limit which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

Operational Boundary	2018/19	2019/20	2020/21	2021/22
	£m	£m	£m	£m
Debt	£28.0m	£28.0m	£28.0m	£28.0m
Other long term liabilities	£4.0m	£4.0m	£4.0m	£4.0m
Total	**£32.0m**	**£32.0m**	**£32.0m**	**£32.0m**

40. **The authorised limit for external debt** – This is a key Prudential Indicator and represents a control on the maximum level of borrowing. This represents a legal limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

(i) The Council is asked to approve the authorised limit:

Authorised Limit	2018/19	2019/20	2020/21	2021/22
	£m	**£m**	**£m**	**£m**
Debt	£30.0m	£30.0m	£30.0m	£30.0m
Other long term liabilities	£4.0m	£4.0m	£4.0m	£4.0m
Total	**£34.0m**	**£34.0m**	**£34.0m**	**£34.0m**

(ii) This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.

(iii) The limits for the "Other long term liabilities" have been increased to £4m to allow for the new finance lease.

41. The Head of Corporate Resources has delegated authority, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long term liabilities. Decisions will be based on the outcome of financial option appraisals and best value considerations. Any movement between these separate limits will be reported to the next meeting of the Council at the earliest opportunity.

Prospects for interest rates and the economy

42. This section contains a commentary for the economic outlook provided by the Council's shared service provider's treasury management consultants, Link Asset Services . This includes a central view of forecast interest rates as follows:

Link Asset Services Interest Rate View													
	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	1.75%	2.00%
3 Month LIBID	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%
6 Month LIBID	1.00%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%
12 Month LIBID	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%
5yr PWLB Rate	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.80%
10yr PWLB Rate	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%
25yr PWLB Rate	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%

43. The flow of generally positive economic statistics after the quarter ended 30 June meant that it came as no surprise that the MPC came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, from 0.5% to 0.75%. Growth became increasingly strong during 2018 until slowing significantly during the last quarter. At their November quarterly Inflation Report meeting, the MPC left Bank Rate unchanged, but expressed some concern at the Chancellor's fiscal stimulus in his Budget, which could increase inflationary pressures. However, it is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. On a major assumption that Parliament and the EU agree a Brexit deal in the first quarter of 2019, then the next increase in Bank Rate is forecast to be in May 2019, followed by increases in February and November 2020, before ending up at 2.0% in February 2022.

44. The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. However, over about the last 25 years, we have been through a period of falling bond yields as inflation subsided to, and then stabilised at, much lower levels than before, and supported by central banks implementing substantial quantitative easing purchases of government and other debt after the financial crash of 2008. Quantitative easing, conversely, also caused a rise in equity values as investors searched for higher returns and purchased riskier assets. In 2016, we saw the start of a reversal of this trend with a sharp rise in bond yields after the US Presidential election in November 2016, with yields then rising further as a result of the big increase in the US government deficit aimed at stimulating even stronger economic growth. That policy change also created concerns around a significant rise in inflationary pressures in an economy which was already running at remarkably low levels of unemployment. Unsurprisingly, the Fed has continued on its series of robust responses to combat its perception of rising inflationary pressures by repeatedly increasing the Fed rate to reach 2.25 – 2.50% in December 2018. It has also continued its policy of not fully reinvesting proceeds from bonds that it holds as a result of quantitative easing, when they mature. We therefore saw US 10 year bond Treasury yields rise above 3.2% during October 2018 and also investors causing a sharp fall in equity prices as they sold out of holding riskier assets. However, by early January 2019, US 10 year bond yields had fallen back considerably on fears that the Fed was being too aggressive in raising interest rates and was going to cause a recession. Equity prices have been very volatile on alternating good and bad news during this period.

45. 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, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.

46. Economic and interest rate forecasting remains difficult with so many external influences weighing on 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. 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.

Investment and borrowing rates

47. Investment returns are likely to remain low during 2019/20 but to be on a gently rising trend over the next few years.

48. Borrowing interest rates have been volatile so far in 2018-19 and while they were on a rising trend during the first half of the year, they have backtracked since then until early January. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt;

49. There will remain a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

Borrowing strategy

50. The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.

51. Against this background and the risks within the economic forecast, caution will be adopted with the 2019/20 treasury operations. The Head of Corporate Resources 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 borrowings 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, perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity, or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

52. Any decisions will be reported to the appropriate decision making body at the next available opportunity.

Policy on borrowing in advance of need

53. 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. 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

Debt rescheduling

54. The Council has one loan from the Public Works Loan Board, repaid by fixed annuities over the life of the loan. As it would not be possible to prematurely repay the existing loan without incurring a premium charge for early settlement, there is currently no intention to redeem the loan early. The loans for the purchase of the Orchard Shopping Centre head lease will be repaid within 3 years and are all at competitively low interest rates.

55. Any rescheduling will be reported to the Council at the earliest meeting following its action.

4. ANNUAL INVESTMENT STRATEGY

Investment policy – management of risk

56. The MHCLG and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with financial investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy, (a separate report).

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

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

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

59. The Head of Corporate Resources, under delegated powers, will undertake through the Shared Service Arrangement the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements, and Prudential Indicators. As conditions in the financial markets remain uncertain, the proposed maximum limits for Specified and Unspecified Investments for 2019/20 are the same as for 2018/19.

60. Investment instruments identified for use in the financial year are listed in Appendices C and D under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the Council's treasury management practices.

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

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

(ii) **Other information**: ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

(iii) **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.

(iv) This authority has defined the list of **types of investment instruments** that the treasury management team is authorised to use. There are two lists in Appendices C and D under the categories of 'specified' and 'non-specified' investments.

- **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year.

- **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.

(v) Lending limits, (amounts and maturity), for each counterparty are set out in Appendices C and D.

(vi) This authority will set a limit for the amount of its investments which are invested for longer than 365 days, (see paragraph 4.8).

(vii) Investments will only be placed with counterparties from countries with a specified minimum sovereign rating, (see paragraph 4.5). The UK is excluded from this limit because it will be necessary to invest in UK banks and other institutions even if the sovereign rating is cut.

(viii) Through the shared service, this authority has access to external consultants, to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.

(ix) All investments will be denominated in sterling.

(x) As a result of the change in accounting standards for 2018/19 under IFRS 9, this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, the Ministry of Housing, Communities and Local Government, [MHCLG], concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years commencing from 1.4.18. Consequently any fluctuations in the value of the Council's investment in the Local Authorities' Property Fund will not be taken through the general fund for the period of the override).

However, this authority will also pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see paragraph 4.14). Regular monitoring of investment performance will be carried out during the year.

Changes in risk management policy from last year

62. The above criteria are unchanged from last year, with the exception of the removal of the sovereign rating requirement from the UK.

Creditworthiness policy

63. The primary principle governing the Council's investment criteria through the Shared Services Arrangement (SSA) is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the SSA will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections in Appendices C and D; and

- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's Prudential Indicators covering the maximum principal sums invested.

64. The SSA will maintain a counterparty list in compliance with the criteria in the Appendices and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

65. Credit rating information is supplied to the SSA by Link Asset Services, our treasury advisors, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating Watches (notification of a likely change), rating Outlooks (notification of the longer term bias outside the central rating view) are provided to the SSA almost immediately after they occur and this information is considered before dealing. For instance, a negative rating Watch applying to a counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.

Use of additional information other than credit ratings

66. Additional requirements under the Code require the Council to supplement credit rating information. Whilst the above criteria rely primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties.

67. Link Asset Services use a sophisticated modelling approach with credit ratings from all three credit rating agencies – Fitch, Moody's and Standard and Poor's. However it does not rely solely on the current credit ratings of counterparties but also uses the following as overlays:

   - credit watches and credit outlooks from credit rating agencies
   - credit Default Swap (CDS) spreads to give early warning of likely changes in credit ratings
   - sovereign ratings to select counterparties from only the most creditworthy countries

68. This additional market information will be applied to compare the relative security of differing investment counterparties.

69. The proposed criteria for specified and non-specified investments are shown in the Appendices for approval.

70. Using Link's ratings service, potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications. The effect of a change in ratings may prompt the following responses:

   - If a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.

   - In addition to the use of Credit Ratings the shared service will be advised by Link of movements in Credit Default Swaps 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 lists.

71. The officers of the shared service recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets, the government support for banks, and the credit ratings of that government support.

72. Accordingly, the shared service will exercise discretion to deviate from Link's suggested durational bands – for example the Council approves the use of Building Societies as set out in the Appendices.

The Council's Minimum Investment Creditworthiness Criteria

73. The minimum credit ratings criteria used by the Council generally will be a short term rating (Fitch or equivalents) of F1, and long term rating A-. There may be occasions when the counterparty ratings from one or more of the three Ratings Agencies are marginally lower than the minimum requirements of F1 Short term, A- Long term (or equivalent). Where this arises, the counterparties to which the ratings apply may still be used with discretion, but in these instances consideration will be given to the whole range of topical market information available, not just ratings.

74. The Council includes **Building Societies** with asset size in excess of £1 billion in the specified investments. It is recognised that they may carry a lower credit rating than the Council's other counterparties, or no rating, therefore the lending limits for the building societies shall be £4m each for the top 3 and £3m for the others.

UK banks – ring fencing

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

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

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

Country Limits and Proposed Monitoring Arrangements

78. Due care will be taken to consider the country, group and sector exposure of the Council's investments.

79. The SSA has determined that it will only use approved counterparties from countries (other than the UK) with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent from other agencies if Fitch does not provide one). The list of countries that qualify using these credit criteria as at the date of this report is reflected in the counterparty approved lending list shown at Appendix B. This list will be added to, or deducted from, by officers should ratings change, in accordance with this policy. No more than 25% of investments shall be placed in non-UK financial institutions for more than 7 days.

Investment strategy

80. **In-house funds -** Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed. For cash flow balances, the shared service will seek to use notice accounts, money market funds and short-dated deposits to benefit from the compounding of interest

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.
- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

81. The Head of Corporate Resources, through the shared service, will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements and Prudential Indicators. Decisions taken on the core investment portfolio will be reported to the meetings of the Audit Committee and the Council in accordance with the reporting arrangements

82. **Investment returns expectations -** Bank Rate is forecast to increase steadily but slowly over the next few years, to reach 2.00% by quarter 1 2022. Bank Rate forecasts for financial year ends (March) are:

2018/19	:	0.75%
2019/20	:	1.25%
2020/21	:	1.50%
2021/22	:	2.00%

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

2018/19	:	0.75%
2019/20	:	1.00%
2020/21	:	1.50%
2021/22	:	1.75%
2022/23	:	1.75%
2023/24	:	2.00%
Later years	:	2.50%

84. The overall balance of risks to economic growth in the UK is probably neutral. The balance of risks to increases in Bank Rate and shorter term PWLB rates are probably also even and are dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quicly the Brexit negotiations move forward positively.

Funds available for investment

85. The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year-end balances.

Investments	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
	£m	£m	£m	£m
Balance at 1 April	37.401	26.238	46.127	33.078
Capital Expenditure	(13.533)	(2.426)	(2.389)	(1.455)
Grants, capital receipts & other new funds	7.497	22.449	(8.521)	2.615
Loan repayments	(5.127)	(0.134)	(2.139)	(5.000)
Balance at 31 March	26.238	46.127	33.078	29.238

Investment treasury indicator and limit - total principal funds invested for greater than 365 days

86. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

87. The Council is asked to approve the treasury indicator limit: -

Maximum proportion of principal sums invested > 365 days	2019/20	2020/21	2021/22
Principal sums invested > 365 days	50%	50%	50%

88. In any sustained period of significant stress in the financial markets, the default position is for investments to be placed with The Debt Management Account Deposit Facility of the Debt Management Office (DMO) of the UK central government. The rates of interest are below equivalent money market rates, however, the returns are an acceptable trade-off for the guarantee that the Council's capital is secure.

89. The Council's proposed investment activity for placing cash deposits in 2019/20 will be to use:

- AAA-rated Money Market Funds with a Constant Net Asset Value (CNAV) or a Low Volatility Net Asset Value (LVNAV) under the new money market fund regulations
- other local authorities, parish councils etc.
- bank business reserve accounts and term deposits. These are primarily restricted to UK institutions that are rated at least A- long term.
- Building Societies with asset size in excess of £1 billion

Other Options for Longer Term Investments

90. To provide the Council with options to enhance returns above those available for short term durations, it is proposed to retain the option to use the following for longer term investments, as an alternative to cash deposits:

a) **Supranational bonds** greater than 1 year to maturity

b) **Gilt edged securities** with a maturity of greater than one year. These are Government bonds and so provide the highest security of interest and the repayment of principal on maturity. Similar to category (a) above, the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.

c) **Building Societies** not meeting the basic security requirements under the specified investments, but on the list in Appendix C (b). The operation of some building societies does not require a credit rating, although in every other respect the security of the society would match similarly sized societies with ratings.

d) Any **bank** that has a minimum long term credit rating of A- for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).

e) Any **non-rated subsidiary** of a credit rated institution included in the specified investment category. These institutions will be included as an investment category subject to a guarantee from the parent company, and exposure up to the limit applicable to the parent.

g) **Property Investment Funds** for example the Local Authorities' Property Fund. The Councils will consult the Treasury Management Advisors and undertake appropriate due diligence before investment of this type is undertaken. Some of these funds are deemed capital expenditure – the Councils will seek guidance on the status of any fund considered for investment.

h) Other **local authorities**, parish councils etc.

i) Other investments listed in Appendices C and D - the Council will seek further advice on the appropriateness and associated risks with investments in these other categories as and when an opportunity presents itself.

91. The **accounting treatment** may differ from the underlying cash transactions arising from investment decisions made by the Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, the accounting implications of new transactions will be reviewed before they are undertaken.

92. The Council will not transact in any investment that may be deemed to constitute capital expenditure (e.g. Share Capital, or pooled investment funds other than Money Market Funds), without the resource implications being approved as part of the consideration of the Capital Programme or other appropriate Committee report.

93. **Investment risk benchmarking** – The shared service will subscribe to Link's Investment Benchmarking Club to review the investment performance and risk of the portfolios.

94. At the end of the financial year the Council will report on investment activity as part of the Annual Treasury Report.

External fund managers

95. The Council does not use external fund managers, but reserves the option to do so in future should this be deemed to be appropriate. Should consideration be given to exercising this option in the future, the relevant Committee will be advised of the reasons for doing so and the Council requested to consider whether it wishes to proceed with the selection and appointment of external fund managers.

THE CAPITAL PRUDENTIAL AND TREASURY INDICATORS 2019/20 – 2021/22

1. The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the Prudential Indicators, which are designed to assist Members' overview and confirm capital expenditure plans.

Capital expenditure	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
	£m	£m	£m	£m	£m
General Fund	3.477	13.533	2.426	2.389	1.455

Affordability Prudential Indicators

2. The previous sections cover the overall capital and control of borrowing Prudential Indicators, but within this framework Prudential Indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators:

Ratio of financing costs to net revenue stream

3. This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
	%	%	%	%	%
Ratio	-0.68%	0.62%	0.58%	-1.44%	-1.30%

4. The estimates of financing costs include current commitments and the proposals in this budget report.

Maturity structure of borrowing

5. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits. However as the Council currently has only two significant loans, the upper limits need to be set very high. The Council does not have any variable rate borrowing.

6. The Council is asked to approve the following treasury indicators and limits:

Maturity structure of fixed interest rate borrowing 2019/20		
	Lower	Upper
Under 12 months	0%	50%
12 months to 2 years	0%	70%
2 years to 5 years	0%	80%
5 years to 10 years	0%	60%
Over 10 years	0%	50%

TREASURY MANAGEMENT PRACTICE (TMP1) – CREDIT AND COUNTERPARTY RISK MANAGEMENT

1. The MHCLG issued Investment Guidance in 2018, and this forms the structure of the Council's policy below. These guidelines do not apply to either trust funds or pension funds which operate under a different regulatory regime.

2. The key intention of the Guidance is to maintain the current requirement for councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes, which will apply to all investment activity. In accordance with the Code, the Council will comply with the treasury management practices (TMPs). This part, TMP 1(1), covering investment counterparty policy requires approval each year.

3. **Annual investment strategy -** The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of the annual treasury strategy for the following year, covering the identification and approval of following:

    - The strategy guidelines for choosing and placing investments, particularly non-specified investments.
    - The principles to be used to determine the maximum periods for which funds can be committed.
    - Specified investments that the Council will use. These are high security (i.e. high credit rating, although this is defined by the Council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
    - Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

4. **Strategy guidelines** – The main strategy guidelines are contained in the body of the treasury strategy statement.

SPECIFIED AND NON SPECIFIED INVESTMENTS

5. Specified Investments will be those that meet the criteria in the MHCLG Guidance, i.e. the investment

    - is sterling denominated
    - has a maximum maturity of 1 year or where the Council has the right to be repaid within 12 months
    - meets the "high" credit criteria as determined by the Council or is made with the UK government or is made with a local authority in England, Wales and Scotland.
    - the making of which is not defined as capital expenditure under section 25(1)(d) in SI 2003 No 3146 (i.e. the investment is not loan capital or share capital in a body corporate).

"Specified" Investments identified for the Council's use are:

- Deposits in the DMO's Debt Management Account Deposit Facility
- Deposits with UK local authorities

- Deposits with banks and building societies
- *Certificates of deposit with banks and building societies
- *Gilts : (bonds issued by the UK government)
- *Bonds issued by multilateral development banks
- AAA-rated Money Market Funds with a Constant Net Asset Value (Constant NAV) or appropriate Low Volatility Net Asset Value (LVNAV) under the new regulations.
- Other Money Market Funds and Collective Investment Schemes– i.e. credit rated funds which meet the definition of a collective investment scheme as defined in SI 2004 No 534 and SI 2007 No 573.

  * Investments in these instruments will be on advice from the Shared Service's treasury advisor.

6. For credit rated counterparties, the minimum criteria, excepting for the Council's own banker and the specified building societies, (see below) will be the short-term / long-term ratings assigned by various agencies which may include Moody's Investors Services, Standard and Poor's, Fitch Ratings, being:

   Long-term investments (over 365 days): minimum: A- (Fitch) or equivalent
   Or
   Short-term investments (365 days or less): minimum: F1 (Fitch) or equivalent

7. For all investments the Shared Service will also take into account information on corporate developments of, and market sentiment towards, investment counterparties.

8. Where appropriate the Ring Fenced entities of banks will be used.

9. If the Council's own banker (currently Lloyds Bank) falls beneath the specified criteria, it will still be used for transactional purposes.

Appendix C

APPROVED INVESTMENT INSTITUTIONS

Specified Investments identified for use by the Council

New specified investments will be made within the following limits:

(a) Banks

Major U.K. and European Banks and their wholly-owned subsidiaries meeting the Council's approved investment criteria.

	Counterparty	Group	Maximum Sum	Maximum Period *
1	HSBC Bank plc	N/A	£4m	5 years
2	The Royal Bank of Scotland Group:	£5m		
	The Royal Bank of Scotland plc		£4m	5 years
	National Westminster Bank plc		£4m	5 years
			£1m	1 year
3	Lloyds Group::	£5m		
	Lloyds Bank plc		£4m	5 years
	Halifax plc		£4m	5 years
	Bank of Scotland plc		£4m	5 years
	HBOS Treasury Services plc		£4m	5 years
4	Barclays Bank plc	N/A	£4m	5 years
5	Santander UK	N/A	£4m	5 years
6	Clydesdale Bank	N/A	£4m	5 years
7	Handelsbanken plc	N/A	£4m	1 year
8	Goldman Sachs International Bank	N/A	£4m	5 years
9	Close Brothers Ltd	N/A	£4m	5 years

*Specified investments are for a maximum period of 1 year, the maximum limits shown in this column are for non-specified investments with these institutions.

(b) Building Societies

(i) Building Societies (Assets in excess of £1 billion):

Rank	Name of Counterparty	Individual	
		Sum	Period*
1	Nationwide	£4m	3 years
2	Coventry	£4m	3 years
3	Yorkshire	£4m	3 years
4	Skipton	£3m	3 years
5	Leeds	£3m	3 years
6	Principality	£3m	3 years
7	West Bromwich	£3m	3 years
8	Nottingham	£3m	3 years
9	Newcastle	£3m	3 years
10	Cumberland	£3m	3 years
11	National Counties	£3m	3 years
12	Progressive	£3m	3 years
13	Cambridge	£3m	3 years
14	Monmouthshire	£3m	3 years
15	Leek United	£3m	3 years
16	Saffron	£3m	3 years
17	Newbury	£3m	3 years

*Specified investments are for a maximum period of 1 year, the maximum limits shown in this column are for non-specified investments with these institutions.

(c) Money Market Funds

Counterparty	Sum	
Invesco Aim – Sterling	£3m	For Short Term Operational Cash Flow Purposes
Blackrock Institutional Sterling Liquidity Fund	£3m	
Goldman Sachs Sterling Liquidity Reserve Fund	£3m	
Fidelity Institutional Cash Fund plc – Sterling	£3m	
CCLA Public Sector Deposit Fund	£3m	
JP Morgan GBP Liquidity LVNAV Fund	£3m	
Federated Short-Term Sterling Prime Liquidity Fund	£3m	

The limit for investing in any one Money Market Fund is £3 million. Total investments in Money Market Funds shall not exceed the higher of £9m or 25% of the total investment portfolio, for more than one week at any one time.

(d) Local Authorities

(i) All the following local authorities mentioned in the Regulations

Schedule Part II Ref	Details	Individual	
		Sum	Period*
1	County Councils (England and Wales)	£3m	5 years
2	District Councils in England and Wales (including Borough, City, Metropolitan Borough Councils and Unitary Councils)	£3m	5 years
3	London Borough Councils	£3m	5 years
4	The Common Council of the City of London	£3m	5 years
5	The Council of the Isles of Scilly	£3m	5 years
7	Combined Police Authorities	£3m	5 years
16	Regional, Islands, or District Councils in Scotland	£3m	5 years
17	Joint boards under s.235 (1) of LG (Scotland) Act 1973	£3m	5 years
28	District Councils in Northern Ireland	£3m	5 years
29	Police Authorities (now Police and Crime Commissioners) under s.3 Police Act 1964 as substituted by s.2 Police & Magistrates Courts Act 1994	£3m	5 years

*Specified investments are for a maximum period of 1 year, the maximum limits shown in this column are for non-specified investments with these institutions.

NON-SPECIFIED INVESTMENTS DETERMINED FOR USE BY THE COUNCIL

Having considered the rationale and risk associated with Non-Specified Investments, the following have been determined for the Council's use.

	In-house use	Use by Fund Managers	Maximum Maturity	Maximum % of portfolio or £m	Capital Expenditure?
• Deposits with banks and building societies and Local Authorities • Certificates of deposit with banks and building societies	√ √	 √	5 years	The higher of £10m or 50% of funds	No
Gilts and Bonds: • Gilts • Bonds issued by multilateral development banks • Bonds issued by financial institutions guaranteed by the UK government • Sterling denominated bonds by non-UK sovereign governments	√ √ √ √ (on advice from treasury advisor)	√ √ √ √	5 years	The higher of £3m or 25% of funds	No
Money Market Funds and Collective Investment Schemes (pooled funds which meet the definition of a collective investment scheme as defined in SI 2004 No. 534 and SI 2007, No. 573), but which are not credit rated.	√ (on advice from treasury advisor)	√	These funds do not have a defined maturity date.	The higher of £9m or 25% of funds	No
Government guaranteed bonds and debt instruments (e.g. floating rate notes) issued by corporate bodies	√ (on advice from treasury advisor)	√	5 years	The higher of £2m or 10% of funds	Subject to test
Property Funds approved by HM Treasury and operated by managers regulated by the Financial Conduct Authority – specifically the Local Authorities' Property Fund	√	√	These funds do not have a defined maturity date.	The higher of £4m or 25% of funds	No
Non-guaranteed bonds and debt instruments (e.g. floating rate notes) issued by corporate bodies	√ (on advice from treasury advisor)	√	5 years	The higher of £2m or 10% of funds	Subject to test
Collective Investment Schemes (pooled funds) which do not meet the definition of collective investment schemes in SI 2004 No. 534 or SI 2007, No. 573.	√ (on advice from treasury advisor)	√	These funds do not have a defined maturity date	The higher of £2m or 20% of funds	Subject to test

In determining the period to maturity of an investment, the investment is regarded as commencing on the date of the commitment of the investment rather than the date on which funds are paid over to the counterparty.

Accounting treatment of investments

The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

Appendix E

TREASURY MANAGEMENT SCHEME OF DELEGATION

(i) **Full Council**

- approval of annual treasury management strategy and Annual Investment Strategy
- approval of MRP Statement

(ii) **Executive Committee (e.g. Cabinet)**

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices
- budget consideration and approval
- approval of the division of responsibilities
- receiving and reviewing regular monitoring reports and acting on recommendations
- approving the selection of external service providers and agreeing terms of appointment.

(iii) **Audit Committee**

Receiving and reviewing the following, and making recommendations to the Cabinet

- regular monitoring reports on compliance with the Treasury Management Strategy, practices and procedures.

(iv) **The S151 (responsible) officer**

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

The Revised CIPFA Treasury Management and Prudential Codes have extended the functions of the S151 role in respect of non-financial investments. Guidance notes giving specific information will follow, but additional responsibilities are likely to include:

- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management
- ensuring that the capital strategy is prudent, sustainable and affordable in the long term and provides value for money

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

Appendix F

COUNTERPARTIES WHERE THE COUNCIL HAS OPTED UP TO PROFESSONAL INVESTOR STATUS

(i) **Money Market Funds**

Invesco
Federated Investors

(ii) **Building Societies**

Skipton Building Society
Coventry Building Society
Progressive Building Society (paperwork not yet approved)

(iii) **Brokers**

BGC (Sterling)
Tradition
ICAP

(iv) **Other**

ICD (Portal used for money market fund investments)
Link Asset Services

These arrangements will be regularly reviewed as appropriate.

Appendix G

ECONOMIC BACKGROUND

Global Outlook

1. **World growth** has been doing reasonably well, aided by strong growth in the US. However, US growth is likely to fall back in 2019 and, together with weakening economic activity in China and the eurozone, overall world growth is likely to weaken.

2. **Inflation** has been weak during 2018 but, at long last, unemployment falling to remarkably low levels in the US and UK has led to a marked acceleration of wage inflation. The US Fed has therefore increased rates nine times and the Bank of England twice. However, the ECB is unlikely to start raising rates until late in 2019 at the earliest.

KEY RISKS - central bank monetary policy measures

3. 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.

4. **The key issue now** is that that period of stimulating economic recovery and warding off the threat of deflation, is coming towards its close. A new period is well advanced in the US, and started more recently in the UK, of 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 a 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 also encouraged investors into a search for yield and into investing in riskier assets such as equities. Consequently, prices in both bond and equity markets rose to historically high valuation levels simultaneously. This meant that both asset categories were exposed to the risk of a sharp downward correction and we have indeed, seen a sharp fall in equity values in the last quarter of 2018. It is important, therefore, that central banks only gradually unwind their holdings of bonds in order to prevent destabilising the financial markets. It is also likely that the timeframe for central banks unwinding their holdings of QE debt purchases will be over several years. They need to balance their timing to neither squash economic recovery, by taking too rapid and too strong action, or, conversely, let inflation run away by taking action that was too slow and/or too weak. **The potential for central banks to get this timing and strength of action wrong are now key risks.** At the time of writing, (early January 2019), financial markets are very concerned that the Fed is being too aggressive with its policy for raising interest rates and was likely to cause a recession in the US economy.

5. The world **economy** also needs to adjust to a sharp change in **liquidity creation** over the last five years where the US has moved from boosting liquidity by QE purchases, to reducing its holdings of debt, (currently about $50bn per month). In addition, the European Central Bank ended its QE purchases in December 2018.

6. **UK.** The flow of positive economic statistics since the end of the first quarter of 2018 has shown that pessimism was overdone about the poor growth in quarter 1 when adverse weather caused a temporary downward blip. Quarter 1 at 0.1% growth in GDP was followed by a return to 0.4% in quarter 2 and by a strong performance in quarter 3 of +0.6%. However, growth in quarter 4 is expected to weaken significantly.

7. At their November quarterly Inflation Report meeting, the MPC repeated their well-worn phrase that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary of contractionary), than before the crash; indeed they gave a figure for this of around 2.5% in ten years time, but declined to give a medium term forecast. However, with so much uncertainty around Brexit, they warned that the next move could be up or down, even if there was a disorderly Brexit. While it would be expected that Bank Rate could be cut if there was a significant fall in GDP growth as a result of a disorderly Brexit, so as to provide a stimulus to growth, they warned they could also *raise* Bank Rate in the same scenario if there was a boost to inflation from a devaluation of sterling, increases in import prices and more expensive goods produced in the UK replacing cheaper goods previously imported, and so on. In addition, the Chancellor could potentially provide fiscal stimulus to support economic growth, though at the cost of increasing the budget deficit above currently projected levels.

8. It is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. Getting parliamentary approval for a Brexit agreement on both sides of the Channel will take well into spring 2019. However, in view of the hawkish stance of the MPC at their November meeting, the next increase in Bank Rate is now forecast to be in May 2019, (on the assumption that a Brexit deal is agreed by both the UK and the EU). The following increases are then forecast to be in February and November 2020 before ending up at 2.0% in February 2022.

9. **Inflation.** The Consumer Price Index (CPI) measure of inflation has been falling from a peak of 3.1% in November 2017 to 2.3% in November. In the November Bank of England quarterly Inflation Report, inflation was forecast to still be marginally above its 2% inflation target two years ahead, (at about 2.1%), given a scenario of minimal increases in Bank Rate. This inflation forecast is likely to be amended upwards due to the Bank's report being produced prior to the Chancellor's announcement of a significant fiscal stimulus in the Budget; this is likely to add 0.3% to GDP growth at a time when there is little spare capacity left in the economy, particularly of labour.

10. As for the **labour market** figures in October**,** unemployment at 4.1% was marginally above a 43 year low of 4% on the Independent Labour Organisation measure. A combination of job vacancies hitting an all-time high, together with negligible growth in total employment numbers, indicates that employers are now having major difficulties filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to 3.3%, (3 month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates less CPI inflation), earnings are currently growing by about 1.0%, the highest level since 2009. This increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. This tends to confirm that the MPC was right to start on a cautious increase in Bank Rate in August as it views wage inflation in excess of 3% as increasing inflationary pressures within the UK economy.

11. In the **political arena**, the Brexit deal put forward by the Conservative minority government was defeated on 15 January. It is unclear at the time of writing, how this situation will move forward. However, our central position is that Prime Minister May's government will endure, despite various setbacks, along the route to reaching an orderly Brexit though the risks are increasing that it may not be possible to get full agreement by the UK and EU before 29 March 2019, in which case this withdrawal date is likely to be pushed back to a new date. If, however, the UK faces a general election in the next 12 months, this could result in a potential loosening of monetary and fiscal policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up.

12. **USA.** President Trump's massive easing of fiscal policy is fuelling a, (temporary), boost in consumption which has generated an upturn in the rate of strong growth which rose from 2.2%, (annualised rate), in quarter 1 to 4.2% in quarter 2 and 3.5%, (3.0% y/y), in quarter 3, but also an upturn in inflationary pressures. The strong growth in employment numbers and the reduction in the unemployment rate to 3.9%, near to a recent 49 year low, has fed through to an upturn in wage inflation which hit 3.2% in November. However, CPI inflation overall fell to 2.2% in November and looks to be on a falling trend to drop below the Fed's target of 2% during 2019. The Fed has continued on its series of increases in interest rates with another 0.25% increase in December to between 2.25% and 2.50%, this being the fifth increase in 2018 and the ninth in this cycle. However, they did also reduce their forecast for further increases from three to two. This latest increase compounded investor fears that the Fed is over doing the rate and level of increases in rates and that it is going to cause a US recession as a result. There is also much evidence in previous monetary policy cycles, of the Fed's series of increases doing exactly that. Consequently, we have seen stock markets around the world plunging under the weight of fears around the Fed's actions, the trade war between the US and China, an expectation that world growth will slow, Brexit etc.

13. The tariff war between the US and China has been generating a lot of heat during 2018, but it is not expected that the current level of actual action would have much in the way of a significant effect on US or world growth. However, there is a risk of escalation if an agreement is not reached soon between the US and China.

14. **Eurozone.** Growth was 0.4% in quarters 1 and 2 but fell back to 0.2% in quarter 3, though this was probably just a temporary dip. In particular, data from Germany has been mixed and it could be negatively impacted by US tariffs on a significant part of manufacturing exports e.g. cars. For that reason, although growth is still expected to be in the region of nearly 2% for 2018, the horizon is less clear than it seemed just a short while ago. Having halved its quantitative easing purchases of debt in October 2018 to €15bn per month, the European Central Bank ended all further purchases in December 2018. The ECB is forecasting inflation to be a little below its 2% top limit through the next three years so it may find it difficult to warrant a start on raising rates by the end of 2019 if the growth rate of the EU economy is on a weakening trend.

15. **China.** Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems. Progress has been made in reducing the rate of credit creation, particularly from the shadow banking sector, which is feeding through into lower economic growth. There are concerns that official economic statistics are inflating the published rate of growth.

16. **Japan** - has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy. It is likely that loose monetary policy will endure for some years yet to try to stimulate growth and modest inflation.

17. **Emerging countries.** Argentina and Turkey are currently experiencing major headwinds and are facing **challenges** in external financing requirements well in excess of their reserves of foreign exchange. However, these countries are small in terms of the overall world economy, (around 1% each), so the fallout from the expected recessions in these countries will be minimal.

INTEREST RATE FORECASTS

18. The interest rate forecasts provided by Link Asset Services in paragraph 3.2 are predicated on an assumption of an agreement being reached on Brexit between the UK and the EU. In the event of an orderly non-agreement exit, it is likely that the Bank of England would take action to cut Bank Rate from 0.75% in order to help economic growth deal with the adverse effects of this situation. This is also likely to cause short to medium term gilt yields to fall. If there was a disorderly Brexit, then any cut in Bank Rate would be likely to last for a longer period and also depress short and medium gilt yields correspondingly. It is also possible that the government could act to protect economic growth by implementing fiscal stimulus.

The balance of risks to the UK

19. The overall balance of risks to economic growth in the UK is probably neutral.

20. The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are broadly dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

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

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

22. **Brexit** – if it were to cause significant economic disruption and a major downturn in the rate of growth.

23. **Bank of England monetary policy** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.

24. A resurgence of the **eurozone sovereign debt crisis**, possibly in **Italy**, due to its high level of government debt, low rate of economic growth and vulnerable banking system, and due to the election in March of a government which has made a lot of anti-austerity noise. The EU rejected the initial proposed Italian budget and demanded cuts in government spending which the Italian government initially refused. However, a fudge was subsequently agreed, but only by delaying the planned increases in expenditure to a later year. This can has therefore only been kicked down the road to a later time. The rating agencies have started on downgrading Italian debt to one notch above junk level. If Italian debt were to fall below investment grade, many investors would be unable to hold it. Unsurprisingly, investors are becoming increasingly concerned by the words and actions of the Italian government and consequently, Italian bond yields have risen – at a time when the government faces having to refinance large amounts of debt maturing in 2019.

25. Weak capitalisation of some **European banks**. Italian banks are particularly vulnerable; one factor is that they hold a high level of Italian government debt - debt which is falling in value. This is therefore undermining their capital ratios and raises the question of whether they will need to raise fresh capital to plug the gap.

26. **German minority government**. In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. Then in October 2018, the results of the Bavarian and Hesse state elections radically undermined the SPD party and showed a sharp fall in support for the CDU. As a result, the SPD is reviewing whether it can continue to support a coalition that is so damaging to its electoral popularity. After the result of the Hesse state election, Angela Merkel announced that she would not stand for re-election as CDU party leader at her party's convention in December 2018, (a new party leader has now been elected). However, this makes little practical difference as she is still expected to aim to continue for now as the Chancellor. However, there are five more state elections coming up in 2019 and EU parliamentary elections in May/June; these could result in a further loss of electoral support for both the CDU and SPD which could also undermine her leadership.

27. **Other minority eurozone governments**. Spain, Portugal, Ireland, the Netherlands and Belgium all have vulnerable minority governments dependent on coalitions which could prove fragile. Sweden is also struggling to form a government due to the anti-immigration party holding the balance of power, and which no other party is willing to form a coalition with. The Belgian coalition collapsed in December 2018 but a minority caretaker government has been appointed until the May EU wide general elections.

28. **Austria, the Czech Republic and Hungary** now form a strongly anti-immigration bloc within the EU while Italy, in 2018, also elected a strongly anti-immigration government. Elections to the EU parliament are due in May/June 2019.

29. Further increases in interest rates in the US could spark a **sudden flight of investment funds** from more risky assets e.g. shares, into bonds yielding a much improved yield. Throughout the last quarter of 2018, we saw sharp falls in equity markets interspersed with occasional partial rallies. Emerging countries which have borrowed heavily in dollar denominated debt, could be particularly exposed to this risk of an investor flight to safe havens e.g. UK gilts.

30. There are concerns around the level of **US corporate debt** which has swollen massively during the period of low borrowing rates in order to finance mergers and acquisitions. This has resulted in the debt of many large corporations being downgraded to a BBB credit rating, close to junk status. Indeed, 48% of total investment grade corporate debt is now rated at BBB. If such corporations fail to generate profits and cash flow to reduce their debt levels as expected, this could tip their debt into junk ratings which will increase their cost of financing and further negatively impact profits and cash flow.

31. **Geopolitical risks**, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

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

32. **Brexit** – if both sides were to agree a compromise that removed all threats of economic and political disruption.

33. **The Fed causing a sudden shock in financial markets** through misjudging the pace and strength of increases in its Fed Funds Rate and in the pace and strength of reversal of QE, 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.

34. 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.

35. **UK inflation**, whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.