# Policy Committee – 2nd February 2021

## 2021/22 Treasury Management Strategy Statement, Minimum Revenue Provision Statement, and Annual Investment Strategy

Report of the Chief Finance Officer (s151 officer)

Lead Member – Financial Resilience: Councillor Mulligan

Ward(s) affected: All

**1. Purpose of Report**

1.1 This report presents for approval the proposed Treasury Management Strategy together with the Minimum Revenue Provision Statement, Prudential Indicators and the Annual Investment Strategy for 2021/22 as required by the Department of Communities and Local Government and CIPFA.

**2. Recommendations**

**2.1** It is recommended to Council that:

- The Operational Boundary for 2021/22 is set at £12.5m
- The Authorised Limits for 2021/22 is set at £15.00m
- Councillors delegate authority to the Chief Finance Officer (s151 Officer) to effect movement within the agreed operational boundary and authorised limits for long-term borrowing for 2021/22 onwards.
- The Treasury Management Strategy Statement 2021/22, incorporating the Minimum Revenue Position Policy Statement and the Annual Investment Strategy, is approved.
- The prudential indicators for 2021/22, which reflect that the capital expenditure plans are affordable, prudent and sustainable, be approved.

**3. Background Information**

**3.1** The Council's Obligations

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

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

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

CIPFA defines treasury management as:
"The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

This authority has not engaged in any commercial investments and has no non-treasury investments.

## 3.2 Reporting Requirements

### 3.2.1 Capital Strategy

The CIPFA 2017 Prudential and Treasury Management Codes require all local authorities to prepare a capital strategy report which will provide the following:

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

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

### 3.2.2 Treasury Management reporting

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

1. Prudential and treasury indicators and treasury strategy (this report) - The first, and most important report is forward looking and covers:

- The capital plans, (including prudential indicators);
- A minimum revenue provision (MRP) policy, (how residual capital expenditure is

charged to revenue over time);
- The treasury management strategy, (how the investments and borrowings are to be organised), including treasury indicators; and
- An investment strategy, (the parameters on how investments are to be managed).

2. A mid-year treasury management report – This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision. If applicable. In addition, this Council will receive quarterly update reports.

3. An annual treasury report – This is a backward-looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

**3.3 Scrutiny**

The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Policy Committee.

**3.4 Training**

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. The training needs of treasury management officers are periodically reviewed. Training is provided by the council's treasury management consultants as required.

**3.5 Treasury Management Strategy for 2021/22**

The strategy for 2021/22 covers two main areas:

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

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

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

**3.6 Treasury management consultants**

The Council uses Link Group as its external treasury management advisors.

The Council recognises that responsibility for treasury management decisions always remains with the organisation and will ensure that undue reliance is not placed upon our external service providers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented and subjected to regular review.

**4. Financial and Value for Money Implications**

Approved counterparties, investment vehicles, lending limits and prudential indicators are reviewed periodically to enable the Council to take full advantage of investment opportunities while maintaining a sufficient level of security of capital, and to help make informed decisions with regard to borrowing requirements.

**5. Legal implications**

The council is required to report its treasury management position during the year in compliance with the CIPFA code.

**6.1 Contribution to Council Priorities**

The Treasury Management function does not contribute directly to the Council's Corporate Priorities albeit the delivery of the Treasury Management Strategy supports the Council's budget strategy which in turn is a fundamental element of the Council's service and financial planning approach to achievement of the Council Plan.

**6.2 Impact on the declared Climate Emergency**

**7.1 Risk Management**

Approval of the Treasury Management Strategy enables the Council to comply with Government guidelines. It also contributes to its business and service objectives, and to the effective management of the risks associated with Treasury Management activities.

**7.2 Chief Finance Officer (s151 Officer) Statement**

**7.3 Monitoring Officer Statement**

**8. Equality Impact Assessment**

The Council's Equality Impact Assessment Procedure has been followed. An Equality Impact Assessment has not been completed on the proposals as completion of Stage 1- Initial Screening of the Procedure identified that the proposed policy, strategy, procedure or function does not have the potential to cause negative impact or discriminate against different groups in the community based on •age • disability •gender • race/ethnicity • religion or religious belief (faith) •sexual orientation, or • rural isolation.

**9. <u>Consultations with Others</u>**

None

**10. <u>Access to Information: Background Documents</u>**

Working papers held in Financial Services.

**11. <u>Author of the Report</u>**

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**12. <u>Appendices</u>**

Appendix A – Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management
Appendix B – Approved Countries for Investments
Appendix C – Treasury Management Scheme of Delegation
Appendix D – Economic Background

**Treasury Management Strategy Statement**

## 1. Introduction

The strategy statement comprises:

- Capital prudential indicators and MRP statement 2021-2024
- Borrowing policy and strategy
- Annual investment strategy
- Treasury Indicators

## 2. CAPITAL PRUDENTIAL INDICATORS 2021/22 – 2023/24

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators which are designed to assist members' overview and confirm capital expenditure plans.

### 2.1 Capital Expenditure

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators which are designed to assist members' overview and confirm capital expenditure plans.

Table 1 Capital expenditure

| Capital Expenditure | 2019/20 Actual £'000 | 2020/21 Estimate £'000 | 2021/22 Estimate £'000 | 2022/23 Estimate £'000 | 2023/24 Estimate £'000 |
|---|---|---|---|---|---|
| **Total** | **3,622** | **10,006** | **4,830** | **1,705** | **977** |

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

Table 2 How capital expenditure is to be financed

| Financing of Capital Expenditure | 2019/20 Actual £'000 | 2020/21 Estimate £'000 | 2021/22 Estimate £'000 | 2022/23 Estimate £'000 | 2023/24 Estimate £'000 |
|---|---|---|---|---|---|
| Capital receipts/grants | 2,763 | 3,745 | 1,802 | 557 | 557 |
| Earmarked reserves | 0 | 1,567 | 428 | 445 | 420 |
| Revenue | 368 | 0 | 0 | 0 | 0 |
| **Net financing need for the year** | **491** | **4,694** | **2,600** | **703** | **0** |

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

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each asset's life.

The Council is asked to approve the CFR projection below:

Table 3 Capital Financing Requirement

| | 2019/20 Actual £'000 | 2020/21 Estimate £'000 | 2021/22 Estimate £'000 | 2022/23 Estimate £'000 | 2023/24 Estimate £'000 |
|---|---|---|---|---|---|
| **Capital Financing Requirement** | | | | | |
| **Total CFR** | **6,462** | **6,865** | **11,470** | **13,876** | **14,332** |
| **Movement in CFR** | **403** | **4,605** | **2,406** | **456** | **(295)** |
| **Movement in CFR represented by** | | | | | |
| Net financing need for the year (above) | 491 | 4,694 | 2,600 | 703 | 0 |
| Less MRP/VRP and other financing movements | (88) | (89) | (194) | (247) | (295) |
| **Movement in CFR** | **403** | **4,605** | **2,406** | **456** | **(295)** |

## 2.3 Core Funds and Expected Investment Balances

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales, etc.). Table 4 below shows estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Table 4 Year end resource

| Year End Resources | 2019/20 Actual £'000 | 2020/21 Estimate £'000 | 2021/22 Estimate £'000 | 2022/23 Estimate £'000 | 2023/23 Estimate £'000 |
|---|---|---|---|---|---|
| General Fund balances and reserves | 7,715 | 6,353 | 6,235 | 5,973 | 5,961 |
| Capital receipts | 2,472 | 3,745 | 1,802 | 577 | 577 |
| Provisions | 0 | 0 | 0 | 0 | 0 |
| Other | 420 | 906 | 906 | 906 | 906 |
| **Total core funds** | **10,607** | **11,004** | **8,943** | **7,456** | **7,444** |
| Working capital* | 9,144 | 7,458 | 9,458 | 11,458 | 11,000 |
| **Expected investments** | **10,000** | **8,500** | **7,500** | **10,000** | **10,000** |

*Working capital balances shown are estimated year end; these may be higher mid-year.

**2.4** Minimum Revenue Provision (MRP) Policy Statement.

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

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

For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, MRP will be provided over a 50-year period on an annuity basis. The annuity method considers the time value of money and tries to ensure each year’s payment is consistent in real terms.

From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will make a provision based on the estimated life of the assets, in accordance with the regulations. This option provides for a reduction in the borrowing need over approximately the asset’s life.

## 3. Borrowing

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

**3.1** Current portfolio position

The overall treasury management portfolio as at 31st March 2020 and for the position as at 31st of December 2020 are shown below for investments and borrowing.

Table 5 Treasury portfolio

| **Treasury Portfolio** | | | | |
|---|---|---|---|---|
| | Actual | Actual | Current | Current |
| **Treasury Investments** | 31.03.20 | 31.03.20 | 31.12.20 | 31.12.20 |
| | £000 | % | £000 | % |
| Banks (incl current account) | 4,145 | 29.30 | 3,833 | 15.13 |
| Building societies – unrated | 3,000 | 21.21 | 1,000 | 3.95 |
| Building societies – rated | 3,000 | 21.21 | 2,000 | 7.89 |
| Local Authorities | 2,000 | 14.14 | 6,000 | 23.68 |
| Money market fund | 0 | 0.00 | 9,000 | 35.53 |
| Other | 2,000 | 14.14 | 3,500 | 13.82 |

| | | | | |
|---|---|---|---|---|
| **Total treasury investments** | 14,145 | 100 | 25,333 | 100 |
| | | | | |
| **Treasury external borrowing** | | | | |
| PWLB | 5,988 | 100 | 5,988 | 100 |
| **Total external borrowing** | **5,988** | **100** | **5,988** | **100** |
| **Net treasury investments/(borrowing)** | **8,157** | | **20,705** | |

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

Table 6 External debt

| | **2019/20 Actual £'000** | **2020/21 Estimate £'000** | **2021/22 Estimate £'000** | **2022/23 Estimate £'000** | **2023/24 Estimate £'000** |
|---|---|---|---|---|---|
| **External Debt** | | | | | |
| Debt at 1 April | 5,988 | 5,988 | 10,682 | 12,782 | 13,485 |
| Expected change in Debt | 0 | 4,694 | 2,100 | 703 | (500) |
| Actual gross debt at 31 March | **5,988** | **10,682** | **12,782** | **13,485** | **12,985** |
| The Capital Financing Requirement | **6,865** | **11,470** | **13,876** | **14,332** | **14,037** |
| Under / (over) borrowing | **877** | **788** | **1,094** | **847** | **1,052** |

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2020/21 and the following two financial years. This allows some flexibility for limited early borrowing for future years but ensures that borrowing is not undertaken for revenue or speculative purposes.

The Chief Finance Officer reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

### 3.2 Treasury indicators: limits to borrowing activity

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

Table 7 Operational boundary for external debt

| | 2020/21 Estimate | 2021/22 Estimate | 2022/23 Estimate | 2023/24 Estimate |
|---|---|---|---|---|
| **Operational boundary £m** | 12.5 | 14.0 | 15.0 | 15.0 |

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

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

Table 8 Authorised limit for external debt

| | 2020/21 Estimate | 2021/22 Estimate | 2022/23 Estimate | 2023/24 Estimate |
|---|---|---|---|---|
| **Authorised limit £m** | 15.00 | 15.00 | 16.00 | 16.00 |

## 3.3 Prospects for interest rates

The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives our central view.

Table 9 Interest rate forecast

| Link Group Interest Rate View 9.11.20 | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| These Link forecasts have been amended for the reduction in PWLB margins by 1.0% from 26.11.20 | | | | | | | | | | | | | | |
| | Dec-20 | Mar-21 | Jun-21 | Sep-21 | Dec-21 | Mar-22 | Jun-22 | Sep-22 | Dec-22 | Mar-23 | Jun-23 | Sep-23 | Dec-23 | Mar-24 |
| BANK RATE | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 |
| 3 month ave earnings | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 |
| 6 month ave earnings | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 |
| 12 month ave earnings | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 |
| 5 yr PWLB | 0.80 | 0.80 | 0.80 | 0.80 | 0.80 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 1.00 | 1.00 | 1.00 | 1.00 |
| 10 yr PWLB | 1.10 | 1.10 | 1.10 | 1.10 | 1.10 | 1.20 | 1.20 | 1.20 | 1.20 | 1.20 | 1.30 | 1.30 | 1.30 | 1.30 |
| 25 yr PWLB | 1.50 | 1.50 | 1.60 | 1.60 | 1.60 | 1.60 | 1.70 | 1.70 | 1.70 | 1.70 | 1.80 | 1.80 | 1.80 | 1.80 |
| 50 yr PWLB | 1.30 | 1.30 | 1.40 | 1.40 | 1.40 | 1.40 | 1.50 | 1.50 | 1.50 | 1.50 | 1.60 | 1.60 | 1.60 | 1.60 |

The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its subsequent meetings to 5th November, although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected in the forecast table above as economic recovery is expected to be only gradual and, therefore, prolonged.

As the interest forecast table for PWLB certainty rates above shows, there is expected to be little upward movement in PWLB rates over the next two years as it will take economies, including the UK, a prolonged period to recover all the momentum they have lost in the sharp recession caused during the coronavirus shut down period. From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment, (as shown on 9th November when the first results of a successful COVID-19 vaccine trial were announced). Such volatility could occur at any time during the forecast period.

**Investment and borrowing rates**

- Investment returns are likely to remain exceptionally low during 2021/22 with little increase in the following two years.
- On 25.11.20, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates; the standard and certainty margins were reduced by 1% but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three year capital programme. The new margins over gilt yields are as follows:
    - **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
    - **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)
    - **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
    - **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
    - **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)
- Borrowing for capital expenditure. As Link's long-term forecast for Bank Rate is 2.00%, and all PWLB rates are under 2.00%, there is now value in borrowing from the PWLB for all types of capital expenditure for all maturity periods, especially as current rates are at historic lows. However, greater value can be obtained in borrowing for shorter maturity periods so the Council will assess its risk appetite in conjunction with budgetary pressures to reduce total interest costs. Longer-term borrowing could also be undertaken to look down lending at a low rate.
- While this authority will not be able to avoid borrowing to finance new capital expenditure and to replace maturing debt, there will be a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

## 3.4 Borrowing Strategy

The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need, (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered. As the CFR grows and brings an increased borrowing requirement, this position may change over time and will be kept under review.

Against this background and the risks within the economic forecast, caution will be adopted with the 2021/22 treasury operations. The Chief Finance Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *if it was felt that there was a significant risk of a sharp FALL in borrowing rates,* then borrowing will be postponed.

- *if it was felt that there was a significant risk of a much sharper RISE in borrowing rates than that currently forecast,* perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity, or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

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

### 3.5 Policy on borrowing in advance of need

The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

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

### 3.6 Debt rescheduling

Rescheduling of current borrowing in our debt portfolio is unlikely to occur as the 100-bps increase in PWLB rates only applied to new borrowing rates and not to premature debt repayment rates.

If rescheduling was done it will be reported to the council at the earliest meeting following its action.

## 4. Annual Investment Strategy

### 4.1 Investment policy

The Council’s investment policy has regard to the following:

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

The Council’s investment priorities will be security first, portfolio liquidity second and then yield, (return). In accordance with the above guidance from MHCLG and CIPFA and in order to minimise the risk to investments, the council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long-Term ratings.

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

Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.
Investment instruments identified for use in the financial year are listed in appendix B under the ‘specified’ and ‘non-specified’ investments categories. Counterparty limits will be as set through the Council’s treasury management practices.

This authority will also pursue value for money in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see paragraph 4.5). Regular monitoring of investment performance will be carried out during the year.

**4.2 Creditworthiness Policy**

The primary principle governing the Council’s investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and
- It has sufficient liquidity in its investments. For this purpose, it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council’s prudential indicators covering the maximum principal sums invested.

The Chief Finance Officer will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary.

Credit rating information is supplied by Link Asset Services, our treasury advisors, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating Watches (notification of a likely change), rating Outlooks (notification of the longer-term bias outside the central rating view) are provided to officers almost immediately after they occur, and this information is considered before dealing.

The criteria for providing a pool of high-quality investment counterparties, (both specified and non-specified investments) is:

- Banks 1 – good credit quality:

  i) UK banks;

  ii) Non-UK and domiciled in a country which has a minimum sovereign rating of AAA

  and have, as a minimum, the following Fitch, Moodys and Standard and Poors credit ratings (where rated):

  i) Long term A-

- Banks 2 - Part nationalised UK bank – Royal Bank of Scotland. This bank can be included provided it continues to be part nationalised or it meets the ratings in Banks 1 above.

- Banks 3 - The Council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time invested.

- Bank subsidiary and treasury operation - The Council will use these where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above.

- Building Societies and challenger banks – The Council will use all institutions which

  i) Meet the ratings for banks outlined above, or

  ii) Have a minimum asset holding of £1bn

- Money market and other pooled funds which are rated AAA

- UK Government (including gilts and DMADF)

- Local Authorities, parish councils, etc

- Ultra-Short Dated Bond Funds

- Housing associations

- Supranational institutions

- Other organisations which pass creditworthiness tests

**Use of additional information other than credit ratings**
Additional requirements under the Code require the Council to supplement credit rating information. Whilst the above criteria rely primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional

operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, rating Watches/Outlooks) will be applied to compare the relative security of differing investment opportunities.

Time and monetary limits applying to investments. The time and monetary limits for institutions on the Council's counterparty list are as follows (these will cover both specified and non-specified investments):

Table 10 Time and monetary limits applying to investments

| | Fitch Long term Rating (or equivalent) | Money and/or % Limit | Time Limit |
|---|---|---|---|
| Banks 1 | AAA to A- | £2m / 20% | 5 yrs |
| Banks 2 – part nationalised | N/A | £2m / 20% | 2 yrs |
| Banks 3 – Council's banker (not meeting Banks 1) | N/A | £3m | 3 yrs |
| Other institutions limit | - | £1m / 10% | 1 yr |
| DMADF | AA | unlimited | 6 months |
| UK government, local authorities & other public bodies | N/A | £2m | 5 yrs |
| UK Registered Social Landlords | A- | £2m | 5 yrs |
| | Fund rating | Money and/or % Limit | Time Limit |
| Money market funds | AAA | £2m / 20% | liquid |
| Short Duration Managed Funds | AAA | £2m / 20% | liquid |

**Creditworthiness**

Although the credit rating agencies changed their outlook on many UK banks from Stable to Negative during the quarter ended 30.6.20 due to upcoming risks to banks' earnings and asset quality during the economic downturn caused by the pandemic, the majority of ratings were affirmed due to the continuing strong credit profiles of major financial institutions, including UK banks. However, during Q1 and Q2 2020, banks made provisions for expected credit losses and the rating changes reflected these provisions. As we move into future quarters, more information will emerge on actual levels of credit losses. (Quarterly earnings reports are normally announced in the second half of the month following the end of the quarter.)

This has the potential to cause rating agencies to revisit their initial rating adjustments earlier in the current year. These adjustments could be negative or positive, although it should also be borne in mind that banks went into this pandemic with strong balance sheets. This is predominantly a result of regulatory changes imposed on banks following the Great Financial Crisis. Indeed, the Financial Policy Committee (FPC) report on 6th August revised down their expected credit losses for the UK banking sector to "somewhat less than £80bn". It stated that in its assessment, "banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC's central projection". The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC's projection, with unemployment rising to above 15%.

**4.3 Other limits**

Due care will be taken to consider the exposure of the Council's total investment portfolio to non-specified investments, countries, groups and sectors.

Country limit. The Council has determined that it will only use approved counterparties from the UK and from countries with a minimum sovereign credit rating of AA-, and have banks operating in sterling markets. The list of countries that qualify using these credit criteria as at the date of this report are shown in Appendix B. This list will be added to, or deducted from, should ratings change in accordance with this policy.

**4.4 Investment strategy**

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

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

**Investment returns expectations**

Bank Rate is unlikely to rise from 0.10% for a considerable period. It is very difficult to say when it may start rising so it may be best to assume that investment earnings from money market-related instruments will be sub 0.50% for the foreseeable future.

The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows (the long-term forecast is for periods over 10 years in the future):

| Average earnings in each year | |
|---|---|
| 2020/21 | 0.10% |
| 2021/22 | 0.10% |
| 2022/23 | 0.10% |
| 2023/24 | 0.10% |
| 2024/25 | 0.25% |
| Long term later years | 2.00% |

- The overall balance of risks to economic growth in the UK is probably now skewed to the upside but is subject to major uncertainty due to the virus and how quickly successful vaccines may become available and widely administered to the population. It may also be affected by what, if any, deal the UK agrees as part of Brexit.
- There is relatively little UK domestic risk of increases or decreases in Bank Rate and significant changes in shorter term PWLB rates. The Bank of England has effectively ruled out the use of negative interest rates in the near term and increases in Bank Rate are likely to be some years away given the underlying economic expectations. However, it is always possible that safe haven flows, due to unexpected domestic developments and those in other major economies, or a return of investor confidence in equities, could impact gilt yields, (and so PWLB rates), in the UK.

**Negative investment rates**
While the Bank of England said in August / September 2020 that it is unlikely to introduce a negative Bank Rate, at least in the next 6 -12 months, and in November omitted any mention of negative rates in the minutes of the meeting of the Monetary Policy Committee, some deposit accounts are already offering negative rates for shorter periods. As part of the response to the pandemic and lockdown, the Bank and the Government have provided financial markets and businesses with plentiful access to credit, either directly or through commercial banks. In addition, the Government has provided large sums of grants to local authorities to help deal with the COVID crisis; this has caused some local authorities to have sudden large increases in cash balances searching for an investment home, some of which was only very short term until those sums were able to be passed on.

**Investment treasury indicator and limit** - Total principal funds invested for greater than 365 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment and are based on the availability of funds after each year-end.

The Council is asked to approve the following treasury indicator and limit:

Table 11 Maximum sums to invest for longer than 365 days

| **Maximum principal sums invested for longer than 365 days** | | | |
|---|---|---|---|
| | **2021/22** | **2022/23** | **2023/24** |
| Principal sums invested for longer than 365 days | £5.0m | £5.0m | £5.0m |

**4.5 Investment performance / risk benchmarking**
This Council will use an investment benchmark to assess the investment performance of its investment portfolio of 3-month LIBID uncompounded. The Council is appreciative that the provision of LIBOR and associated LIBID rates is expected to cease at the end of 2021. It will work with its advisors in determining suitable replacement investment benchmark(s) ahead of this cessation and will report back to members accordingly.

**4.6 End of Year Investment Report**

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

## 5. Treasury indicators 2021/22-2023/24

**5.1 Affordability Prudential Indicators**

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

**Ratio of financing costs to net revenue stream**

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

Table 12 Ratio of financing costs to net revenue stream

| % | 2019/20 Actual £'000 | 2020/21 Estimate £'000 | 2021/22 Estimate £'000 | 2022/23 Estimate £'000 | 2023/24 Estimate £'000 |
|---|---|---|---|---|---|
| Ratio | 2.38 | 3.28 | 5.71 | 6.25 | 5.55 |

**5.2 Maturity structure of borrowing**

Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing and are required for upper and lower limits.

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

Table 13 Maturity structure of debt

| Interest rate exposures | 2021/22 | 2022/23 | 2023/24 |
|---|---|---|---|
| | Upper | Upper | Upper |
| Limits on variable interest rates based on debt | 30% | 30% | 30% |
| Limits on fixed interest rates based on debt | 100% | 100% | 100% |

| Maturity structure of fixed interest rate borrowing 2021/22 | | |
|---|---|---|
| | Lower | Upper |
| Under 12 months | 0% | 8.35% |
| 12 months to 2 years | 0% | 0% |
| 2 years to 5 years | 0% | 8.35% |
| 5 years to 10 years | 0% | 11.69% |
| 10 years to 25 years | 0% | 0% |

| | | |
|---|---|---|
| Over 25 years | 0% | 71.96% |
| | | |
| **Maturity structure of variable interest rate borrowing 2021/22** | | |
| | Lower | Upper |
| Under 12 months | 0% | 0% |
| 12 months to 2 years | 0% | 0% |
| 2 years to 5 years | 0% | 0% |
| 5 years to 10 years | 0% | 0% |
| 10 years to 25 years | 0% | 0% |
| Over 25 years | 0% | 0% |

**Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management**

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

The key intention of the Guidance is to maintain the current requirement for councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective, the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. This Council adopted the Code on 27/03/2012 and will apply its principles to all investment activity. In accordance with the Code, the Chief Finance Officer has produced its treasury management practices (TMPs). This part, TMP1(1), covering investment counterparty policy requires approval each year.

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

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

The investment policy proposed for the Council is:

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

Specified investments – These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. They also include investments which were originally classed as being non-specified investments, but which would have been classified as specified investments apart from originally being for a period longer than 12 months, once the remaining period to maturity falls to under twelve months. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

1. The UK Government (such as the Debt Management Account deposit facility, UK treasury bills or a gilt with less than one year to maturity).
2. Supranational bonds of less than one year's duration.

3. A local authority, parish council or community council.
4. Pooled investment vehicles (such as money market funds and short duration managed funds) that have been awarded a high credit rating by a credit rating agency.
5. A body that is considered of a high credit quality (such as a bank or building society).

*For category 5 this covers bodies with a minimum Short-Term rating of F2 (or the equivalent) as rated by Fitch, Moody's and/or Standard and Poor's rating agencies.*

Within these bodies, and in accordance with the Code, the Council has set additional criteria to set the duration and amount of monies which will be invested in these bodies. These criteria are detailed in Section 4.

Non-specified investments –are any other type of investment (i.e. not defined as specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Non specified investments would include any investments with:

| | **Non-Specified Investment Category** | **Limit (£ or %)** |
|---|---|---|
| a. | **Supranational bonds greater than 1 year to maturity**<br><br>**(a) Multilateral development bank bonds** - These are bonds defined as an international financial institution having as one of its objects economic development, either generally or in any region of the world (e.g. European Reconstruction and Development Bank etc.).<br><br>**(b) A financial institution that is guaranteed by the United Kingdom Government** (e.g. National Rail, the Guaranteed Export Finance Company {GEFCO})<br><br>The security of interest and principal on maturity is on a par with the Government and so very secure. These bonds usually provide returns above equivalent gilt-edged securities. However, the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity. | <br><br>£1m or 10%<br><br><br><br><br><br>£2m or 20% |
| b. | **Gilt edged securities** with a maturity of greater than one year. These are Government bonds and so provide the highest security of interest and the repayment of principal on maturity. Similar to category (a) above, the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity. | £2m or 20% |
| c. | **The Council's own banker** if it fails to meet the basic credit criteria. In this instance balances will be minimised as far as is possible. | £3m or 30% |
| d. | **Building societies not meeting the basic security requirements under the specified investments**. The operation of some building societies does not require a credit rating, although in every other respect the security of the society would match similarly sized societies with ratings. | £1m or 10% |

| | | |
|---|---|---|
| | The Council may use such building societies which have a minimum asset size of £1bn. | |
| e. | Any **bank or building society** that has a minimum long-term credit rating of BBB+ for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment). | £1m or 10% |
| f. | **Bond funds.** See note 1 below. | £2m or 20% |
| g. | **Pooled property funds** – The use of these instruments can be deemed to be capital expenditure, and as such will be an application (spending) of capital resources. This Authority will seek guidance on the status of any fund it may consider using. | £2m or 20% |

NOTE 1. This Authority will seek further advice on the appropriateness and associated risks with investments in these categories.

Within categories c and d, and in accordance with the Code, the Council has developed additional criteria to set the overall amount of monies which will be invested in these bodies. These criteria are a robust balance sheet, a supportive trading and credit history, and information published by the Prudential Regulation Authority, the Financial Conduct Authority, and the Bank of England.

**The monitoring of investment counterparties** - The credit rating of counterparties will be monitored regularly. The Council receives credit rating information (changes, rating watches and rating outlooks) from Link Asset Services as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Chief Finance Officer, and if required new counterparties which meet the criteria will be added to the list.

## Approved Countries for Investments

This list is based on those countries which have sovereign ratings of AA- or higher, (we show the lowest rating from Fitch, Moody's and S&P) and also, (except - at the time of writing - for Hong Kong, Norway and Luxembourg), have banks operating in sterling markets which have credit ratings of green or above in the Link Asset Services credit worthiness service.

Based on the lowest available rating:

AAA

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Finland
- U.S.A.

AA

- Abu Dhabi (UAE)
- Hong Kong
- France
- UK

AA-

- Belgium
- Qatar

## Treasury Management Scheme of Delegation

### (i) Full Council

- Receiving and reviewing reports on treasury management policies, practices and activities

- Approval of annual strategy

### (ii) Policy Committee

- Approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices

- Budget consideration and approval

- Approval of the division of responsibilities

- Receiving and reviewing regular monitoring reports and acting on recommendations

- Approving the selection of external service providers and agreeing terms of Appointment

### (iii) Audit and Governance Committee

- Reviewing the treasury management policy and procedures and making recommendations to the responsible body.

**Economic background**
The Bank Of England responded to the Coronavirus was to cut the bank rate to 0.10% and following the second lockdown that ended on the 2nd of December it announced a further tranche of quantitative easing (QE) of £150bn, to start in January when the current programme of £300bn of QE announced in March to June, runs out. It did this so that "announcing further asset purchases now should support the economy and help to ensure the unavoidable near-term slowdown in activity was not amplified by a tightening in monetary conditions that could slow the return of inflation to the target".

Its forecasts appeared, at the time, to be rather optimistic in terms of three areas:
- The economy would recover to reach its pre-pandemic level in Q1 2022.
- The Bank also expects there to be excess demand in the economy by Q4 2022.
- CPI inflation is therefore projected to be a bit above its 2% target by the start of 2023 and the "inflation risks were judged to be balanced".

Significantly, there was no mention of negative interest rates in the minutes or Monetary Policy Report, suggesting that the MPC remains some way from being persuaded of the case for such a policy, at least for the next 6 -12 months. However, rather than saying that it "stands ready to adjust monetary policy", the MPC this time said that it will take "whatever additional action was necessary to achieve its remit". The latter seems stronger and wider and may indicate the Bank's willingness to embrace new tools.

The BoE stated, "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably". That seems designed to say, in effect, that even if inflation rises to 2% in a couple of years' time, do not expect any action from the MPC to raise Bank Rate – until they can clearly see that level of inflation is going to be persistently above target if it takes no action to raise Bank Rate.

The MPC stated that downside risks could well include severe restrictions remaining in place in some form during the rest of December and most of January too. That has proved accurate with the current lockdown causing significant pressure and damage to businesses. This will mean that there will be some level of further permanent loss of economic activity, although the extension of the furlough scheme to the end of 31st March should mitigate the degree of damage done.

As for upside risks, markets have been waiting expectantly for positive news about the various COVID19 vaccines.
Effective vaccines would radically improve the economic outlook once they have been widely administered. While this would reduce the need for more QE and/or negative interest rates, increases in Bank Rate would remain some years away. There is also a potential question as to whether the relatively optimistic outlook of the Monetary Policy Report was swayed by making positive assumptions around effective vaccines being available too soon. It should also be borne in mind that as effective vaccines will take time to administer, economic news could well get worse before it starts getting better.

Public borrowing is now forecast by the Office for Budget Responsibility (the OBR) to reach £394bn in the current financial year, the highest ever peace time deficit and equivalent to 19% of GDP. In normal times, such an increase in total gilt issuance would lead to a rise in gilt yields, and so PWLB rates. However, the QE done by the Bank of England has depressed gilt yields to historic low levels, this means that new UK debt being issued, and this is being done across the whole yield curve in all maturities, is locking in those historic low levels through until maturity. In addition, the UK has one of the longest average maturities for its entire debt portfolio, of any country in the world. Overall, this means that the total interest bill paid by the Government is manageable despite the huge increase in the total amount of debt. The OBR was also forecasting that the government will still be running a budget deficit of £102bn (3.9% of GDP) by 2025/26. However, initial impressions are that they have taken a pessimistic view of the impact that vaccines could make in the speed of economic recovery.

World growth will be in recession this year. Inflation is unlikely to be a problem for some years due to the creation of excess production capacity and depressed demand caused by the coronavirus crisis.

Until recent years, world growth has been boosted by increasing globalisation i.e. countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last thirty years, which now accounts for nearly 20% of total world GDP, has unbalanced the world economy. However, recent trade policies and emerging re-balancing among some western economies suggest a move away from dependence on China and so there may be some reversal of globalisation in coming years.

This is regarded as being unfair competition that is putting western firms at an unfair disadvantage or even putting some out of business. It is also regarded with suspicion on the political front as China is an authoritarian country that is not averse to using economic and military power for political advantage. The current trade war between the US and China therefore needs to be seen against that backdrop. It is, therefore, likely that we are heading into a period where there will be a reversal of world globalisation and a decoupling of western countries from dependence on China to supply products. This is likely to produce a backdrop in the coming years of weak global growth and so weak inflation.

This may produce a backdrop in the coming years of weak global growth and so continuing weak inflation.