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NORTH DEVON COUNCIL

REPORT TO:	**STRATEGY AND RESOURCES**
DATE:	**1st FEBRUARY 2021**
TOPIC:	**TREASURY MANAGEMENT STRATEGY STATEMENT 2021/22**
REPORT BY:	**CHIEF FINANCIAL OFFICER**

1. INTRODUCTION

This report sets out the Council's strategy for Treasury Management, Minimum Revenue Provision (MRP) and Investments for the forthcoming financial year.

2. RECOMMENDATIONS

The Committee is asked to recommend to full Council that:

2.1 The Treasury Management Strategy Statement, Minimum Revenue Provision Policy Statement and Annual Investment Statement 2021/2022, including the Treasury Management and Prudential Indicators for 2021/22 to 2023/24, be approved.

3. REASONS FOR RECOMMENDATIONS

3.1 The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (SI 2003/3146) requires the Council to have regard to the Treasury Management Code.

3.2 Under section 3(5) of the Local Government Act 2003 the Council is required to have regard to the Prudential Code when setting limits to the level of its affordable borrowing.

3.3 This Council is also required under the Code to give prior scrutiny of the treasury management reports by the Policy Development Committee before they are reported to the full Council.

4. TREASURY MANAGEMENT

4.1 Background

Part of the treasury management operation is to ensure that 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 material commercial investments or non-treasury investments.

4.2. Reporting Requirements

The Council will receive and approve three main reports each year, which incorporate a variety of polices, estimates and actuals.

a) **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).

b) **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.

c) **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.

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

4.3 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 will 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, the MHCLG MRP Guidance, the CIPFA Treasury Management Code and the MHCLG Investment Guidance.

4.4 Training

The CIPFA Code requires the Chief Finance 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.

4.5 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 our external service providers. All decisions will be undertaken with regards to all the available information, including, but solely, our treasury advisors.

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.

5 THE 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 prudential indicators, which are designed to assist members’ overview and confirm capital expenditure plans.

5.1 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. Members are asked to approve the capital expenditure forecasts:

Capital Expenditure £000	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Chief Executive & Corporate	209	334	543	432	351
Corporate & Community	2,876	3,776	11,319	0	0
Environmental Health & Housing	1,429	1,575	2,293	979	979
Operational Services	235	515	2,588	348	1,146
Place	149	156	2,000	0	0
Resources	556	755	3,677	165	150
Total	**5,454**	**7,111**	**22,420**	**1,924**	**2,626**

** 2023/24 are estimates as not yet approved by Members*

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.

Financing of Capital Expenditure £000	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Capital receipts	329	500	150	150	150
Capital grants	3,976	4,280	8,578	1,029	979
Capital reserves	605	782	1,502	440	365
Net financing need for the year	**544**	**1,549**	**12,190**	**305**	**1,132**

5.2 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 indebtedness and so it's underlying borrowing need. Any capital expenditure in the table above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the indebtedness in line with each assets life, and so charges the economic consumption of capital assets as they are used.

The Council is asked to approve the CFR projections below:

£000	**2019/20 Actual**	**2020/21 Estimate**	**2021/22 Estimate**	**2022/23 Estimate**	**2023/24 Estimate**
Capital Financing Requirement					
Total CFR	**4,746**	**5,755**	**17,410**	**16,864**	**17,092**
Movement in CFR	**35**	**1,009**	**11,655**	**(546)**	**228**

Movement in CFR represented by:					
Net financing need for the year (above)	**544**	**1,549**	**12,190**	**305**	**1,132**
Less MRP/VRP and other financing movements	(509)	(540)	(535)	(851)	(904)
Movement in CFR	**35**	**1,009**	**11,655**	**(546)**	**228**

5.3 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.). Detailed below are estimates of the year-end balances for each resource and anticipated day to day cash flow balances.

Year End Resources £000	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Fund balances / reserves	9,665	9,149	4,200	3,850	3,600
Provisions	763	550	500	500	500
Total core funds	**10,428**	**9,699**	**4,700**	**4,350**	**4,100**
Working capital*	10,189	10,000	750	750	750
Total cash to invest	**20,617**	**19,699**	**5,450**	**5,100**	**4,850**
(Under)/over borrowing	**(3,496)**	**(5,255)**	**(2,910)**	**(2,364)**	**(2,592)**
Expected external investments	**17,121**	**14,444**	**2,540**	**2,736**	**2,258**

*Working capital balances shown for 19/20 and 20/21 include Central Government grants for Covid-19.

5.4 Affordability Prudential Indicator

This prudential indicator is 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 indicator:

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.

%	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
General Fund	2.62	3.73	4.47	9.03	9.49

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

5.5 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:

From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be*:*

Asset Life Method – MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction).

This option provides for a reduction in the borrowing need over approximately the asset’s life. MRP will always start in the financial year after the asset becomes operational.

Leisure centre – An element of the funding for this project is future S106 income. When this income is received it will be used to reduce the Capital Financing Requirement, therefore no MRP will be required. Should any of this funding not be forthcoming then an MRP adjustment will be required at that time. Where affordable the Council will make additional voluntary revenue provisions to help pay off the debt early.

MRP Overpayments

A change introduced by the revised MHCLG MRP Guidance was the allowance that any charges made over the statutory <u>minimum</u> revenue provision (MRP), 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 the 31 March 2021 the Council had made no voluntary revenue provision (VRP) overpayments.

6 BORROWING

The capital expenditure plans set out in Section 5, provide details of the service activity of the Council. The treasury management function ensures that the Council’s cash is organised in accordance with the the relevant professional codes, so that sufficient cash is available to meet this service activity and the Council’s capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

6.1 Current Portfolio Position

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

Treasury Portfolio **£000**	**31/03/20** **Actual**	**31/12/20** **Actual**
Investment with banks	16,250	32,650
Total investments managed in-house	**16,250**	**32,650**
Borrowing with PWLB	(1,250)	(500)
Total external borrowing	**(1,250)**	**(500)**
Net treasury investments / (borrowing)	15,000	32,150

* *Investment figures are higher than usual in both years due to timing of monies to/from Central Government regarding Covid-19 support payments and business grants.*

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.

£000	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
External Debt					
Debt at 1 April	1,250	1,250	500	14,500	14,500
Expected change in Debt	0	(750)	14,000	0	0
Other long-term liabilities (OLTL)	0	0	0	0	0
Expected change in OLTL	0	0	0	0	0
Actual gross debt at 31 March	**1,250**	**500**	**14,500**	**14,500**	**14,500**
The Capital Financing Requirement	**4,746**	**5,755**	**17,410**	**16,864**	**17,092**
(Under) / over borrowing	**(3,496)**	**(5,255)**	**(2,910)**	**(2,364)**	**(2,592)**

Within the range of prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2021/22 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 Financial 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.

6.2 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 £000	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Debt & Other long term liabilities	1,000	16,000	16,000	16,000
Total	**1,000**	**16,000**	**16,000**	**16,000**

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

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:

Authorised limit £000	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Debt & Other long term liabilities	22,000	22,000	22,000	22,000
Total	**22,000**	**22,000**	**22,000**	**22,000**

6.3 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. The following table gives their central view. For further economic information please see Appendix C.

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

	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
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
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
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
5 yr PWLB	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	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.30	1.30
25 yr PWLB	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	1.40	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 16th December, 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 near-term as economic recovery is expected to be only gradual and, therefore, prolonged. These forecasts were based on an assumption that a Brexit trade deal would be agreed by 31.12.20: as this has now occurred, these forecasts do not need to be revised.

PWLB rates

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.

- **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: indeed, gilt yields up to 6 years were negative during most of the first half of 20/21. The policy of avoiding new borrowing by running down spare cash balances has served the Council well over the last few years. The unexpected increase of 100 bps in PWLB rates on top of the then current margin over gilt yields of 80 bps in October 2019, required an initial major rethink of local authority treasury management strategy and risk management. However, in March 2020, the Government started a consultation process for reviewing the margins over gilt rates for PWLB borrowing for different types of local authority capital expenditure. It also introduced the following rates for borrowing for different types of capital expenditure: -

- PWLB Standard Rate is gilt plus 200 basis points (G+200bps)
- PWLB Certainty Rate is gilt plus 180 basis points (G+180bps)
- Local Infrastructure Rate is gilt plus 60bps (G+60bps)

As a consequence of these increases in margins, the Council decided to refrain from PWLB borrowing until such time as the review of margins was concluded.

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)
- 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 for the purpose of certainty, where that is desirable, or for flattening the profile of a heavily unbalanced maturity profile.

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 borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

6.4 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.

Against this background and the risks within the economic forecast, caution will be adopted with the 2021/22 treasury operations. The Chief Financial 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.

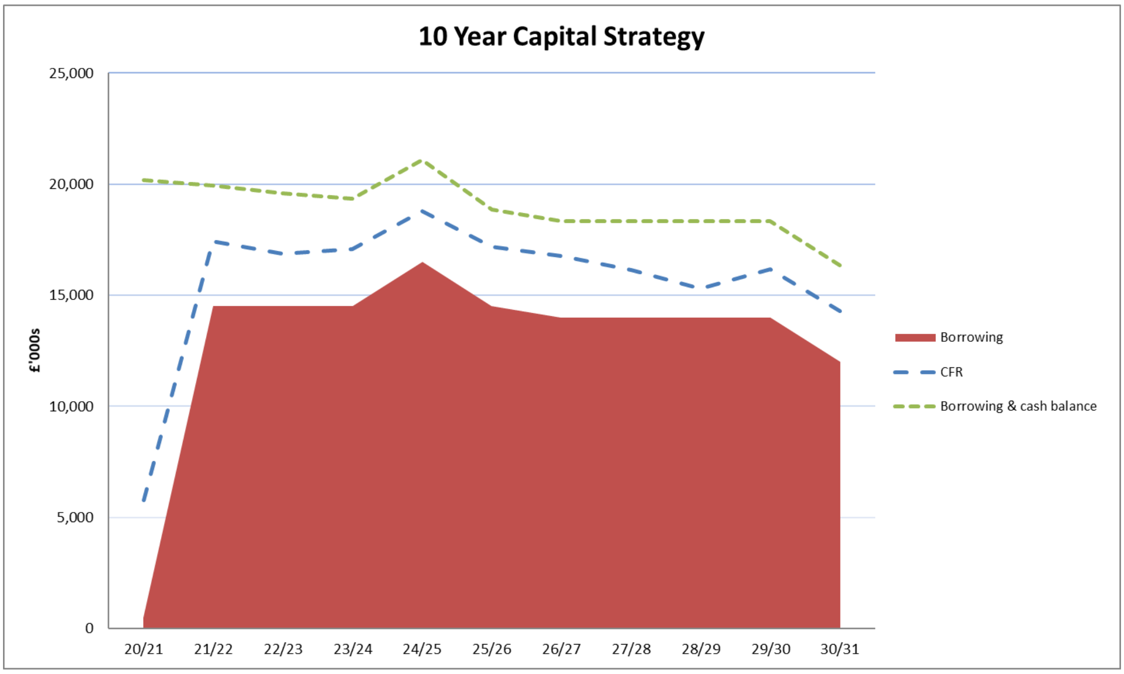
- *if it was felt that there was a significant risk of a much sharper RISE in borrowing rates than that currently forecast,* perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, 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 Leader and Lead Member for Resources and Commercialisation.

It is anticipated that additional external borrowing of £14m will be required during 2021/22 to support the approved capital programme, taking total projected external borrowing to £14.5m by March 2022. This still prudently assumes using £2.9m of internal borrowing from reserves and cash balances to fund the £17.4m Capital Financing Requirement.

This increased borrowing reflects the funding requirements of the approved capital programme of £22.4m in 2021/22, which includes large schemes such as the new Leisure Centre.

Any further substantial increases to capital expenditure and/or decreases in the reserve balances within the forthcoming years may result in the need for additional external borrowing to ensure the Council holds sufficient cash balances to meet its day to day commitments. The graph below sets out the current borrowing strategy for the next ten years. For further details please refer to the Council’s ten year capital strategy on this agenda.



In accordance with the Council’s accounting policy, the borrowing interest incurred during the construction of the leisure centre can be capitalised, thereby increasing the CFR and allowing this cost to be covered by external borrowing, if required.

6.5 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 treasury indicators and limits:

Maturity Structure of fixed interest rate borrowing 2021/22		
	Lower	**Upper**
Under 12 months	0%	60%
12 months to 2 years	0%	60%
2 years to 5 years	0%	100%
5 years to 10 years	0%	100%
10 years and above	0%	90%
Maturity Structure of variable interest rate borrowing 2021/22		
	Lower	**Upper**
Under 12 months	0%	60%
12 months to 2 years	0%	60%
2 years to 5 years	0%	100%
5 years to 10 years	0%	100%
10 years and above	0%	90%

6.6 Control of interest rate exposures

The Council is asked to approve the following local indicator to reduce the impact of any adverse movement in interest rates, whilst not impairing opportunities to reduce costs / improve performance.

Interest rate Exposures	2021/22 £000	2022/23 £000	2023/24 £000
Limit on fixed interest rates: • **Debt only** • **Investments only**	100% 100%	100% 100%	100% 100%
Limit on variable interest rates: • **Debt only** • **Investments only**	30% 100%	30% 100%	30% 100%

Paragraphs 6.3, 6.4, 6.5 and 7.4 provide further details on the controls in place to limit and manage interest rate exposure in line with financial requirements, borrowing maturities and interest rate forecasts.

6.7 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.

6.8 Debt rescheduling

Rescheduling of current borrowing in our debt portfolio is unlikely to occur. If rescheduling was done, it will be reported to the Leader and Lead Member for Resources and Commercialisation.

6.9 New financial institutions as a source of borrowing

Currently the PWLB Certainty Rate is set at gilts + 80 basis points. However, consideration may still need to be given to sourcing funding from the following if rates should be cheaper:

- Local authorities (primarily shorter dated maturities)
- Financial institutions (primarily insurance companies and pension funds but also some banks, out of forward dates)
- Municipal Bonds Agency (possibly still a viable alternative depending on market circumstances prevailing at the time)

Our advisors will keep us informed as to the relative merits of each of these alternative funding sources.

Given the relative scale of our external borrowing it is likely that the PWLB will remain the Council's best option as a source of borrowing.

6.10 Approved Sources of Long and Short term Borrowing

Members are asked to review and approve the following list of sources and types of funding:

On Balance Sheet	**Fixed**	**Variable**
PWLB	●	●
Municipal bond agency	●	●
Local authorities	●	●
Banks	●	●
Pension funds	●	●
Insurance companies	●	●
Market (long-term)	●	●
Market (temporary)	●	●
Market (LOBOs)	●	●
Stock issues	●	●
Local temporary	●	●
Local Bonds	●	
Local authority bills	●	●
Overdraft		●
Negotiable Bonds	●	●
Internal (capital receipts & revenue balances)	●	●
Commercial Paper	●	
Medium Term Notes	●	
Finance leases	●	●

7 ANNUAL INVESTMENT STRATEGY

7.1 Investment Policy – management of risk

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). 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.

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

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 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.

3. **Other information sources** used will include the financial press, share price and other such information pertaining to the financial sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

4. This authority has defined the list of **types of investment instruments** that the treasury management team are authorised to use. Appendix A list the instruments under the categories of 'specified' and 'non-specified' investments.

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

- **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use. The Council will consider using this category only for investments that would come under Specified, except that the maturities are greater than 1 year.

5. **Lending limits**, (amounts and maturity), for each counterparty will be set through applying the matrix table in paragraph 7.2.

6. **Transaction limits** are set for each type of investment in paragraph 7.2.

7. This authority will set a limit for the amount of its investments which are invested for **longer than 365 days**, (see paragraph 7.4).

8. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating**, (see paragraph 7.3).

9. This authority has engaged **external consultants**, (see paragraph 4.5), 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.

10. All investments will be denominated in **sterling**.

11. As a result of the change in accounting standards for 2020/21 under **IFRS 9**, this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund.

However, this authority will also pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see paragraph 7.4). Regular monitoring of investment performance will be carried out during the year.

Changes in risk management policy from last year.

The above criteria is largely unchanged from last year.

7.2 Creditworthiness policy

This Council applies the creditworthiness service provided by the Link Group. This service employs a sophisticated modelling approach utlilising credit ratings from the three main credit rating agencies - Fitch, Moodys and Standard & Poor’s. The credit ratings of counterparties are supplemented with the following overlays:

- “watches” and “outlooks” from credit rating agencies;
- 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, watches and outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads. 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*:*

- Dark pink — 5 years for Ultra-Short Dated Bond Fund with a credit score of 1.25
- Light pink — 5 years for Ultra-Short Dated Bond Fund with a credit score of 1.5
- Yellow — 5 years (UK Government debt)
- Purple — 2 years
- Blue — 1 year (only applies to nationalised or semi-nationalised UK Banks)
- Orange — 1 year
- Red — 6 months
- Green — 100 days
- No Colour — not to be used

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

Typically the minimum credit ratings criteria the Council use will be a short term rating (Fitch or equivalents) of F1 and a long term rating A-. 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 weekly. The Council is alerted to changes to ratings of all three agencies through its use of the Link 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 Eurpoean Financials benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link. 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 this Council will also use market data and market information, information on any external support for banks to help support its decision making process.

	Colour (and long term rating where applicable)	Money Limit	Time Limit
Banks	**yellow**	**£1m**	**5 yrs**
Banks	**purple**	**£1m**	**2 yrs**
Banks	**orange**	**£4m**	**1 yr**
Banks – part nationalised	**blue**	**£4m**	**1 yr**
Banks	**red**	**£3.5m**	**6 mths**
Banks	**green**	**£3.5m**	**100 days**
Banks	**No colour**	**Not to be used**	
Other institutions limit	**-**	**£2m**	**1yr**
DMADF	**UK sovereign rating**	**Unlimited**	**6 months**
Local authorities	**n/a**	**£2m**	**1yr**
	Fund rating*	**Money Limit**	**Time Limit**
Money market funds CNAV	**AAA**	**£3m**	**liquid**
Money market funds LVNAV	**AAA**	**£3m**	**liquid**
Money market funds VNAV	**AAA**	**£3m**	**liquid**
Ultra-Short Dated Bond Fund	**Dark pink / AAA**	**£1m**	**liquid**

with a credit score of 1.25			
Ultra-Short Dated Bond Fund with a credit score of 1.5	**Light pink / AAA**	**£1m**	**liquid**

- *fund ratings are different to individual counterparty ratings, coming under specific MMF rating criteria*

No limit will be set on placing funds with the Council's own bank due to the volatility / fluctuations in day to day cash flows. Should the Council's bank have no colour then funds will be kept instant access.

Group limits where a number of institutions are under one ownership is a maximum of £6m.

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%.

All three rating agencies have reviewed banks around the world with similar results in many countries of most banks being placed on Negative Outlook, but with a small number of actual downgrades.

7.3 Country limits

The Council has determined that it will mainly use approved counterparties from within the United Kingdom.

However, the Council may consider counterparties from outside the United Kingdom providing the country has a minimum sovereign credit rating of AA- from Fitch or equivalent.

7.4 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:

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%

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.

As for money market funds (MMFs), yields have continued to drift lower. Some managers have already resorted to trimming fee levels to ensure that net yields for investors remain in positive territory where possible and practical. Investor cash flow uncertainty, and the need to maintain liquidity in these unprecedented times, has meant there is a surfeit of money swilling around at the very short end of the market. This has seen a number of market operators, now including the DMADF, offer nil or negative rates for very short term maturities. This is not universal, and MMFs are still offering a marginally positive return, as are a number of financial institutions for investments at the very short end of the yield curve.

Inter-local authority lending and borrowing rates have also declined due to the surge in the levels of cash seeking a short-term home at a time when many local authorities are probably having difficulties over accurately forecasting when disbursements of funds received will occur or when further large receipts will be received from the Government.

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 treasury indicator and limit: -

Upper limit for principal sums invested for longer than 365 days			
£m	**2021/22**	**2022/23**	**2023/24**
Principal sums invested for longer than 365 days	£1m	£1m	£1m

The Council currently has no investments in excess of one year.

For its cash flow generated balances, the Council will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated deposits (overnight to 100 days), in order to benefit from the compounding of interest.

Investment risk benchmarking.

This Council will use an investment benchmark to assess the investment performance of its investment portfolio of 7 day LIBID rate. 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.

The Chief Financial Officer will monitor the current and trend position of the treasury function and amend the operational strategy to manage risk, as interest rates and counterparty conditions change. Performance results will be reported through the Quarterly Performance and Financial Management, Mid-Year and Annual Treasury reports to Strategy and Resources.

7.5 Non-Treasury Investments

The Council will adopt a low risk, immaterial, approach to non-treasury (commercial) investments in line with the investment categories and authorised limits set out in Appendix B.

Under the new PWLB lending terms, the PWLB will no longer lend to local authorities that plan to buy commercial assets primarily for yield.

Given the above, the Council may consider opportunities within the Council boundary, but where the main purpose of the scheme is regeneration.

8. RESOURCE IMPLICATIONS

As detailed in the report.

9. EQUALITIES ASSESSMENT

There are not any equalities implications anticipated as a result of this report, as the purpose of this report is to present the Council's financial position only.

10. CONSTITUTIONAL CONTEXT

11.

Article and paragraph	Referred or delegated power?
Part 4 Financial Procedure Rules (Article 13.8) Part 2, Article 4.4	Delegated

STATEMENT OF CONFIDENTIALITY

This report contains no confidential or exempt information under the provisions of Schedule 12A of 1972 Act.

12. BACKGROUND PAPERS

The background papers are available for inspection and will be kept by the author of the report.

13. STATEMENT OF INTERNAL ADVICE

The author (below) confirms that advice has been taken from all appropriate Councillors and Officers.

Author: Jon Triggs, Head of Resources Date: 18th January 2021

Reference: T:\Technical\Adam\Treasury Management\ TM & Annual Investment Strategy 2021.doc