Appendix B - Treasury Management Strategy Statement (TMSS) 2017/18

Introduction

In a Council meeting on the 29th November 2012 the Council adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice (2011 Edition)* (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year.

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

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.

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.

External Context

Economic background: The major external influence on the Council's treasury management strategy for 2017/18 will be the UK's progress in negotiating a smooth exit from the European Union (EU). 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 Index (CPI) inflation will breach its 2.0% target in 2017, the first time since 2013. The Monetary Policy Committee (MPC) meets on a monthly basis to set the Bank of England's Base Rate, which is used to control the level of inflation. The MPC aims for a target CPI inflation rate of 2.0%, within a range of plus or minus 1.0%, i.e., between 1.0% and 3.0%. 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 given the pressure on household spending and business investment.

Looking overseas, with the US economy and its labour market showing steady improvement, the market has priced in a high probability of the Federal Reserve increasing interest rates in December 2016. The Eurozone meanwhile 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 (QE).

Interest rate forecast: The Council's treasury advisers, Arlingclose, do not expect the Bank of England to raise its Base Rate from its current level of 0.25% over the next three years.

Gilt yields have risen sharply, but remain at low levels. Arlingclose expect yields to decline when the Government triggers Article 50 of the Treaty of Lisbon by the end of March 2017 to formally give notice of its intention to exit from the EU. Long-term economic fundamentals remain weak, and further Quantitative Easing (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 *Schedule 1*.

For the purpose of setting the 2017/18 budget, it has been assumed that new investments will be made at an average rate of 0.3%, and that new short-term loans will be borrowed on an average variable interest rate of 0.5% based on the forecast prevailing Base Rate plus a prudent allowance for uncertainty and brokerage fees.

Local Context

At 30th November 2016, the Council held £336.2M of borrowing and £24.4M of investments. This is set out in further detail at *Schedule 2.* Forecast changes in these sums are shown in the balance sheet analysis in Table 1 below.

Table 1: Balance Sheet Summary and Forecast

	31/3/16 Actual £M	**31/3/17 Estimate £M**	**31/3/18 Estimate £M**	**31/3/19 Estimate £M**	**31/3/20 Estimate £M**
General Fund CFR	310.8	347.4	377.8	402.0	414.6
HRA CFR	165.0	165.0	163.5	162.0	159.1
Total CFR	**475.8**	**512.4**	**541.3**	**564.0**	**573.7**
Less: Other long-term liabilities *	(15.7)	(17.7)	(17.2)	(16.5)	(15.9)
Borrowing CFR	**460.1**	**494.7**	**524.1**	**547.5**	**557.8**
Less: External borrowing **	338.1	275.6	275.6	275.6	275.6
Internal (over) borrowing	**122.0**	**219.1**	**248.5**	**271.9**	**282.2**
Less: Usable reserves	85.6	88.7	92.7	90.4	79.4
Less: Working capital	36.4	25.0	25.0	25.0	25.0
New borrowing ***	**0.0**	**(105.4)**	**(130.8)**	**(156.5)**	**(177.8)**

* PFI liabilities that form part of the Council's debt which includes an upward restatement in 2016/17

** shows only loans to which the Council is committed and excludes optional refinancing

*** Forecast borrowing is based on the full Capital Programme being achieved.

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. However, usable reserves include schools balances, those specific to the Housing Revenue Account (HRA) and other earmarked reserves. The usable General Fund reserves balance as at 31st March 2016 was £15.5M.

The Council has an increasing CFR due to the Capital Programme and continues to adhere to its long-standing strategy of holding low cash balances to reduce investment counterparty risk and contain its borrowing costs by utilising cash balances in lieu of borrowing externally. The Balance Sheet summary in Table 1 shows that the Council's extent of internal borrowing was £122.0M as at 31st March 2016. The Council uses internal resources in lieu of borrowing to the full extent as this has continued to be the most cost effective means of funding capital expenditure.

CIPFA's *Prudential Code for Capital Finance in Local Authorities (2011 Edition)* recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Council expects to comply with this recommendation during 2017/18.

Following the external audit of the 2015/16 accounts the longstanding model used to calculate PFI contract related entries within the Council's accounts was restated. As reported to the 26th September 2016 Audit Committee agenda item 8, the PFI financial liability (short and long term) disclosed in the accounts of £15.733M has been understated by £1.929M and the unusable Capital Adjustment Account Reserve of £550.790M has been overstated by the same amount. There is no financial impact on either the Council's General Fund or the two academy schools who use the PFI funded facilities. The difference has not been adjusted on the grounds that the change would not materially impact on the presentation of the Council's financial position at 31st March 2016 and that the adjustment will be made in the year ended 31st March 2017.

Borrowing Strategy

At 30th November 2016, the Council held external borrowing of £336.2M. The Balance Sheet forecast in Table 1 shows that it is estimated that net borrowing will increase by £34.6M in 2016/17 (new gross borrowing of £41.2M less £6.6M refinancing of maturing existing borrowing) to finance its Capital Programme.

The primary objective when borrowing money is to strike an appropriate balance between securing low interest costs and achieving cost certainty 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.

Given the significant reductions in public expenditure and in particular local government funding, the 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 fixed rate 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 and short term fixed rate loan finance will be monitored regularly against the potential for incurring additional costs when long term borrowing rates are forecast to rise modestly. Arlingclose will assist with this ‘cost of carry’ calculation and breakeven analysis. The output may determine whether the Council considers borrowing 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.

In addition, the Council may take out short term fixed rate loans (normally for up to one to six months) to cover unexpected cash flow shortages.

The approved sources of long term and short term borrowing are:

- the PWLB
- UK local authorities, police and fire authorities
- 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
- special purpose companies created to enable joint local authority bond issues
- capital market bond investors.

The Council and its predecessors raised the majority of the long term borrowing from the PWLB. The Council plans to maintain minimal cash levels for operational purposes to minimise investment counterparty risk and source its borrowing needs from other UK local authorities, police and fire authorities on a short term rolling basis. This strategy is expected to achieve significant revenue cost savings over the more traditional route of long term fixed rate borrowing from the PWLB.

The revenue implications of the Capital Programme over 2017/18 to 2020/21 have been calculated on the assumption that most new borrowing will be taken on a short term fixed rate basis taking advantage of current low levels of interest rates. This borrowing strategy assumes that interest rates will continue to remain low for longer than previously envisaged, in line with advice from Arlingclose who do not expect the Bank of England to raise its Base Rate from its current level of 0.25% over the next three years. However, the Council will continue to monitor long term rates with a view to fixing a portion of its borrowing if rates are favourable.

There is a risk that interest rates may increase or be higher than current rates when it comes to refinancing debt taken out on a short term basis. This would lead to higher revenue implications arising from the draft Capital Programme over the longer term, beyond the current Medium Term Financial Plan (MTFP) period. However, interest rate risk is preferable to credit risk which is minimised through the use of short term fixed rate borrowing to enable the Council to maintain minimal operational cash balances.

The Council holds £13.5M 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. All 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 low cost if it has the opportunity to do so.

Short term fixed rate and variable rate loans leave the Council exposed to the risk of short term interest rate rises and are therefore subject to the limits on the 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. Some bank lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some loans with new loans, where this is expected to lead to an overall saving or a reduction in risk.

Investment Strategy

At 30th November 2016, the Council held £24.4M of invested funds, (excludes an external investment in the Aviva Investors' Lime Property Fund Unit Trust valued at £5.3M as at 30th November 2016). Over the past 12 months, the investment balance which is determined by reference to the Council's day-to-day cash flow requirements has ranged between £2M and £36M. The Council plans to maintain minimum cash levels for operational purposes in the forthcoming year.

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 of receiving unsuitably low investment income.

If the UK enters into a recession in 2017/18, there is a small chance that the Bank of England could set its Base 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.

Given the increasing risk and continued low returns from short-term unsecured bank deposits, the Council aims to effectively manage this risk by maintaining minimum cash levels for operational purposes and diversifying investments between several counterparties to mitigate the impact of any bail-in of unsecured investments. Local authority investments in bank call/notice accounts, deposits and Money Market Funds (MMFs) are unsecured investments.

The Council may invest its surplus funds with any of the counterparties in Table 2 below:

Table 2: Approved Investment Counterparties

<table>
<tr><th colspan="2">Counterparty</th></tr>
<tr><td rowspan="8">Banks and other organisations and securities whose lowest published long-term credit rating from Fitch, Moody’s and Standard & Poor’s is:</td><td>AAA</td></tr>
<tr><td>AA+</td></tr>
<tr><td>AA</td></tr>
<tr><td>AA-</td></tr>
<tr><td>A+</td></tr>
<tr><td>A</td></tr>
<tr><td>A-</td></tr>
<tr><td>BBB+</td></tr>
<tr><td colspan="2">UK Central Government (irrespective of credit rating)</td></tr>
<tr><td colspan="2">UK Local Authorities, Police and Fire Authorities (irrespective of credit rating)</td></tr>
<tr><td colspan="2">Money market funds and other pooled funds</td></tr>
</table>

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

Current Account Bank: The Council's current accounts are held with NatWest which is currently rated at the minimum BBB+ (or Moody's equivalent of Baa1) rating in Table 2. Should the credit ratings fall below BBB+, the Council may continue to deposit surplus operational cash with NatWest providing that the cash can be withdrawn on the next working day, and that the bank maintains a credit rating no lower than BBB- (or Moody's equivalent of Baa3) which is the lowest investment grade rating.

Registered Providers: Formerly known as Housing Associations, Registered Providers of Social Housing are tightly regulated by the Homes and Communities Agency and retain the likelihood of receiving Government support if needed. The Council will consider investing with unrated Registered Providers with adequate credit safeguards, subject to receiving independent advice.

Money Market Funds: These funds are pooled investment vehicles consisting of money market deposits and similar instruments. They have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager. Funds that offer same-day liquidity and aim for a constant net asset value will be used as an alternative to instant access bank accounts.

Other Pooled Funds: These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. They offer enhanced returns over the longer term, but are potentially more volatile in the shorter term, and their performance and continued suitability in meeting the Council's investment objectives need be monitored regularly. The Council has one pooled fund, investing in UK commercial property, inherited from one of the legacy councils (the "Lime Fund"). This investment is monitored regularly with our treasury management adviser, Arlingclose, and continues to meet the Council's investment objectives. There are no plans currently to invest further in pooled funds.

Other Organisations: The Council may also invest cash with other organisations, for example by making loans to small businesses. Because of the higher perceived risk of unrated businesses, such investments may provide considerably higher rates of return. They will however only be made following a favourable external credit assessment and on the specific advice of the Council's treasury management adviser, Arlingclose.

Risk Assessment and Credit Ratings: The Council uses long-term credit ratings from the three main rating agencies Fitch Ratings, Moody’s Investors Service and Standard & Poor’s Financial Services to assess the risk of investment default. The lowest available counterparty credit rating will be used to determine credit quality, unless an investment-specific rating is available. Credit ratings are obtained and monitored by the Council’s treasury adviser, Arlingclose, 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; and
- 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 BBB+ 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 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 authority, police or fire authority, 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.

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. Non-specified investments will therefore include the existing investment in the Lime Fund and 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 of high credit quality. Limits on non-specified investments are shown in Table 3 below.

Table 3: Non-Specified Investment Limits

	Cash limit
Total long term investments	£10M
Total investments without credit ratings or rated below A-	£10M
Total investments (except MMFs and other pooled funds) in foreign countries rated below AA+ by individual country	£10M

Investment Limits: The Council's general revenue reserves available to cover investment losses are forecast to be £15.5M on 31st March 2017. In order that no more than £7M 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 £7M. A group of banks under the same ownership will be treated as a single organisation for limit purposes.

Table 4: Investment Limits

	Cash limit
Any single organisation, except the UK Central Government	£7M each
UK Central Government (irrespective of credit rating)	unlimited
UK Local Authorities, Police and Fire Authorities (irrespective of credit rating)	unlimited
Any group of organisations under the same ownership	£7M per group
Any group of pooled funds under the same management	£10M per manger
Negotiable instruments held in a broker's nominee account	£10M per broker
Foreign countries	£10M per country
Registered Providers	£10M in total
Unsecured investments with Building Societies	£10M in total
Loans to small businesses	£10M in total
Money Market Funds	70% in total

Liquidity management: Cash flow forecasting is used to determine the maximum period for which funds may prudently be committed. Limits on long term investments are set by reference to the Council's Medium Term Financial Plan and cash flow forecast.

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

Table 5: Limits on Fixed and Variable Rate Exposures

	Actual fixed and variable rate borrowing as at 30/11/2016 %	**2016/17 %**	**2017/18 %**	**2018/19 %**	**2019/20 %**
Upper limit on fixed rate exposure	69	100	100	100	100
Upper limit for variable rate exposure	31	50	50	50	50

The Council is exposed to risk in terms of its exposure to interest rate movements on its borrowings and investments. Movements in interest rates have a complex impact on the Council. For example, a rise in interest rates would increase the revenue cost of borrowings at variable rates. The Council has a number of strategies for managing interest rate risk and aims to keep a maximum of 50% of its borrowings in variable rate loans during 2017/18.

Maturity 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:

	Actual Fixed Rate Borrowing as at 30/11/2016 %	Upper Limit %	Lower Limit %
Under 12 months	6	20	0
12 months - 24 months	0	20	0
24 months - 5 years	0	60	0
5 years - 10 years	14	100	0
10 years - 20 years	53	100	0
20 years - 30 years	0	100	0
30 years - 40 years	20	100	0
40 years - 50 years	7	100	0
50 years and above	0	100	0

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment, e.g., LOBO option dates (on which the lender can require payment) are treated as potential repayment dates.

Principal Sums Invested for Periods Longer than 364 days: The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end will be:

	2017/18	2018/19	2019/20
Limit on principal invested beyond year end	£10M	£10M	£10M

Other Items

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

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, 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: The Council has adopted a two pooled approach and all the costs/income arising from long-term loans (e.g., premiums and discounts on early redemption) will be either charged from or 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 and interest transferred between the General Fund and HRA based on a "risk free" rate sourced from HM Treasury's Debt Management Account Deposit Facility (DMADF).

Investment Training: The needs of the Council's treasury management staff for training in investment management are assessed regularly as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.

Staff regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA, the Association of Corporate Treasurers and other appropriate organisations.

Investment Advisers: Arlingclose is the appointed treasury management advisers providing 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 for 2017/18 of £578.2M. 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.

Other Options Considered

The CLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Director of Resources, having consulted the Executive Member for Corporate Resources, 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. Unable to deliver the full Capital Programme.	Reduced investment balance leading to a lower impact in the event of a default; however long term interest costs may be less certain

Schedule 1 – 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 (1.6% in the year to December 2016) will continue, breaching the Bank of England's 2.0% 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 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 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. Arlingclose expect the Bank of England Base 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. Arlingclose expect 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**

Schedule 2 – Existing Investment & Debt Portfolio Position

	30/11/16 **Actual Portfolio** **£M**
External Borrowing:	
PWLB – Fixed Rate	217.1
PWLB – Variable Rate	51.6
LOBO Loans	13.5
Local Government Loans	54.0
Total External Borrowing	**336.2**
Other Long Term Liabilities:	
PFI	18.0
Total Gross External Debt	**354.2**
Investments:	
Managed in-house	
Short-term investments	24.4
Pooled Funds *(Lime Fund)*	5.3
Total Investments	**29.7**
Net Debt	**324.5**