

# Treasury Management Strategy 2022/23 to 2025/26

For Consideration by Cabinet 8 February 2022

## 1 INTRODUCTION

### 1.1 Background

The Council is required to operate a balanced budget, which means broadly that income to be raised during the year will meet expenditure to be incurred, after allowing for any changes in reserves and balances. Part of the treasury management operation is to ensure that the associated 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 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.

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

The Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as:

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

## 1.2 Reporting Requirements

### Capital Strategy

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

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

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.

### Treasury Management Reporting

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

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

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

**A mid-year treasury management report** – This will update Members with the progress of the treasury position, amending prudential indicators as necessary, and whether any policies require revision.

**An annual treasury report** – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

**Scrutiny** - The above reports are required to be adequately considered and scrutinised before being presented to Council. This is undertaken by Cabinet and the Budget and Performance Panel.

## 1.3 Treasury Management Strategy for 2022/23

The strategy for 2022/22 covers two main areas:

### Capital Issues

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

## **Treasury Management Issues**

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

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

### **1.4 Training**

The CIPFA Code requires the responsible officer to ensure that Members with responsibility for treasury management receive adequate associated training. This especially applies to Members responsible for scrutiny. Further training will be arranged as required during the year. The training needs of treasury management Officers are periodically reviewed.

### **1.5 Treasury Management Consultants**

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

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.

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.

## **2 CAPITAL PRUDENTIAL INDICATORS 2021/22 – 2025/26**

The Council's capital expenditure plans are the key driver of treasury management activity. The plans are reflected in various prudential indicators, as determined under regulation, to assist Members in their overview of such capital expenditure planning.

### **2.1 Capital Expenditure**

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle.

The table below provides that summary, showing how the plans are being financed by capital or revenue resources. Any shortfall of resources results in an underlying borrowing or financing need.

| <b>Capital expenditure</b>             | <b>2020/21 Actual £m</b> | <b>2021/22 Estimate £m</b> | <b>2022/23 Estimate £m</b> | <b>2023/24 Estimate £m</b> | <b>2024/25 Estimate £m</b> | <b>2025/26 Estimate £m</b> |
|--|--------------------------|----------------------------|----------------------------|----------------------------|----------------------------|----------------------------|
| General Fund                           | 19.03                    | 17.25                      | 13.85                      | 5,21                       | 10.14                      | 4.84                       |
| Housing Revenue Account (HRA)          | 3.04                     | 4.78                       | 5.37                       | 5.45                       | 4.78                       | 4.59                       |
| <b>Total</b>                           | <b>22.07</b>             | <b>22.03</b>               | <b>19.22</b>               | <b>10.66</b>               | <b>14.92</b>               | <b>9.43</b>                |
| <b>Financed by:</b>                    |                          |                            |                            |                            |                            |                            |
| Capital receipts                       | (0.01)                   | (0.64)                     | (0.54)                     | (0.54)                     | (0.54)                     | (0.54)                     |
| Capital grants                         | (7.69)                   | (7.75)                     | (5.79)                     | (2.28)                     | (2.14)                     | (0.00)                     |
| Capital reserves                       | (2.91)                   | (4.14)                     | (4.37)                     | (4.84)                     | (4.17)                     | (4.05)                     |
| Revenue                                | (0.40)                   | (0.63)                     | (1.40)                     | (0.56)                     | (0.36)                     | (0.00)                     |
| <b>Net financing need for the year</b> | <b>11.06</b>             | <b>8.87</b>                | <b>7.12</b>                | <b>2.44</b>                | <b>7.71</b>                | <b>4.84</b>                |

## 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 amount of capital expenditure (including that from prior years) that has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying need to borrow. Any capital expenditure, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

The CFR does not increase indefinitely. This is because the Minimum Revenue Provision (MRP), which is a statutory annual charge to revenue, broadly reduces the borrowing need in line with each asset's life.

The CFR includes any other long term liabilities (e.g. finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has no leases within the CFR.

Members are asked to approve the CFR projections below:

| £m                                   | 2020/21<br>Actual<br>£m | 2021/22<br>Estimate<br>£m | 2022/23<br>Estimate<br>£m | 2023/24<br>Estimate<br>£m | 2024/25<br>Estimate<br>£m | 2025/26<br>Estimate<br>£m |
|--------------------------------------|-------------------------|---------------------------|---------------------------|---------------------------|---------------------------|---------------------------|
| <b>Capital Financing Requirement</b> |                         |                           |                           |                           |                           |                           |
| CFR – Non Housing                    | 57.72                   | 64.43                     | 68.86                     | 67.98                     | 72.28                     | 73.26                     |
| CFR – Housing                        | 37.23                   | 36.19                     | 35.14                     | 34.10                     | 33.06                     | 32.02                     |
| <b>Total CFR</b>                     | <b>94.95</b>            | <b>100.62</b>             | <b>104.00</b>             | <b>102.08</b>             | <b>105.34</b>             | <b>105.28</b>             |
| <b>Movement in CFR</b>               |                         |                           |                           |                           |                           |                           |
| Non Housing                          | 9.29                    | 6.72                      | 4.42                      | (0.88)                    | 4.30                      | 0.98                      |
| Housing                              | (1.06)                  | (1.04)                    | (1.04)                    | (1.04)                    | (1.04)                    | (1.04)                    |
| <b>Net Movement in CFR</b>           | <b>8.25</b>             | <b>5.68</b>               | <b>3.38</b>               | <b>(1.92)</b>             | <b>3.26</b>               | <b>(0.06)</b>             |

| <b>Movement in CFR represented by</b>                  |             |             |             |               |             |               |
|--|-------------|-------------|-------------|---------------|-------------|---------------|
| Net financing need for the year (above) re Non Housing | 11.06       | 8.87        | 7.12        | 2.44          | 7.71        | 4.84          |
| Less MRP/VRP and other financing movements             | (2.81)      | (3.19)      | (3.74)      | (4.36)        | (4.45)      | (4.90)        |
| <b>Net Movement in CFR</b>                             | <b>8.25</b> | <b>5.68</b> | <b>3.38</b> | <b>(1.92)</b> | <b>3.26</b> | <b>(0.06)</b> |

### 2.3 Minimum Revenue Provision (MRP) Policy Statement

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

Government Regulations require 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 being made. In approving this Strategy, Council approves the following MRP Statement:

From 1 April 2008 for all unsupported borrowing the MRP will be:

- **Asset life method** – MRP will be based on the estimated life of each asset created as a result of the related capital expenditure, in accordance with the Regulations (this option must also be applied for any expenditure capitalised under a Capitalisation Direction).

This option provides for a reduction in the borrowing need over the approximate life of the asset concerned.

In line with Government guidance, the MRP in respect of capital expenditure incurred before 01 April 2008 will be charged over a period of 60 years.

There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made (although there are transitional arrangements in place).

Repayments included in annual finance leases are applied as MRP.

**MRP Overpayments** – A change introduced by the revised Government MRP Guidance was the allowance that any charges made over the statutory minimum revenue provision, voluntary revenue provision or overpayments, can, if needed be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year. Up until 31 March 2021 the total VRP overpayments were £9.37m

## 2.4 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 (e.g. asset sales). The following table provides estimates of the year end balances for each resource and anticipated year end cash flow balances from other day to day activities:

| Year End Resources          | 2020/21<br>Actual<br>£m | 2021/22<br>Estimate<br>£m | 2022/23<br>Estimate<br>£m | 2023/24<br>Estimate<br>£m | 2024/25<br>Estimate<br>£m | 2025/26<br>Estimate<br>£m |
|-----------------------------|-------------------------|---------------------------|---------------------------|---------------------------|---------------------------|---------------------------|
| Fund balances / reserves    | 38.87                   | 26.14                     | 24.47                     | 21.91                     | 21.53                     | 21.29                     |
| Capital receipts            | 0.52                    | 0.00                      | 0.00                      | 0.00                      | 0.00                      | 0.00                      |
| Provisions                  | 7.14                    | 6.00                      | 6.00                      | 6.00                      | 6.00                      | 6.00                      |
| <b>Total core funds</b>     | <b>46.53</b>            | <b>32.14</b>              | <b>30.47</b>              | <b>27.91</b>              | <b>27.53</b>              | <b>27.29</b>              |
| Working capital*            | 12.43                   | 9.00                      | 9.00                      | 9.00                      | 9.00                      | 9.00                      |
| Under borrowing             | (33.86)                 | (30.58)                   | (20.00)                   | (19.12)                   | (23.42)                   | (24.40)                   |
| <b>Expected investments</b> | <b>25.10</b>            | <b>10.56</b>              | <b>19.47</b>              | <b>17.79</b>              | <b>13.11</b>              | <b>11.89</b>              |

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

## 2.5 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. Members are asked to approve the following indicators:

## 2.6 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.

|              | 2020/21<br>Actual<br>£m | 2021/22<br>Estimate<br>£m | 2022/23<br>Estimate<br>£m | 2023/24<br>Estimate<br>£m | 2024/25<br>Estimate<br>£m | 2025/26<br>Estimate<br>£m |
|--------------|-------------------------|---------------------------|---------------------------|---------------------------|---------------------------|---------------------------|
| General Fund | 14.61                   | 19.97                     | 20.24                     | 23.09                     | 22.25                     | 22.95                     |
| HRA          | 20.79                   | 19.41                     | 18.42                     | 17.69                     | 17.25                     | 16.98                     |

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

## 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 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 or CFR), highlighting any over or under borrowing.

|  | 2020/21<br>Actual<br>£m | 2021/22<br>Estimate<br>£m | 2022/23<br>Estimate<br>£m | 2023/24<br>Estimate<br>£m | 2024/25<br>Estimate<br>£m | 2025/26<br>Estimate<br>£m |
|--|-------------------------|---------------------------|---------------------------|---------------------------|---------------------------|---------------------------|
| <b>External Debt</b>                     |                         |                           |                           |                           |                           |                           |
| Debt at 1 April                          | 62.12                   | 61.08                     | 70.04                     | 84.00                     | 82.96                     | 81.92                     |
| Expected change in Debt                  | (1.04)                  | 8.96                      | 13.96                     | (1.04)                    | (1.04)                    | (1.04)                    |
| Other long-term liabilities (OLTL)       | 0.00                    | 0.00                      | 0.00                      | 0.00                      | 0.00                      | 0.00                      |
| Expected change in OLTL                  | 0.00                    | 0.00                      | 0.00                      | 0.00                      | 0.00                      | 0.00                      |
| <b>Actual gross debt at 31 March</b>     | <b>61.08</b>            | <b>70.04</b>              | <b>84.00</b>              | <b>82.96</b>              | <b>81.92</b>              | <b>80.88</b>              |
| <b>The Capital Financing Requirement</b> | <b>94.95</b>            | <b>100.62</b>             | <b>104.00</b>             | <b>102.08</b>             | <b>105.34</b>             | <b>105.28</b>             |
| <b>Under Borrowing</b>                   | <b>(33.86)</b>          | <b>(30.58)</b>            | <b>(20.00)</b>            | <b>(19.12)</b>            | <b>(23.42)</b>            | <b>(24.40)</b>            |

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 2022/23 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 Head of Financial Services 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 the 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.

| Operational boundary        | 2021/22 Estimate £m | 2022/23 Estimate £m | 2023/24 Estimate £m | 2024/25 Estimate £m | 2025/26 Estimate £m |
|-----------------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| Debt*                       | 100.62              | 104.00              | 102.08              | 105.34              | 105.28              |
| Other long term liabilities | 0.00                | 1.00                | 1.00                | 1.00                | 1.00                |
| <b>Total</b>                | <b>100.62</b>       | <b>105.00</b>       | <b>103.08</b>       | <b>106.34</b>       | <b>106.28</b>       |

- *The term debt in this instance is CFR minus the effect of leases*

#### The Authorised Limit for External Debt

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

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. Council is asked to approve the following authorised limit:



| Authorised Limit            | 2021/22<br>Estimate<br>£m | 2022/23<br>Estimate<br>£m | 2023/24<br>Estimate<br>£m | 2024/25<br>Estimate<br>£m | 2025/26<br>Estimate<br>£m |
|-----------------------------|---------------------------|---------------------------|---------------------------|---------------------------|---------------------------|
| Debt                        | 116.00                    | 119.00                    | 117.00                    | 120.00                    | 120.00                    |
| Other long-term liabilities | 0.00                      | 1.00                      | 1.00                      | 1.00                      | 1.00                      |
| <b>Total</b>                | <b>116.00</b>             | <b>120.00</b>             | <b>118.00</b>             | <b>121.00</b>             | <b>121.00</b>             |

### 3.3 Prospects for Interest Rates

The Council has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Link provided forecasts on 20.12.2021. These are forecasts for certainty rates, gilt yields plus 80 bps:

|                           | Mar-22 | Mar-23 | Mar-24 | Mar-25 |
|---------------------------|--------|--------|--------|--------|
| Bank Rate                 | 0.25   | 0.75   | 1.00   | 1.25   |
| 3 Month average earnings  | 0.30   | 0.70   | 1.00   | 1.00   |
| 6 Month average earnings  | 0.50   | 0.80   | 1.10   | 1.10   |
| 12 Month average earnings | 0.70   | 0.90   | 1.20   | 1.20   |
| 5yr PWLB rate             | 1.50   | 1.70   | 1.90   | 2.00   |
| 10yr PWLB rate            | 1.70   | 1.90   | 2.10   | 2.30   |
| 25yr PWLB rate            | 1.90   | 2.20   | 2.30   | 2.50   |
| 50yr PWLB rate            | 1.70   | 2.00   | 2.10   | 2.30   |

Additional notes by Link on this forecast table: -

- LIBOR and LIBID rates will cease from the end of 2121. Work is currently progressing to replace LIBOR with a rate based on SONIA (Sterling Overnight Index Average). In the meantime, our forecasts are based on expected average earnings by local authorities for 3 to 12 months.
- Our forecasts for average earnings are averages i.e./ rates offered by individual banks may differ significantly from these averages, reflecting their different needs for borrowing short term cash at any one point in time

Further commentary on economic prospects provided by Link: -

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 until raising it to 0.25% at its meeting on 16th December.

The forecast for Bank Rate now includes four further increases, quarter 2 of 2022 to 0.50%, quarter 1 of 2023 to 0.75%, quarter 1 of 2024 to 1.00% and, finally, one in quarter 1 of 2025 to 1.25%

*It is not expected that Bank Rate will go up fast after the initial rate rise as the supply potential of the economy is not likely to have taken a major hit during the pandemic: it should, therefore, be able to cope well with meeting demand after supply shortages subside over the next year, without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the MPC's 2% target after the spike up to around 5%.*

*It is likely that rate forecasts will need changing within a relatively short timeframe for the following reasons: -*

- We do not know how severe an impact Omicron could have on the economy*
- There were already increasing grounds for viewing the economic recovery as running out of steam during the autumn and now into the winter. And then along came Omicron to pose a significant downside threat to economic activity. This could lead into stagflation, or even into recession, which would then pose a dilemma for the MPC as to whether to focus on combating inflation or supporting economic growth through keeping interest rates low.*
- Will some current key supply shortages spill over into causing economic activity in some sectors to take a significant hit?*
- Rising gas and electricity prices in October and next April and increases in other prices caused by supply shortages and increases in taxation next April, are already going to deflate consumer spending power without the MPC having to take any action on Bank Rate to cool inflation.*
- On the other hand, consumers are sitting on over £160bn of excess savings left over from the pandemic so when will they spend this sum, in part or in total?*
- It looks as if the economy coped well with the end of furlough on 30<sup>th</sup> September. It is estimated that there were around 1 million people who came off furlough then and there was not a huge spike up in unemployment. The other side of the coin is that vacancies have been hitting record levels so there is a continuing acute shortage of workers. This is a potential danger area if this shortage drives up wages which then feed through into producer prices and the prices of services i.e., a second-round effect that the MPC would have to act against if it looked like gaining significant momentum.*
- We also recognise there could be further nasty surprises on the Covid front beyond the Omicron mutation.*
- If the UK invokes article 16 of the Brexit deal over the dislocation in trading arrangements with Northern Ireland, this has the potential to end up in a no-deal Brexit.*

*In summary, with the high level of uncertainty prevailing on several different fronts, we expect to have to revise our forecasts again - in line with whatever the new news is.*

*It should also be borne in mind that Bank Rate being cut to 0.25% and then to 0.10%, were emergency measures to deal with the Covid crisis hitting the UK in March 2020. At any time, the MPC could decide to simply take away such emergency cuts on no other grounds than they are no longer warranted, and as a step forward in the return*

to normalisation. In addition, any Bank Rate under 1% is both highly unusual and highly supportive of economic growth.

### Investment and borrowing rates

- **Investment returns** are likely to improve in 2022/23. However, while markets are pricing in a series of Bank Rate rises, actual economic circumstances may see the MPC fall short of these elevated expectations.
- **Borrowing interest rates** fell to historically very low rates as a result of the COVID crisis and the quantitative easing operations of the Bank of England and still remain at historically low levels. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few 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.
- As some PWLB certainty rates are currently below 2.00% there remains value in considering long-term borrowing from the PWLB where appropriate. Temporary borrowing rates are likely, however, to remain near Bank rate and may also prove attractive as part of a balance debt portfolio
- While this authority will not be able to avoid borrowing to finance new capital expenditure, there will be a cost of carry, (the difference between higher borrowing costs and lower investment returns) to any new short or medium-term borrowing that causes a temporary increase in cash balances

### 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 provisions, reserves, balances and working capital 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.

Against this background and the risks within the economic forecast, caution will be adopted with the 2022/23 treasury operations. The Section 151 Officer, under delegated powers 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 (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then borrowing would be postponed.*
- *if it was felt that there was a significant risk of a much sharper RISE 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 would be re-appraised*

Any decisions will be reported to Cabinet at the next available opportunity.

### 3.5 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 indicators and limits:

| <b>Maturity structure of fixed interest rate borrowing 2020/21</b> | <b>£m</b> | <b>Current %</b> | <b>Lower %</b> | <b>Upper %</b> |
|--|-----------|------------------|----------------|----------------|
| Under 12 months  | 1.04      | 1.73             | 0              | 100            |
| 12 months and within 24 months                                     | 1.04      | 1.73             | 0              | 100            |
| 24 months and within 5 years                                       | 3.12      | 5.20             | 0              | 100            |
| 5 years and within 10 years  | 5.20      | 8.66             | 0              | 100            |
| 10 years and within 20 years                                       | 10.40     | 17.32            | 0              | 100            |
| 20 years and within 30 years                                       | 0.04      | 0.06             | 0              | 100            |
| 30 years and within 40 years                                       | 39.20     | 65.30            | 0              | 100            |
| 40 years and within 50 years                                       | 0.00      | 0.00             | 0              | 100            |

### 3.6 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, allowing for authorised increases, 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.

### 3.7 Debt Rescheduling

Rescheduling of current borrowing in our debt portfolio is unlikely to occur as there is still a very large difference between premature redemption rates and new borrowing rates, even though the general margin of pWLB rates over gilt yields was reduced by 100bps in November 2020.

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

## 4 ANNUAL INVESTMENT STRATEGY

### 4.1 Investment Policy

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

Council's investment policy has regard to the following:

- DLUHC'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, liquidity second, then return.

The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the Council's risk appetite. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs. However, where appropriate (from an internal as well as external perspective), the Council will also consider the value available in periods up to 12 months with high credit rated financial institutions, as well as wider range fund options.

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

1. Minimum acceptable **credit criteria** are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long term ratings.
2. **Other Information:** ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this 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.
3. **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.
4. The authority has defined the list of types of investment instruments that the treasury management team are authorised to use. There are two lists in **annex B2** under the categories of 'specified' and 'non-specified' investments.

- **Specified investments** are those with a high level of credit quality and subject of a maturity limit of one year.
  - **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or more complex instruments which require greater consideration by members and officers before being authorised for use.
5. **Non-specified investments limit.** The Council has determined that it will limit the maximum total exposure to non-specified investments as being 20% of the total investment portfolio. (see paragraph 4.3)
  6. **Lending limits** (amounts and maturity), for each counterparty will be set through applying the matrix table in paragraph 4.2
  7. **Transaction limits** are set for each type of investment in 4.2
  8. The Council will set a limit for the amount of its investments which are invested for **longer than 365 days** (see paragraph 4.4)
  9. Investments will only be placed with counterparties from countries with a specified minimum sovereign rating (see paragraph 4.3)
  10. The Council has engaged **external consultants** (see paragraph 1.5), to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.
  11. All investments will be denominated in **sterling**.
  12. As a result of the change in accounting standards for 2020/21 under IFRS9, the authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund

The Council will also pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance. Regular monitoring of investment performance will be carried out during the year.

**Changes in risk management policy from last year.**

The above criteria are unchanged from last year

## **4.2 Creditworthiness Policy**

This Council will apply the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- Credit Default Swap (CDS) spreads to give early warning of likely changes in credit ratings;

- sovereign ratings to select counterparties from only the most creditworthy countries.

This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:

- **Yellow (Y)** up to but less than 1 year
- **Dark pink (Pi1)** liquid - Ultra-Short Dated Bond Funds with a credit score of 1.25
- **Light pink (Pi2)** liquid – Ultra-Short Dated Bond Funds with a credit score of 1.5
- **Purple (P)** up to but less than 1 year
- **Blue (B)** up to but less than 1 year (only applies to nationalised or part-nationalised UK Banks)
- **Orange (O)** up to but less than 1 year
- **Red (R)** 6 months
- **Green (G)** 100 days
- **No colour (N/C)** not to be used

|   |      |     |   |   |   |   |   |     |
|---|------|-----|---|---|---|---|---|-----|
| Y | Pi1  | Pi2 | P | B | O | R | G | N/C |
| 1 | 1.25 | 1.5 | 2 | 3 | 4 | 5 | 6 | 7   |

|   | Colour (and long term rating where applicable) | Money Limit          | Time Limit |
|---|--|----------------------|------------|
| Banks /UK Govt. backed instruments*                                 | yellow   | £12m                 | ≤1 year    |
| Banks   | purple   | £6m                  | ≤1 year    |
| Banks   | orange   | £6m                  | ≤1 year    |
| Banks – part nationalised   | blue   | £12m                 | ≤1 year    |
| Banks   | red  | £6m                  | ≤6 mths    |
| Banks   | green  | £3m                  | ≤100 days  |
| Banks   | No colour                                      | Not to be used       |            |
| Limit 3 category – Council’s banker (for non-specified investments) | n/a  | £1m                  | 1 day      |
| DMADF   | AAA  | unlimited            | ≤6 months  |
| Local authorities   | n/a  | £12m                 | ≤1 year    |
|   | Fund rating**                                  | Money and/or % Limit | Time Limit |
| Money Market Funds CNAV   | AAA  | £6m                  | liquid     |
| Money Market Funds LVNAV  | AAA  | £6m                  | liquid     |

|   |                         |            |               |
|---|-------------------------|------------|---------------|
| <b>Money Market Funds VNAV</b>                                  | <b>AAA</b>              | <b>£6m</b> | <b>liquid</b> |
| <b>Ultra-Short Dated Bond Funds with a credit score of 1.25</b> | <b>Dark pink / AAA</b>  | <b>£6m</b> | <b>liquid</b> |
| <b>Ultra-Short Dated Bond Funds with a credit score of 1.5</b>  | <b>Light pink / AAA</b> | <b>£6m</b> | <b>liquid</b> |

*\* the yellow colour category includes UK Government debt, or its equivalent, money market funds and collateralised deposits where the collateral is UK Government debt – see Annex B2.*

*\*\* “fund” ratings are different to individual counterparty ratings, coming under either specific “MMF” or “Bond Fund” rating criteria.*

The creditworthiness service uses a wider array of information other than just primary ratings and by using a risk weighted scoring system, does not give undue preponderance to just one agency’s ratings.

Typically the minimum credit ratings criteria (built in) that the Council use will be a Short Term rating of F1 and a Long Term rating of A- (Fitch, or equivalents). There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

All credit ratings will be monitored daily. The Council is alerted to changes to ratings of all three agencies through its use of the creditworthiness service.

- If a downgrade results in the counterparty / investment scheme no longer meeting the Council’s minimum criteria, its further use as a new investment will be withdrawn immediately.
- In addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council’s lending list.

Sole reliance will not be placed on the use of this external service. In addition, the Council will also use to some limited extent market data and market information, information on sovereign support for banks and the credit ratings of that supporting government to help support its decision making process.

### **Creditworthiness**

Significant levels of downgrades to Short- and Long-Term credit ratings have not materialised since the crisis in March 2020. In the main, where they did change, any alterations were limited to Outlooks. However, as economies are beginning to reopen, there have been some instances of previous lowering of Outlooks being reversed

### **CDS prices**

Although bank CDS prices, (these are market indicators of credit risk), spiked upwards at the end of March / early April 2020 due to the heightened market uncertainty and ensuing liquidity crisis that affected financial markets, they have returned to more



average levels since then. Nevertheless, prices are still elevated compared to end-February 2020. Pricing is likely to remain volatile as uncertainty continues. However, sentiment can easily shift, so it will remain important to undertake continual monitoring of all aspects of risk and return in the current circumstances. Link monitor CDS prices as part of their creditworthiness service to local authorities and the Council has access to this information via its Link-provided Passport portal.

### 4.3 Country 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

- a) **Non-specified investment limit.** The Council has determined that it will limit the maximum total exposure to non-specified investments as being 20% of the total investment portfolio.
- b) **Country limit.** The Council has determined that it will only use approved counterparties from other countries with a minimum sovereign credit rating of AAA (Fitch) or equivalent from each of the credit rating agencies. This list will be added to, or deducted from, by Officers 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 (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 reliably identified that could be invested for longer periods the value to be obtained from longer term investments will be carefully assessed.

**Investment Returns Expectations:** The current forecast includes a first increase in Bank Rate in May 2022, though it could come in February.

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

- 2022/23 0.50%
- 2023/24 0.75%
- 2024/25 1.00%
- 2025/26 1.25%

**Investment treasury indicator and limit** - the total principal funds that can be 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. Council is asked to approve the following treasury indicator and limit:

| Maximum principal sums invested > 365 days |         |         |         |         |         |
|--|---------|---------|---------|---------|---------|
|  | 2020/21 | 2021/22 | 2022/23 | 2023/24 | 2024/25 |
| Principal sums invested > 365 days         | Nil     | Nil     | Nil     | Nil     | Nil     |

#### **4.5 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.

## Treasury Management Glossary of Terms

- **Annuity** – method of repaying a loan where the payment amount remains uniform throughout the life of the loan, therefore the split varies such that the proportion of the payment relating to the principal increases as the amount of interest decreases.
- **CIPFA** – the Chartered Institute of Public Finance and Accountancy, is the professional body for accountants working in Local Government and other public sector organisations, also the standard setting organisation for Local Government Finance.
- **Call account** – instant access deposit account.
- **Counterparty** – an institution (e.g. a bank) with whom a borrowing or investment transaction is made.
- **Credit Rating** – is an opinion on the credit-worthiness of an institution, based on judgements about the future status of that institution. It is based on any information available regarding the institution: published results, Shareholders' reports, reports from trading partners, and also an analysis of the environment in which the institution operates (e.g. its home economy, and its market sector). The main rating agencies are Fitch, Standard and Poor's, and Moody's. They currently analyse credit worthiness under four headings (but see changes referred to in the strategy):
  - **Short Term Rating** – the perceived ability of the organisation to meet its obligations in the short term, this will be based on measures of liquidity.
  - **Long Term Rating** – the ability of the organisation to repay its debts in the long term, based on opinions regarding future stability, e.g. its exposure to 'risky' markets.
  - **Individual/Financial Strength Rating** – a measure of an institution's soundness on a stand-alone basis based on its structure, past performance and credit profile.
  - **Legal Support Rating** – a view of the likelihood, in the case of a financial institution failing, that its obligations would be met, in whole or part, by its shareholders, central bank, or national government.

The rating agencies constantly monitor information received regarding financial institutions, and will amend the credit ratings assigned as necessary.

- **DMADF and the DMO** – The DMADF is the 'Debt Management Account Deposit Facility'; this is highly secure fixed term deposit account with the Debt Management Office (DMO), part of Her Majesty's Treasury.
- **EIP** – Equal Instalments of Principal, a type of loan where each payment includes an equal amount in respect of loan principal, therefore the interest due with each payment reduces as the principal is eroded, and so the total amount reduces with each instalment.
- **Gilts** – the name given to bonds issued by the U K Government. Gilts are issued bearing interest at a specified rate, however they are then traded on the markets like

shares and their value rises or falls accordingly. The Yield on a gilt is the interest paid divided by the Market Value of that gilt.

E.g. a 30 year gilt is issued in 1994 at £1, bearing interest of 8%. In 1999 the market value of the gilt is £1.45. The yield on that gilt is calculated as  $8\%/1.45 = 5.5\%$ .

See also PWLB.

- **LIBID** – The London Inter-Bank Bid Rate, the rate which banks would have to bid to borrow funds from other banks for a given period. The official rate is published by the Bank of England at 11am each day based on trades up to that time.
- **LIBOR** – The London Inter-Bank Offer Rate, the rate at which banks with surplus funds are offering to lend them to other banks, again published at 11am each day.
- **Liquidity** – Relates to the amount of readily available or short term investment money which can be used for either day to day or unforeseen expenses. For example Call Accounts allow instant daily access to invested funds.
- **Maturity** – Type of loan where only payments of interest are made during the life of the loan, with the total amount of principal falling due at the end of the loan period.
- **Money Market Fund (MMF)** – Type of investment where the Council purchases a share of a cash fund that makes short term deposits with a broad range of high quality counterparties. These are highly regulated in terms of average length of deposit and counterparty quality, to ensure AAA rated status. As from 21 July 2018 there will be three structural options for existing money market funds – Public Debt Constant Net Asset Value (CNAV), Low Volatility Net Asset Value (LVNAV) and Variable Net Asset Value (VNAV)
- **Policy and Strategy Documents** – documents required by the CIPFA Code of Practice on Treasury Management in Local Authorities. These set out the framework for treasury management operations during the year.
- **Public Works Loans Board (PWLB)** – a central government agency providing long and short term loans to Local Authorities. Rates are set daily at a margin over the Gilt yield (see Gilts above). Loans may be taken at fixed or variable rates and as Annuity, Maturity, or EIP loans (see separate definitions) over periods of up to fifty years. Financing is also available from the money markets, however because of its nature the PWLB is generally able to offer better terms.
- **Link Asset Services** – Link Asset Services are the City Council's Treasury Management advisors. They provide advice on borrowing strategy, investment strategy, and vetting of investment counterparties, in addition to ad hoc guidance throughout the year.
- **Yield** – see Gilts

Members may also wish to make reference to *The Councillor's Guide to Local Government Finance*.

## ANNEX B2

A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the above categories.

The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

|   | Minimum credit criteria / colour band | Max % of counterparty limit - *Specified | Max % of counterparty limit – **Non - Specified | Max. maturity period |
|---|---------------------------------------|--|---|----------------------|
| <b>DMADF – UK Government</b>  | N/A                                   | <b>100%</b>                              | <b>N/A</b>                                      | <b>6 months</b>      |
| UK Government gilts   | UK sovereign rating                   | 100%                                     | <b>N/A</b>                                      | 1 year               |
| UK Government Treasury bills  | UK sovereign rating                   | 100%                                     | <b>N/A</b>                                      | 1 year               |
| Bonds issued by multilateral development banks                                | AAA                                   | 100%                                     | <b>N/A</b>                                      | 6 months             |
| Money Market Funds CNAV   | AAA                                   | 100%                                     | <b>N/A</b>                                      | Liquid               |
| Money Market Funds LVNAV  | AAA                                   | 100%                                     | <b>N/A</b>                                      | Liquid               |
| Money Market Funds VNAV   | AAA                                   | 100%                                     | <b>N/A</b>                                      | Liquid               |
| Ultra-Short Dated Bond Funds with a credit score of 1.25                      | AAA                                   | 100%                                     | <b>N/A</b>                                      | Liquid               |
| Ultra-Short Dated Bond Funds with a credit score of 1.5                       | AAA                                   | 100%                                     | <b>N/A</b>                                      | Liquid               |
| Local authorities   | N/A                                   | 100%                                     | <b>N/A</b>                                      | 1 year               |
| Term deposits with banks and building societies                               | Yellow                                | 100%                                     | 20%   | Up to 1 year         |
|   | Purple                                | 100%                                     | 20%   | Up to 1 year         |
|   | Blue                                  | 100%                                     | N/A   | Up to 1 year         |
|   | Orange                                | 100%                                     | 20%   | Up to 1 year         |
|   | Red                                   | 100%                                     | 20%   | Up to 6 Months       |
|   | Green                                 | 100%                                     | 20%   | Up to 100 days       |
|   | No Colour                             | 0%                                       | 0%  | Not for use          |
| Certificates of Deposit and corporate bonds with banks and building societies | Yellow                                | 20%                                      | 0%  | Up to 1 year         |
|   | Purple                                | 20%                                      | 0%  | Up to 1 year         |
|   | Blue                                  | 20%                                      | 0%  | Up to 1 year         |
|   | Orange                                | 20%                                      | 0%  | Up to 1 year         |
|   | Red                                   | 0%                                       | 0%  | Up to 6 Months       |
|   | Green                                 | 0%                                       | 0%  | Up to 100 days       |
|   | No Colour                             | 0%                                       | 0%  | Not for use          |

**\*SPECIFIED INVESTMENTS:** All such investments will be sterling denominated, with maturities up to maximum of 1 year, meeting the quality criteria as applicable.

**\*\*NON-SPECIFIED INVESTMENTS:** These are any investments which do not meet the specified investment criteria. A maximum of up to 20% \*\* will be held in aggregate in relevant non-specified investments (as at the trade date of investing).

## Background information on credit ratings

Credit ratings are an important part of the Authority's investment strategy. The information below summarises some of the key features of credit ratings and why they are important.

### What is a Credit Rating?

A credit rating is:

- An independent assessment of an organisation;
- It gauges the likelihood of getting money back on the terms it was invested;
- It is a statement of opinion, not statement of fact;
- They help to measure the risk associated with investing with a counterparty;

### Who Provides / Uses Credit Ratings?

There are three main ratings agencies, all of which are used in the Authority's treasury strategy.

- Fitch
- Moody's Investor Services
- Standard & Poor's

The ratings supplied by these agencies are used by a broad range of institutions to help with investment decisions, these include:

- Local Authorities;
- Other non-financial institutional investors;
- Financial institutions;
- Regulators;
- Central Banks;

### Rating Criteria

There are many different types of rating supplied by the agencies. The key ones used by the Authority are ratings to indicate the likelihood of getting money back on terms invested. These can be split into two main categories:

- 'Short Term' ratings for time horizons of 12 months or less. These may be considered as the most important for local authorities.
- 'Long Term' ratings for time horizons of over 12 months. These may be considered as less important in the current climate.

In addition, the agencies issue sovereign, individual and support ratings which will also feed into the investment strategy.

### Rating Scales (Fitch, Moody's and Standard & Poor's)

The table below shows how some of the higher graded short and long term ratings compare across the agencies; the top line represents the highest grade possible. (There are other ratings that go much lower than those shown below, and ratings for other elements).

| Short Term |         |      | Long Term |         |     |
|------------|---------|------|-----------|---------|-----|
| Fitch      | Moody's | S&P  | Fitch     | Moody's | S&P |
| F1+        | P-1     | A-1+ | AAA       | Aaa     | AAA |
| F1         | P-1     | A-1  | AA        | Aa2     | AA  |
| F2         | P-2     | A-2  | A         | A2      | A   |