**APPENDIX A**

# SLOUGH BOROUGH COUNCIL

# TREASURY MANAGEMENT STRATEGY 2017/18

## 1 Introduction & Background

The Council is required to adopt the CIPFA Treasury Management in the Public Services: Code of Practice and it is a requirement under that Code of Practice to produce an annual strategy report on proposed treasury management activities for the year.

In addition, the Department for Communities and Local Government (CLG) issued revised Guidance on Local Council Investments in March 2010 that requires the Council to approve an investment strategy before the start of each financial year.

In accordance with the Treasury Management code, the Council defines treasury management activities as:

"The management of the Council's cash flows, its banking, money market and capital market transactions; the effective control of the risks `The purpose of the Treasury Strategy is to establish the framework for the effective and efficient management of the Council's treasury management activity, within legislative, regulatory, and best practice regimes, and balancing risk against reward in the best interests of stewardship of the public purse.

This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the CLG Guidance.

In accordance with the CLG Guidance, the Council will be asked to approve a revised Treasury Management Strategy Statement should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates, or in the Council's capital programme or in the level of its investment balance.

## 2 Key Principles

The key principles of the CIPFA Treasury Management in the Public Services: Code of Practice is that:

- Public service organisations should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities.
- Their policies and practices should make clear that the effective management and control of risk are prime objectives of their treasury management activities and that responsibility for these lies clearly within their organisations. Their appetite for risk should form part of their annual strategy, including any use of financial instruments for the prudent management of those risks, and should ensure that priority is given to security and liquidity when investing funds.
- They should acknowledge that the pursuit of value for money in treasury management, and the use of suitable performance measures are valid and important tools for responsible organisations to employ in support of their business and service objectives; and that within the context of effective risk management, their treasury management policies and practices should reflect this.

In setting the Treasury Management Strategy, the Council must have regard for the following factors:

- The current treasury position and debt portfolio position
- The prospects for interest rates

- The approved Capital Programme
- Limits on treasury management activities and prudential indicators

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

According to the Prudential Code- the professional code of practice to support local authorities in taking capital investment decisions- the Council's prime policy objective of its investment activities is the security and liquidity of funds. Therefore the Council should avoid exposing public funds to unnecessary or un-quantified risk. The Council should consider the return on their investments; however, this should not be at the expense of security and liquidity. It is therefore important that the Council adopt an appropriate approach to risk management with regard to its investment activities. The Council employs a Treasury Management advisor, Arlingclose, to assist in the management of risk.

## 3 External Context

Economic background: The major external influence on the Authority's treasury management strategy for 2017/18 will be the UK's progress in negotiating a smooth exit from the European Union. Financial markets, wrong-footed by the referendum outcome, have since been weighed down by uncertainty over whether leaving the Union means leaving the single market. Negotiations are expected to start once the UK formally triggers exit in early 2017 and last for at least two years. Uncertainty over future economic prospects will therefore remain throughout 2017/18.

The fall and continuing weakness in sterling and the near doubling in the price of oil in 2016 have combined to drive inflation expectations higher. The Bank of England is forecasting that Consumer Price Inflation will breach its 2% target in 2017, the first time since late 2013, but the Bank is expected to look through inflation overshoots over the course of 2017 when setting interest rates so as to avoid derailing the economy.

Initial post-referendum economic data showed that the feared collapse in business and consumer confidence had not immediately led to lower GDP growth. However, the prospect of leaving the single market has dented business confidence and resulted in a delay in new business investment and, unless counteracted by higher public spending or retail sales, will weaken economic growth in 2017/18.

The Eurozone has continued to struggle with very low inflation and lack of momentum in growth, and the European Central Bank has left the door open for further quantitative easing.

The impact of political risk on financial markets remains significant over the next year. With challenges such as immigration, the rise of populist, anti-establishment parties and negative interest rates resulting in savers being paid nothing for their frugal efforts or even penalised for them, the French presidential and general elections (April – June 2017) and the German federal elections (August – October 2017) have the potential for upsets.

Credit outlook: Markets have expressed concern over the financial viability of a number of European banks recently. Sluggish economies and continuing fines for pre-crisis behaviour have weighed on bank profits, and any future slowdown will exacerbate concerns in this regard.

Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the European Union, Switzerland and USA, while Australia and Canada are progressing with their own plans. The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Authority; returns from cash deposits however continue to fall.

Interest rate forecast: The Authority's treasury adviser Arlingclose's central case is for the UK Bank Rate to remain at 0.25% during 2017/18. The Bank of England has, however, highlighted that excessive levels of inflation will not be tolerated for sustained periods. With this view and the current inflation outlook, further falls in the Bank Rate look less likely. Negative Bank Rate is currently perceived by some policymakers to be counterproductive but, although a low probability, cannot be entirely ruled out in the medium term, particularly if the UK enters recession as a result of concerns over leaving the European Union.

Gilt yields have risen sharply, but remain at low levels. The Arlingclose central case is for yields to decline when the government triggers Article 50. Long-term economic fundamentals remain weak, and the quantitative easing (QE) stimulus provided by central banks globally has only delayed the fallout from the build-up of public and private sector debt. The Bank of England has defended QE as a monetary policy tool, and further QE in support of the UK economy in 2017/18 remains a possibility, to keep long-term interest rates low.

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

For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 0.75%, and that new long-term loans will be borrowed at an average rate of 2.8%.

## 4 Local Current Position

As at 31 December 2016, the Council held £209m (£126m being HRA self-financing) borrowing and £54m investments. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

**Table 1: Balance Sheet Forecast**

| Slough Borough Council | | | | | |
|---|---|---|---|---|---|
| **Balance Sheet Summary and Projections** | | | | | |
| **31st March** | **2016** | **2017** | **2018** | **2019** | **2020** |
| | **Actual £m** | **Estimate £m** | **Forecast £m** | **Forecast £m** | **Forecast £m** |
| General Fund Capital Financing Requirement | 158 | 199 | 229 | 257 | 274 |
| HRA Capital Financing Requirement | 158 | 158 | 158 | 158 | 158 |
| **Total Capital Financing Requirement** | **316** | **357** | **387** | **415** | **432** |
| Less: Other long-term liabilities * | (46) | (44) | (43) | (40) | (38) |
| **Loans Capital Financing Requirement** | **270** | **313** | **344** | **375** | **394** |
| Less: External borrowing ** | (177) | (200) | (240) | (271) | (298) |
| **Internal (over) borrowing** | **93** | **113** | **104** | **104** | **96** |
| Less: Usable reserves | (143) | (140) | (139) | (138) | (137) |
| Net Borrowing Requirement/(Investments) | **(50)** | **(27)** | **(35)** | **(34)** | **(41)** |

* finance leases and PFI liabilities that form part of the Council's debt
** shows only loans to which the Council is committed and excludes optional refinancing

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves are the underlying resources available for investment. CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Authority expects to comply with this recommendation during 2017/18.

The Council has an increasing CFR due to the capital programme, but minimal investments and will therefore be required to borrow up to £292m over the forecast period.

## 5 Borrowing Strategy

The Council currently holds £209 million of loans, an increase of £32m million on the previous year, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 1 shows that the Council expects to borrow an additional £23m in 2017/18

**Objectives:** The Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

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

By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Council with this 'cost of carry' and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2017/18 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

Alternatively, the Council may arrange forward starting loans during 2017/18, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

In addition, the Council may borrow further short-term loans to cover unplanned cash flow shortages.

**Sources:** The approved sources of long-term and short-term borrowing are:

- Public Works Loan Board (PWLB) and any successor body
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds (except [your local] Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local Council bond issues

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

- operating and finance leases
- hire purchase
- Private Finance Initiative
- sale and leaseback

The Council has previously raised the majority of its long-term borrowing from the PWLB but it continues to investigate other sources of finance, such as local authority loans and bank loans that may be available at more favourable rates.

**Municipal Bond Agency:** The UK Municipal Bonds Agency was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for three reasons: borrowing authorities are required to provide lenders with a joint and several guarantee over the very small risk that other local authority borrowers default on their loans; there will be a lead time between committing to borrow and knowing the precise interest rate payable; however the interest payable will always be lower than the PWLB certainty rate. Any decision to borrow from the Agency will therefore be the subject of a separate report to Cabinet.

**LOBOs:** The Council holds £9m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate as set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. £4m of these LOBOS have options during 2017/18, and although the Council understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The Council will take the option to repay LOBO loans at no cost if it has the opportunity to do so.

**Short-term and Variable Rate loans**: These loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators below.

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

***Table 2: Current Borrowing Position***

| PWLB or Market | Type | Loan | Start Date | Maturity | Principal £ | Type |
|---|---|---|---|---|---|---|
| PWLB | Fixed | 481989 | 14/01/1999 | 25/03/2030 | 30,364 | Pooled |
| PWLB | Fixed | 487800 | 02/08/2004 | 25/03/2028 | 1,000,000 | Pooled |
| PWLB | Fixed | 488859 | 02/08/2004 | 25/03/2029 | 500,000 | Pooled |
| PWLB | Fixed | 489227 | 24/10/2004 | 15/10/2031 | 5,000,000 | Pooled |
| PWLB | Fixed | 490923 | 22/12/2005 | 01/05/2036 | 3,000,000 | Pooled |
| PWLB | Fixed | 490924 | 22/12/2005 | 01/08/2036 | 5,000,000 | Pooled |
| PWLB | Fixed | 494837 | 01/10/2008 | 01/08/2038 | 5,000,000 | Pooled |
| PWLB | Fixed | 497752 | 27/08/2010 | 24/08/2017 | 3,000,000 | Pooled |
| PWLB | Fixed | 497998 | 30/09/2010 | 30/03/2017 | 4,000,000 | Pooled |
| PWLB | Fixed | 497999 | 30/09/2010 | 29/09/2021 | 4,000,000 | Pooled |

| PWLB or Market | Type | Loan | Start Date | Maturity | Principal £ | Type |
|---|---|---|---|---|---|---|
| PWLB | Fixed | 498000 | 30/09/2010 | 29/09/2024 | 4,000,000 | Pooled |
| PWLB | Fixed | 498001 | 30/09/2010 | 30/09/2027 | 4,000,000 | Pooled |
| PWLB | Fixed | 500578 | 28/03/2012 | 28/03/2028 | 20,000,000 | HRA Self Financing |
| PWLB | Fixed | 500579 | 28/03/2012 | 28/03/2037 | 20,000,000 | HRA Self Financing |
| PWLB | Fixed | 500580 | 28/03/2012 | 28/03/2042 | 20,000,000 | HRA Self Financing |
| PWLB | Fixed | 500581 | 28/03/2012 | 28/03/2041 | 15,841,000 | HRA Self Financing |
| PWLB | Fixed | 500582 | 28/03/2012 | 28/03/2032 | 20,000,000 | HRA Self Financing |
| PWLB | Fixed | 500583 | 28/03/2012 | 28/03/2022 | 10,000,000 | HRA Self Financing |
| PWLB | Fixed | 500584 | 28/03/2012 | 28/03/2039 | 20,000,000 | HRA Self Financing |
| Market | L/T Variable | 64 | 12/07/2004 | 10/07/2054 | 4,000,000 | Pooled |
| Market | L-T LOBO | 65 | 07/04/2006 | 07/04/2066 | 5,000,000 | Pooled |
| Market | L-T LOBO | 66 | 28/04/2006 | 28/04/2066 | 4,000,000 | Pooled |
| Market | S/T Variable | 2478 | 08/07/2016 | 27/06/2017 | 5,000,000 | Pooled |
| Market | S/T Variable | 2479 | 08/07/2016 | 07/07/2017 | 5,000,000 | Pooled |
| Market | S/T Variable | 2480 | 29/09/2016 | 20/02/2017 | 3,500,000 | Pooled |
| Market | S/T Variable | 2481 | 30/11/2016 | 16/02/2017 | 3,000,000 | Pooled |
| Market | S/T Variable | 2482 | 20/12/2016 | 21/02/2017 | 7,000,000 | Pooled |
| Market | S/T Variable | 2483 | 22/12/2016 | 17/03/2017 | 5,000,000 | Pooled |
| Market | S/T Variable | 2484 | 22/12/2016 | 22/06/2017 | 3,000,000 | Pooled |
| | | | | | 208,871,364 | |

## 6 Housing Revenue Account Self-Financing

Central Government completed its reform of the Housing Revenue Account Subsidy system at the end of 2011/12. Local authorities are required to recharge interest expenditure and income attributable to the HRA in accordance with Determinations issued by the Department for Communities and Local Government.

The Determinations do not set out a methodology for calculating the interest rate to use in each instance. The Council is therefore required to adopt a policy that will set out how interest charges attributable to the HRA will be determined. The CIPFA Code recommends that authorities present this policy in their TMSS. 3

On 1st April 2012, the Council notionally split each of its existing long-term loans into General Fund and HRA pools. In the future, new long-term loans borrowed will be assigned in their entirety to one pool or the other. Interest payable and other costs/income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged/ credited to the respective revenue account.

As part of the reform of the HRA Housing Revenue Account Subsidy system at the end of 2011/12, the HRA needed to make a payment of £136m to the Government. £126m of this was financed by PWLB loans listed above. £10m was in respect of an internal loan from the General Fund. The General Fund currently charges 3.27% interest on this amount or £327,000 per annum.

## 7 Investment Strategy

The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council's investment balance has ranged between £54m and £91m. Levels are expected to decrease during the forthcoming year in order to finance an expanding capital programme.

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

Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

**Negative Interest Rates:** If the UK enters into a recession in 2017/18, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

**Strategy**: Given the increasing risk and falling returns from short-term unsecured bank investments, the Council aims to further diversify into more secure and/or higher yielding asset classes during 2017/18 where opportunities arise. This is especially the case for the estimated £32m that is available for longer-term investment. The Council has reduced the amount it invests in short-term unsecured bank deposits, certificates of deposit and money market funds to around 40% of its total investments. Most of these investments are for the management of the Council's short term cash flow, and are invested in either instant access call accounts or notice accounts where the exposure is for a maximum of 95 days.

**Approved Counterparties:** The Council may invest its surplus funds with any of the counterparty types in table 3 below, subject to the cash limits (per counterparty) and the time limits shown.

**Table 3: Approved Investment Counterparties and Limits**

| Credit Rating | Banks Unsecured | Banks Secured | Government | Corporates | Registered Providers |
|---|---|---|---|---|---|
| UK Govt | n/a | n/a | £ Unlimited<br>50 years | n/a | n/a |
| AAA | £15m<br>5 years | £15m<br>20 years | £15m<br>50 years | £5m<br>20 years | £5m<br>20 years |
| AA+ | £15m<br>5 years | £15m<br>10 years | £15m<br>25 years | £5m<br>10 years | £5m<br>10 years |
| AA | £15m<br>4 years | £15m<br>5 years | £15m<br>15 years | £5m<br>5 years | £5m<br>10 years |
| AA- | £15m | £15m | £15m | £5m | £5m |

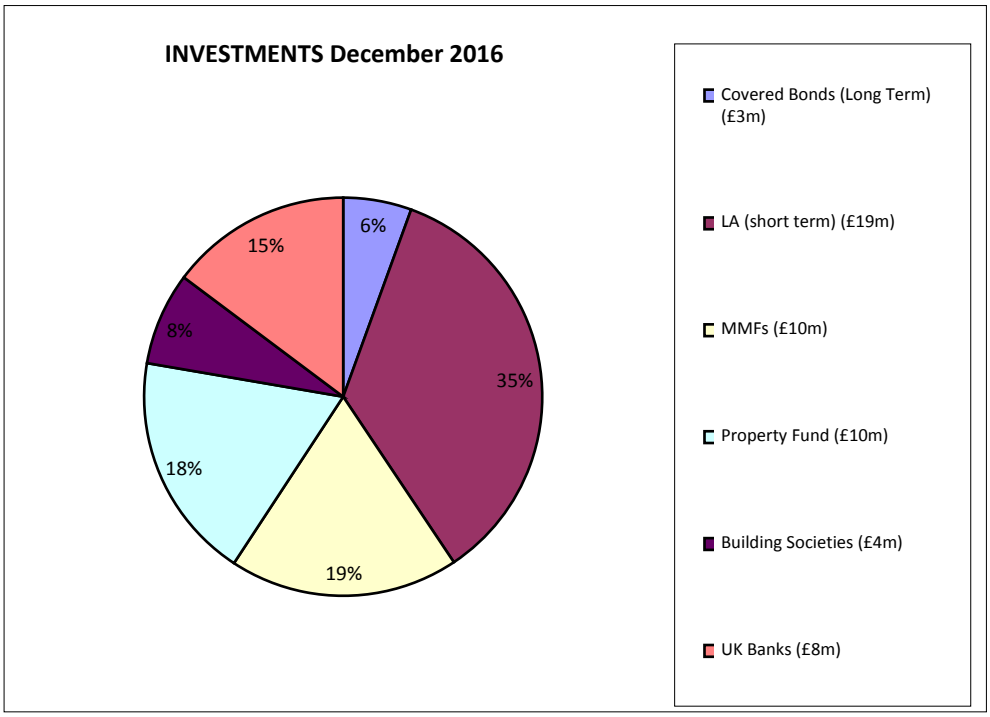
| | 3 years | 4 years | 10 years | 4 years | 10 years |
|---|---|---|---|---|---|
| A+ | £15m<br>2 years | £15m<br>3 years | £15m<br>5 years | £5m<br>3 years | £5m<br>5 years |
| A | £15m<br>13 months | £15m<br>2 years | £15m<br>5 years | £5m<br>2 years | £5m<br>5 years |
| A- | £15m 6<br>months | £15m<br>13 months | £15m<br>5 years | £5m<br>13 months | £5m<br>5 years |
| BBB+ | £5m<br>100 days | £5m<br>6 months | £15m<br>2 years | £2.5m<br>6 months | £2.5m<br>2 years |
| None | £3m<br>12 months | n/a | £5m<br>25 years | n/a | £5m<br>5 years |
| Pooled funds | £10m per fund | | | | |

There is no intention to restrict investments to bank deposits, and investments may be made with any public or private sector organisations that meet the above credit rating criteria. This reflects a lower likelihood that the UK and other governments will support failing banks as the bail-in provisions in the *Banking Reform Act 2014* and the EU *Bank Recovery and Resolution Directive* are implemented.

In addition, the Council may invest with organisations and pooled funds without credit ratings, following an external credit assessment and advice from the Council's treasury management adviser.

The current level of investments and the type of institution invested in is summarised in Table 4 below:

**Table 4: Current Investments**




£22m of the above is in instant access accounts (i.e. Call Accounts and Money Market Funds) and £3m in 95 day notice accounts.

## 8 Investment Opportunities

**Credit Rating:** Investment limits are set by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

**Banks Unsecured:** Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail.

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

**Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

**Corporates:** Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made as part of a diversified pool in order to spread the risk widely.

**Registered Providers:** Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing, formerly known as Housing Associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services, they retain the likelihood of receiving government support if needed.

**Pooled Funds:** Shares in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.
Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.

**Slough Urban Renewal (SUR):** The Council has entered into a partnership with Morgan Sindall, a Private Sector developer, for the regeneration of Slough. Under this partnership, the Council land assets are transferred into the SUR vehicle. The Council then receives a loan

note from the SUR for the value of the land transferred. This loan note is then repaid by the SUR over time and the Council will receive interest on the loan note of 6%.

## 9 Risk Management

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

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

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

**Other Information on the Security of Investments**: The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations, in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

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

**Specified Investments**: The CLG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
  - the UK Government,
  - a UK local Council, parish council or community council, or
  - a body or investment scheme of "high credit quality".

The Council defines "high credit quality" organisations and securities as those having a credit rating of [A-] or higher that are domiciled in the UK or a foreign country with a sovereign rating of [AA+] or higher. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of [A-] or higher.

**Non-specified Investments**: Any investment not meeting the definition of a specified investment is classed as non-specified. The Council does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement, and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown in table 3 below.

Table 5: Non-Specified Investment Limits:

| | **Cash limit** |
|---|---|
| Total long-term investments | £40m |
| Total investments without credit ratings or rated below A- | £10m |
| Total investments with institutions domiciled in foreign countries rated below AA+ | £10m |
| Total non-specified investments | £60m |

**10** **Investment Limits**

The Council's revenue reserves available to cover investment losses are forecast to be £76 million on 31st March 2017. In order that no more than 20% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be **£15 million** A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below:

Table 6: Investment Limits

| | **Cash limit** |
|---|---|
| Any single organisation, except the UK Central Government | £15m each |
| UK Central Government | unlimited |
| Any group of organisations under the same ownership | £15m per group |
| Any group of pooled funds under the same management | £25m per manager |
| Negotiable instruments held in a broker's nominee account | £25m per broker |
| Foreign countries | £10m per country |
| Registered Providers | £5m in total |
| Unsecured investments with Building Societies | £10m in total |
| Loans to unrated corporates | £5m in total |
| Money Market Funds | £50m in total |
| Slough Urban Renewal Loan Notes | £5m above land value |

## 11 Prudential Indicators

The Local Government Act 2003 requires the Council to have regard to the Chartered Institute of Public Finance and Accountancy's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow.

The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Authority has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

**Estimates of Capital Expenditure:** The Council's planned capital expenditure and financing may be summarised as follows.

**Table 5: Capital Programme**

| Capital Expenditure and Financing | 31.03.17 Revised £m | 31.03.18 Estimate £m | 31.03.19 Estimate £m | 31.03.20 Estimate £m |
|---|---|---|---|---|
| General Fund | 94 | 101 | 50 | 37 |
| HRA | 22 | 20 | 18 | 23 |
| **Total Expenditure** | **117** | **120** | **68** | **60** |
| Capital Receipts | 5 | 10 | 12 | 22 |
| Grants & Contributions | 30 | 52 | 12 | 3 |
| Revenue | 11 | 1 | 0 | 0 |
| Reserves | 7 | 7 | 6 | 1 |
| Borrowing (incl. internal) | 65 | 51 | 38 | 34 |
| **Total Financing** | **117** | **120** | **68** | **60** |

**Estimates of Capital Financing Requirement:** The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose.

| Capital Financing Requirement | 31.03.17 Revised £m | 31.03.18 Estimate £m | 31.03.19 Estimate £m | 31.03.20 Estimate £m |
|---|---|---|---|---|
| General Fund | 199 | 229 | 257 | 274 |
| HRA | 158 | 158 | 158 | 158 |
| **Total CFR** | **357** | **387** | **415** | **432** |

The CFR is forecast to rise by £40m over the next two years as capital expenditure financed by internal borrowing outweighs resources put aside for debt repayment before reducing in subsequent years where budgeted capital expenditure reduces.

**Gross Debt and the Capital Financing Requirement:** In order to ensure that over the medium term debt will only be for a capital purpose, the Council should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.

| **Debt** | **31.03.17 Revised £m** | **31.03.18 Estimate £m** | **31.03.19 Estimate £m** | **31.03.20 Estimate £m** |
|---|---|---|---|---|
| Borrowing | 177 | 200 | 240 | 271 |
| Finance leases | 8 | 8 | 6 | 5 |
| PFI liabilities | 36 | 35 | 34 | 33 |
| **Total Debt** | **221** | **243** | **280** | **309** |

Total debt is expected to remain below the CFR during the forecast period.

**Operational Boundary for External Debt:** The operational boundary is based on the Council's estimate of most likely (i.e. prudent but not worst case) scenario for external debt. It links directly to the Authority's estimates of capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring. Other long-term liabilities comprise finance lease, Private Finance Initiative and other liabilities that are not borrowing but form part of the Council's debt.

| **Operational Boundary** | **2016/17 Revised £m** | **2017/18 Estimate £m** | **2018/19 Estimate £m** | **2019/20 Estimate £m** |
|---|---|---|---|---|
| Borrowing | 316 | 347 | 378 | 397 |
| Other long-term liabilities | 44 | 43 | 40 | 38 |
| **Total Debt** | **360** | **390** | **418** | **435** |

**Authorised Limit for External Debt:** The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Council can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

| **Authorised Limit** | **2016/17 Limit £m** | **2017/18 Limit £m** | **2018/19 Limit £m** | **2019/20 Limit £m** |
|---|---|---|---|---|
| Borrowing | 326 | 357 | 388 | 407 |
| Other long-term liabilities | 44 | 43 | 40 | 38 |
| **Total Debt** | **370** | **400** | **428** | **445** |

**Ratio of Financing Costs to Net Revenue Stream:** This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

| **Ratio of Financing Costs to Net Revenue Stream** | **2016/17 Revised %** | **2017/18 Estimate %** | **2018/19 Estimate %** | **2019/20 Estimate %** |
|---|---|---|---|---|
| General Fund | 9.0 | 10.7 | 12.6 | 16.5 |
| HRA | 13.1 | 12.9 | 12.7 | 12.5 |

**Incremental Impact of Capital Investment Decisions:** This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax and housing rent levels. The incremental impact is the difference between the total revenue budget requirement of the current approved capital programme and the revenue budget requirement arising from the capital programme

| Incremental Impact of Capital Investment Decisions | 2017/18 Estimate £ | 2018/19 Estimate £ | 2019/20 Estimate £ |
|---|---|---|---|
| General Fund - increase in annual band D Council Tax | 14.8 | 15.2 | 16.1 |
| HRA - increase in average weekly rents | 18.2 | 11.8 | 16.4 |

**Adoption of the CIPFA Treasury Management Code:** The Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2011 Edition. It fully complies with the Codes recommendations

## 12 MRP Statement 2017/18

Where the Council finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the Council to have regard to the Department for Communities and Local Government's Guidance on Minimum Revenue Provision (the CLG Guidance) most recently issued in 2012.

The broad aim of the CLG Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

The CLG Guidance requires the Council to approve an Annual MRP Statement each year, and recommends a number of options for calculating a prudent amount of MRP.

CLG has issued guidance on the calculation of MRP, including a number of methods which it considers to be prudent. The guidance is clear that authorities are also free to devise other methods they consider prudent.

The guidance suggests that:

- A: Regularity Method: Finance leases and Private Finance Initiative (PFI) :

  MRP on assets acquired through finance leases and Private Finance Initiative (PFI) should be equal to the cash payments that reduce the outstanding liability each year;

- B: CFR Method: Capital expenditure incurred before 1st April 2008:

  MRP on all capital expenditure incurred before 1st April 2008, and on expenditure funded by supported borrowing thereafter, is equal to 4% of the opening CFR with some optional adjustments.

- C: Asset Life/ Depreciation Method: Unsupported Capital Expenditure ("Prudential" borrowing):

  MRP on expenditure incurred from April 2008 onwards that is funded by unsupported "prudential" borrowing should be calculated by reference to the asset's useful life, using either a straight line or an annuity method, starting in the year after the asset becomes operational. This may also be used for supported Non-HRA capital expenditure if the Council chooses. There is no requirement to charge MRP in respect of HRA capital expenditure funded from borrowing.

Here, the Council has three broad options:

- Option 1: the 4% reducing balance method
- Option 2: the straight line asset life method, and
- Option 3: the annuity asset life method.

Up to 2015-16 the Council used Option 1 respect of supported capital expenditure funded from borrowing and Option 2 in respect of unsupported capital expenditure funded from borrowing and Private Finance Initiative schemes.
MRP in respect of leases brought on Balance Sheet under the International Financial Reporting Standards (IFRS) based Accounting Code of Practice matched the annual principal repayment for the associated deferred liability.

2016/17 policy
At a time of increasing pressure on the revenue budget, savings in the annual cost of MRP may reduce the need for savings to be made in front line services. Following a commissioned study to conduct a review of MRP, the Council's financial advisors recommended moving to an annuity basis (Option 3) for both supported and unsupported capital expenditure (including PFI liability) with effect from 1st April 2016. This will reduce the MRP charged in this and future years.

This is a change to the current MRP policy, and results in a credit from the overprovision made in previous years (approximately £3.6m). The benefit arising will be applied prospectively, spread over a period of 10 to 15 years to link in with the Medium Term Financial Planning process. This "recovery" method is in line with guidance issued by the National Audit Office (NAO).

Capital expenditure incurred during 2017/18 would not be subject to a MRP charge until 2018/19.
Based on the Council's latest estimate of its Capital Financing Requirement on 31st March 2017, the budget for MRP has been set as follows:

**Table 7: MRP Method – Option 2 (Straight Line) Vs Option 3 (Annuity)**

| 31 March | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|
| | £k | £k | £k | £k | £k |
| 60 Year Annuity MRP charge | 216 | 225 | 235 | 245 | 256 |
| Over provision of £3.6m spread over 10 years: | (360) | (360) | (360) | (360) | (360) |
| | (144) | (135) | (125) | (115) | (104) |
| **i.e. MRP charge** | **0** | **0** | **0** | **0** | **0** |
| Cumulative written back | (216) | (441) | (676) | (921) | (1,177) |

## 13 Treasury Management Indicators

The Council measures and manages its exposures to treasury management risks using the following four new prudential indicators.

- Upper limits on variable rate exposure. This indicator identifies a maximum limit for variable interest rates based upon the debt provision net of investments.
- Upper limits on fixed rate exposure. Similar to the previous indicators, this covers a maximum limit on fixed interest rates
- Total principal funds invested for a period longer than 364 days. These limits are set to reduce the need for early sale of an investment and are based on the availability of investments after each year-end
- Maturity Structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing

Interest Rate Exposures: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the amount of principal borrowed will be:

| LIMITS ON INTEREST RATE EXPOSURE | | | |
|---|---|---|---|
| | **2016/17** | **2017/18** | **2018/19** |
| Limit on Principal invested beyond year end | £45m | £45m | £45m |
| Upper limit on fixed interest rate exposure | £100m | £100m | £100m |
| Upper limit on variable interest rate exposure | £50m | £50m | £50m |

Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

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

| MATURITY STRUCTURE OF BORROWING | | | |
|---|---|---|---|
| | **Existing Level** | **Lower** | **Upper** |
| Under 12 months | 38.5 | 0% | 50% |
| 12 months and within 24 months | 0.0 | 0% | 50% |
| 24 months and within 5 years | 4.0 | 0% | 50% |
| 5 years and within 10 years | 14.0 | 0% | 75% |
| 10 years and within 15 years | 30.5 | 10% | 95% |
| 15 years and within 20 years | 28.0 | 10% | 95% |
| 20 years and within 25 years | 61.0 | 10% | 95% |
| Over 25 years | 29.0 | 10% | 95% |

## 14 The purpose of the Strategic Asset Fund

On 14 September 2015, Cabinet approved the introduction of the Strategic Acquisition Strategy, which provided a framework for the Council to operate commercially and undertake a new approach to asset investment through the acquisition of land and/or property generating income up to £25m (inclusive of acquisition costs). Following a subsequent report in November 2016, the budget for strategic asset purchases was increased to £50m. In approving the Strategy, the drivers were to acquire income generating assets to offset continued reductions in central government grant and for the Council to realise the regenerative benefits associated with purchasing sites to bring forward housing and commercial development.

**How investments are decided upon**
A strategic acquisition can be defined as the acquisition of land or properties that will allow the Council to expedite key outcomes contained within the 5 Year Plan. To be considered strategic, it is suggested that acquisition must make a significant contribution towards regeneration objectives and/or provide a commercial return on investment that will improve the financial resilience of the Council:

**a) Property Investments**

Under commercial investment objectives, a strategic acquisition would typically:

- Generate income through a satisfactory level of return, with a net initial yield range between 5% and 9%, and/or
- Improve investment value of commercial assets over time in addition to the level of returns through rental growth.

**b) Regeneration**

Under regeneration objectives, a strategic acquisition will typically:

- Deliver large scale development that will provide attractive, accessible places to live and work and do business; or
- Allow the redevelopment of smaller development sites in key locations that have stalled, or
- Enable the Council to acquire land required to deliver infrastructure projects, or
- Enable collaborative working with adjoining owners to maximise land value; or
- Improve the image of Slough to a status that fully recognises the strategic importance and benefits offered by the town as a sub-regional gateway to and from London.
- Generate additional capital and revenue income to support the financial projections set out in the Medium Term Financial Plan.

Whilst the acquisition of strategic regeneration sites will typically be dependent on land becoming available for sale, the Council will be proactive and will consider off market acquisitions and the use of Compulsory Purchase Orders as required.

**How decisions are made**

In order to balance the objectives of introducing a streamlined approach (to avoid losing acquisition opportunities through delays in process) with high levels of probity, a Strategic Acquisition Board ("SAB") was introduced.

The SAB meet on a monthly basis and is chaired by the Assistant Director Assets, Infrastructure & Regeneration. The standing members of the SAB include the:

- Leader of the Council
- Commissioner for Housing & Urban Renewals
- Strategic Director Regeneration, Housing & Resources
- Assistant Director Assets, Infrastructure and Regeneration
- Assistant Director Housing & Environmental Services
- Directorate Finance Manager Customer & Community Services, Regeneration & Housing
- Head of Asset Management

The SAB has a remit to:

- Consider acquisition recommendations put forward by the Head of Asset Management (or delegate).
- Review proposed land acquisition and/or property investment proposals, taking into account the extent to which the proposition fulfils the Council's policy objectives against a set of agreed criteria.
- Make strategic acquisition and investment decisions on behalf of the Council.
- Oversee and monitor the performance of approved acquisition and investments.
- Report acquisitions to the Capital Strategy Board and Cabinet.
- Dispose of assets acquired via the SAB.

The SAB has a responsibility to monitor the performance of the investment portfolio, ensuring that individual assets are performing thereby maximising rental returns and selling assets when they no longer perform.

When a strategic acquisition is identified by Asset Management an agreed Acquisition Protocol is followed.

**Any controls in place**
When acquiring investment assets, it is important to have a well balanced portfolio which can counteract significant market changes. As the portfolio expands, each asset acquired is considered in line with the existing portfolio e.g. if the majority of the portfolio were industrial then it would need to be balanced with further office and retail property, or if the portfolio income was very insecure then it could be balanced by investments with longer projected income.

Officers apply a defined list of property specific criteria when making recommendations to the SAB on investment acquisitions using agreed property based criteria.

All acquisition opportunities presented to the SAB are supported by a financial appraisal and business case. Before approving any acquisition, the SAB requires confirmation that the acquisition will not increase the Council's ongoing revenue costs, including the cost of borrowing and officer time.

The appraisal and business case assess how the strategic acquisition will be financed. They:

1. Consider if the investment achieves corporate objectives.
2. Confirm that for the acquisition of land the price is reasonable (allowing for a special purchase consideration) and supported by an independent valuation.
3. Confirm that for the acquisition of a standing investment the price is reasonable and supported by an independent valuation (reference will be made to previously identified added value opportunities).
4. Confirm there is a market requirement.
5. Where appropriate, there is secure rental income taking into account risks associated with the security of future payments, including (where appropriate) sensitivity analysis for void periods.
6. Identify whole life costs (where appropriate).
7. Identify the most appropriate funding source(s) and confirm availability.
8. Clarify that the Council's Finance Section has assessed the business case and confirmed a suitable return on investment.

The financial appraisals considered by the SAB identify all costs and assumed income to assist informed decision making on whether the acquisition is suitable. In the case of revenue generating assets, assets are assessed by comparing the anticipated net income against the rate of return the Council could otherwise expect to achieve on its capital.

In all instances, acquisitions must be supported by advice from the Section 151 Officer.

Acquisitions to date are:

| | £ | Annual Yield |
|---|---|---|
| | | % |
| In Borough | 13,453,150 | 6.18 |
| Out of Borough | 10,866,150 | 6.47 |
| Total | 24,319,300 | |

## 15 Other Items

There are a number of additional items that the Council is obliged by CIPFA or CLG to include in its Treasury Management Strategy.

**Policy on Use of Financial Derivatives:** Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the *Localism Act 2011* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).
The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.
Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

**Policy on Apportioning Interest to the HRA:** On 1st April 2012, the Council notionally split each of its existing long-term loans into General Fund and HRA pools. In the future, new long-term loans borrowed will be assigned in their entirety to one pool or the other. Interest payable and other costs/income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged/ credited to the respective revenue account. Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. This balance will be measured each month and interest transferred between the General Fund and HRA at the Council's average interest rate on investments, adjusted for credit risk.

**Investment Training:** The needs of the Council's treasury management staff for training in investment management are assessed as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change. Treasury management employees regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA. Relevant employees are also encouraged to study professional qualifications from CIPFA, the Association of Corporate Treasurers and other appropriate organisations.

**Investment Advisers:** The Council has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues.

**Investment of Money Borrowed in Advance of Need:** The Council may, from time to time, borrow in advance of need, where this is expected to provide the best long term value for money. Since amounts borrowed will be invested until spent, the Council is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Council's overall management of its treasury risks.
The total amount borrowed will not exceed the authorised borrowing limit. The maximum period between borrowing and expenditure is expected to be two years, although the Council is not required to link particular loans with particular items of expenditure.

## 15 Other Options Considered

The CLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Financial Officer believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

| Alternative | Impact on income and expenditure | Impact on risk management |
|---|---|---|
| Invest in a narrower range of counterparties and/or for shorter times | Interest income will be lower | Lower chance of losses from credit related defaults, but any such losses may be greater |
| Invest in a wider range of counterparties and/or for longer times | Interest income will be higher | Increased risk of losses from credit related defaults, but any such losses may be smaller |
| Borrow additional sums at long-term fixed interest rates | Debt interest costs will rise; this is unlikely to be offset by higher investment income | Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain |
| Borrow short-term or variable loans instead of long-term fixed rates | Debt interest costs will initially be lower | Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long term costs may be less certain |
| Reduce level of borrowing | Saving on debt interest is likely to exceed lost investment income | Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain |

## 16 Ethical Investment Policy

The preservation of capital is the Council's principal and overriding priority. The banks and building societies on the Council's lending list are selected only if the institutions and the sovereign meet minimum credit criteria. In accordance with its social and corporate governance responsibilities, the Council seeks to support institutions which additionally have an ethical and responsible approach to environmental and social issues including employment and global trade

The Council could seek to invest in specific ethical funds, though there would be a charge to undertake the risk analysis of doing so from the Council's Treasury Management advisors

**Appendix A – Arlingclose Economic & Interest Rate Forecast November 2016**

**Underlying assumptions:**

- The medium term outlook for the UK economy is dominated by the negotiations to leave the EU. The long-term position of the UK economy will be largely dependent on the agreements the government is able to secure with the EU and other countries.
- The global environment is also riddled with uncertainty, with repercussions for financial market volatility and long-term interest rates. Donald Trump's victory in the US general election and Brexit are symptomatic of the popular disaffection with globalisation trends. The potential rise in protectionism could dampen global growth prospects and therefore inflation. Financial market volatility will remain the norm for some time.
- However, following significant global fiscal and monetary stimulus, the short term outlook for the global economy is somewhat brighter than earlier in the year. US fiscal stimulus is also a possibility following Trump's victory.
- Recent data present a more positive picture for the post-Referendum UK economy than predicted due to continued strong household spending.
- Over the medium term, economic and political uncertainty will likely dampen investment intentions and tighten credit availability, prompting lower activity levels and potentially a rise in unemployment.
- The currency-led rise in CPI inflation (currently 1.0% year/year) will continue, breaching the target in 2017, which will act to slow real growth in household spending due to a sharp decline in real wage growth.
- The depreciation in sterling will, however, assist the economy to rebalance away from spending. The negative contribution from net trade to GDP growth is likely to diminish, largely due to weaker domestic demand. Export volumes will increase marginally.
- Given the pressure on household spending and business investment, the rise in inflation is highly unlikely to prompt monetary tightening by the Bank of England, with policymakers looking through import-led CPI spikes to the negative effects of Brexit on economic activity and, ultimately, inflation.
- Bank of England policymakers have, however, highlighted that excessive levels of inflation will not be tolerated for sustained periods. Given this view and the current inflation outlook, further monetary loosening looks less likely..

**Forecast:**

- Globally, the outlook is uncertain and risks remain weighted to the downside. The UK domestic outlook is uncertain, but likely to be weaker in the short term than previously expected.
- The likely path for Bank Rate is weighted to the downside. The Arlingclose central case is for Bank Rate to remain at 0.25%, but there is a 25% possibility of a drop to close to zero, with a very small chance of a reduction below zero.
- Gilt yields have risen sharply, but remain at low levels. The Arlingclose central case is for yields to decline when the government triggers Article 50.

| | Dec-16 | Mar-17 | Jun-17 | Sep-17 | Dec-17 | Mar-18 | Jun-18 | Sep-18 | Dec-18 | Mar-19 | Jun-19 | Sep-19 | Dec-19 | Average |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Official Bank Rate | | | | | | | | | | | | | | |
| Upside risk | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | **0.12** |
| Arlingclose Central Case | **0.25** | **0.25** | **0.25** | **0.25** | **0.25** | **0.25** | **0.25** | **0.25** | **0.25** | **0.25** | **0.25** | **0.25** | **0.25** | **0.25** |
| Downside risk | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | **0.40** |
| | | | | | | | | | | | | | | |
| 3-month LIBID rate | | | | | | | | | | | | | | |
| Upside risk | 0.05 | 0.05 | 0.10 | 0.10 | 0.10 | 0.15 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | **0.18** |
| Arlingclose Central Case | **0.25** | **0.25** | **0.25** | **0.30** | **0.30** | **0.30** | **0.30** | **0.30** | **0.30** | **0.30** | **0.30** | **0.30** | **0.30** | **0.29** |
| Downside risk | 0.20 | 0.25 | 0.25 | 0.25 | 0.30 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | **0.34** |
| | | | | | | | | | | | | | | |
| 1-yr LIBID rate | | | | | | | | | | | | | | |
| Upside risk | 0.10 | 0.10 | 0.15 | 0.15 | 0.15 | 0.20 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 | **0.23** |
| Arlingclose Central Case | **0.60** | **0.50** | **0.50** | **0.50** | **0.50** | **0.50** | **0.50** | **0.60** | **0.70** | **0.85** | **0.90** | **0.90** | **0.90** | **0.65** |
| Downside risk | 0.10 | 0.15 | 0.15 | 0.15 | 0.20 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 | **0.24** |
| | | | | | | | | | | | | | | |
| 5-yr gilt yield | | | | | | | | | | | | | | |
| Upside risk | 0.25 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | **0.39** |
| Arlingclose Central Case | **0.50** | **0.40** | **0.35** | **0.35** | **0.35** | **0.40** | **0.40** | **0.40** | **0.45** | **0.50** | **0.55** | **0.60** | **0.65** | **0.45** |
| Downside risk | 0.30 | 0.45 | 0.45 | 0.45 | 0.45 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | **0.47** |
| | | | | | | | | | | | | | | |
| 10-yr gilt yield | | | | | | | | | | | | | | |
| Upside risk | 0.30 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | **0.39** |
| Arlingclose Central Case | **1.15** | **0.95** | **0.85** | **0.85** | **0.85** | **0.85** | **0.85** | **0.90** | **0.95** | **1.00** | **1.05** | **1.10** | **1.15** | **0.96** |
| Downside risk | 0.30 | 0.45 | 0.45 | 0.45 | 0.45 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | **0.47** |
| | | | | | | | | | | | | | | |
| 20-yr gilt yield | | | | | | | | | | | | | | |
| Upside risk | 0.25 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | **0.39** |
| Arlingclose Central Case | **1.70** | **1.50** | **1.40** | **1.40** | **1.40** | **1.40** | **1.40** | **1.45** | **1.50** | **1.55** | **1.60** | **1.65** | **1.70** | **1.75** |
| Downside risk | 0.40 | 0.55 | 0.55 | 0.55 | 0.55 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | **0.57** |
| | | | | | | | | | | | | | | |
| 50-yr gilt yield | | | | | | | | | | | | | | |

| | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Upside risk | 0.25 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 | **0.39** |
| Arlingclose Central Case | **1.60** | **1.40** | **1.30** | **1.30** | **1.30** | **1.30** | **1.30** | **1.35** | **1.40** | **1.45** | **1.50** | **1.55** | **1.60** | **1.41** |
| Downside risk | 0.40 | 0.55 | 0.55 | 0.55 | 0.55 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | **0.57** |