Executive **11 February 2021**

Report of the Chief Finance Officer
Portfolio of the Executive Member for Finance & Performance

Treasury Management Strategy Statement and Prudential Indicators for 2021/22 to 2025/26

Report Summary

1. The purpose of this report is to seek the recommendation of Executive to Full Council for the approval of the treasury management strategy and prudential indicators for the 2021/22 financial year.

Recommendations

2. Executive are asked to recommend that Council approve:
   - The proposed treasury management strategy for 2021/22 including the annual investment strategy and the minimum revenue provision policy statement;
   - The prudential indicators for 2021/22 to 2025/26 in the main body of the report;
   - The specified and non-specified investments schedule (annex B)
   - The scheme of delegation and the role of the section 151 officer (annex D)

   Reason: To enable the continued effective operation of the treasury management function and ensure that all council borrowing is prudent, affordable and sustainable.

Background

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

4. The second main function of the treasury management service is funding of the council’s capital programme. The capital programme provides 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.

5. The contribution the treasury management function makes to the council 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.

6. 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.

7. CIPFA (Chartered Institute of Public Finance and Accountancy) 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. ”

Reporting requirements – Capital Strategy

8. The CIPFA revised 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

9. 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.

10. This capital strategy is reported separately from the Treasury Management Strategy Statement; non-treasury investments will be reported through the former. This ensures the separation of the core treasury function under security, liquidity and yield principles, and the policy and commercialism investments usually driven by expenditure on an asset. The capital strategy will show:
    - The corporate governance arrangements for these types of activities;
    - Any service objectives relating to the investments;
    - The debt related to the activity and the associated interest costs;
    - The payback period (MRP policy);
    - The risks associated with each activity.

11. Where a physical asset is being bought, details of market research, advisers used, ongoing costs and investment requirements will be disclosed, including the ability to sell the asset and realise the investment cash.

12. Where the Council has borrowed to fund any non-treasury investment, there should also be an explanation of why borrowing was required and why the MHCLG Investment Guidance and CIPFA Prudential Code have not been adhered to.

13. If any non-treasury investment sustains a loss during the final accounts and audit process, the strategy and revenue implications will be reported through the same procedure as the capital strategy.

Reporting requirements – Treasury Management

14. The council is currently required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of polices, estimates and actuals. The three reports are:
    - **Treasury mangement strategy statement and prudential indicators report** (this report) – which covers the capital plans including prudential indicators, the minimum revenue provision policy, the treasury managment strategy and the annual investment strategy;
    - **Mid year treasury management report** – updates members as to whether the treasury activities are meeting the strategy, whether any policies require revision, amending prudential indicators if necessary;

- **Annual treasury report** – updates on treasury activity/ operations for the year and compares actual prudential indicators with estimates in the strategy.

15. These reports are required to be scrutinised before being recommended to the council. This scrutiny role is undertaken by Audit & Governance Committee.

16. The CIPFA code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsibe for scrutiny. The training needs of treasury management officers is also periodically reviewed.

Treasury management strategy for 2021/22

17. The treasury managment strategy for 2021/22 covers two main areas:

Capital issues

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

Treasury management issues

- prudential indicators which will limit the treasury management risk and activities of the Council;
- the current treasury position;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- creditworthiness policy;
- investment strategy;
- policy on use of external service providers;
- scheme of delegation and the role of the S151 officer

18. These elements cover the statutory and regulatory requirements of the Local Government Act 2003, the CIPFA Prudential Code, the Ministry of Housing, Communities and Local Government (MHCLG) Minimum Revenue Provision (MRP) Guidance, the CIPFA Treasury Management Code and the MHCLG Investment Guidance.

Treasury management consultants

19. The council uses the Link Group, Treasury solutions as its external treasury management advisors.

20. 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 available information, including, but not solely, our treasury advisers.

21. 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.

The capital prudential indicators 2021/22 – 2025/26

22. The council's capital expenditure plans are the key driver of treasury management activity and are the subject of a separate report on this agenda. The output of the capital programme is reflected in the capital prudential indicators, which are designed to assist member's overview of the council's capital programme to ensure that the capital expenditure plans are affordable, sustainable and prudent.

23. The capital prudential indicators along with the treasury management prudential indicators are included throughout the report:

    PI 1: Capital expenditure
    PI 2: Capital financing requirement
    PI 3: Ratio of financing cost to net revenue stream
    PI 4: External debt
    PI 5a: Authorised limit for external debt
    PI 5b: Operational boundary for external debt
    PI 6: Maturity structure of debt

    PI 7: Surplus funds invested >364 days

24. **Prudential indicator 1 - capital expenditure**. This prudential Indicator is a summary of the council's capital expenditure plans forming part of this budget cycle. 2020/21 is included as a comparator. Detailed information on the individual schemes is provided in the capital monitor 3 and capital strategy report.

Capital Expenditure	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m
General fund (Non HRA)	76.9	137.8	135.9	85.1	13.7	16.6
Housing revenue account	43.0	64.5	39.2	35.0	9.6	9.5

Total	**119.9**	**202.3**	**175.1**	**120.1**	**23.3**	**26.1**

Table 1: Capital expenditure

25. Table 1 details the capital expenditure of the council, based on the capital programme strategy report, excluding other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments. There are no new PFI schemes forecast to be entered into in 2021/22.

26. Further details on this capital expenditure, and how it is funded, are included within the Capital Programme report elsewhere on this agenda.

27. **Prudential indicator 2 - the capital financing requirement (CFR) (council's borrowing need);** the second prudential indicator is the council's capital financing requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

28. The CFR does not increase indefinitely, because 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.

29. The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the council's overall borrowing requirement, these types of scheme include a borrowing facility and so the council is not required to separately borrow for these schemes. As set out in paragraph 47 table 5 the projected level of debt is significantly below the CFR over the 5 year period.

30. Table 2 below, shows the capital financing requirement, excluding other long term liabilities:

Capital Financing Requirement	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m
Non Housing	**264.6**	**325.7**	**338.2**	**349.2**	**341.1**	**335.4**
Housing	**146.4**	**146.4**	**146.4**	**146.4**	**146.4**	**146.4**
Other Long Term Borrowing*	**45.2**	**44.0**	**47.1**	**46.0**	**44.9**	**43.7**
Total CFR	**456.2**	**516.1**	**531.7**	**541.6**	**532.4**	**525.5**

*Other Long Term is for PFI/PPP & Leases

Table 2: Capital financing requirement (CFR)

Minimum revenue provision (MRP) policy statement

31. The council is required to pay off an element of the accumulated general fund capital expenditure 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).

32. MHCLG 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 prudent provision. Full Council is recommended to approved the following MRP statement:

33. For capital expenditure incurred before 1 April 2008 the MRP policy will be:

    - **Asset life method (local approach)** - MRP will be based on the average life of the overall asset base of 33 years. This will be calculated as 3% on a fixed, straight line basis.

34. This provides for a 3% reduction in the borrowing need (CFR) each year.

35. From 1 April 2008 for all 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);

36. This option provides for a reduction in the borrowing need over approximately the asset's life. The asset life is an absolute maximum and wherever possible debt is repaid over a shorter period. Estimated asset life periods will be determined under delegated powers. With all debts, the longer the repayment period the higher the amount of interest incurred over the period of the loan and accordingly it is deemed prudent to reduce the period over which the repayments are made.

37. 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).

38. Repayments included in annual PFI or finance leases are also applied as MRP.

Affordability prudential indicators

39. The prudential indicators mentioned so far in the report cover the overall capital programme and the control of borrowing through the capital financing requirement (CFR), but within this framework prudential indicators are required to assess the affordability of capital investment plans. These provide an indication of the impact of the capital programme investment plans on the council's overall finances.

40. **Prudential indicator 3 - ratio of financing costs to net revenue stream.** This indicator identifies the trend in the cost of capital (borrowing net of investment income) and compares it to the council's net revenue stream.

Financing Costs	2020/21 Estimate %	2021/22 Estimate %	2022/23 Estimate %	2023/24 Estimate %	2024/25 Estimate %	2025/26 Estimate %
Non-HRA	**11.15**	**13.49**	**16.41**	**17.19**	**18.17**	**18.40**
HRA	**12.39**	**12.38**	**12.07**	**11.79**	**11.52**	**11.30**
Total Ratio	**11.39**	**13.28**	**15.56**	**16.11**	**16.82**	**16.93**

Table 3: Ratio of financing costs to net revenue stream

41. The estimates of financing costs include current commitments and the proposals in the capital budget report considered elsewhere on this agenda.

42. The capital prudential indicators set out above ensure that the council's capital expenditure plans are affordable, sustainable and prudent. The treasury management function ensures that cash is available to meet the council's requirements in accordance with the Local Government Act 2003 and relevant professional codes

43. The treasury management function involves both the forecasting of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the prudential / treasury indicators, the current and projected debt positions and the annual investment strategy.

Current portfolio position

44. The council's treasury portfolio position at 31st December 2020 is detailed below in table 4:

Institution Type	Principal	Average Rate

<u>Public Works Loan Board</u> PWLB (58) – Money borrowed from the Debt Management Office (Treasury Agency)	£254.1m	3.49%
<u>Market Loans</u> LOBO Loans (1) – Lender Option Borrower Option	£5.0m	3.88%
<u>West Yorkshire Combined Authority</u> WYCA (4) – Zero interest loans the purpose of which are to help to fund York Central infrastructure projects	£2.4m	0.00%
Total Gross Borrowing (GF & HRA)	**£261.5m**	**3.50%**
Total Investments	**£0.1m**	**0.01%**

Table 4: Current position at 31st December 2020

45. The council had £261.5m of fixed interest rate debt, of which £146.4m was HRA and £115.1m general fund. The cash balance available for investment was £0.1m. As the capital programme has progressed the level of cash available for investment is gradually decreasing as expected as the Council is using previously held balances to fund the programme.

46. Within the prudential indicators, there are a number of key indicators to ensure that the council operates its activities within well-defined limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. One of these is that the council needs to ensure that its total gross debt does not, except in the short term, exceed the total of the capital financing requirement (CFR) in the preceding year plus the estimates of any additional CFR for 2021/22 and the following two financial years. This allows the flexibility to borrow in advance of need but ensures that borrowing is not undertaken for revenue purposes.

47. **Prudential indicator 4 – external debt** Table 5 shows that the estimated gross debt position of the council does not exceed the underlying capital borrowing need. The Chief Finance Officer (s151 officer) confirms that the council complies with this prudential indicator and does not envisage difficulties for the future.

	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m
Gross projected debt*	**354.7**	**425.5**	**455.6**	**480.5**	**487.4**	**497.2**

Total CFR	**456.2**	**516.1**	**531.7**	**541.6**	**532.4**	**525.5**
Under/(over) borrowed	**Under**	**Under**	**Under**	**Under**	**Under**	**Under**

*Gross projected debt includes Other Long Term liabilities such as PFI/PPP & Leases

Table 5: External debt< capital financing requirement

48. Table 5 shows a gap between actual and estimated borrowing and the CFR (driven by the use of internal funds to finance capital expenditure). The decision as to whether to continue to do this will take into account current assumptions on borrowing rates and levels of internal reserves and balances held by the council. The figures above show a decrease in the gap between CFR and external debt as borrowing is taken to support capital expenditure, however this will be determined by the s151 officer and the figure above is a current broad assumption. Actual borrowing will be determined by the circumstances that prevail at the time on borrowing rates and levels of cash balances.

Prudential indicators: limits on authority to borrow

49. **Prudential indicator 5A – authorised borrowing limit** - It is a statutory duty under Section 3 (1) of the Local Government Act 2003 and supporting regulations, for the council to determine and keep under review how much it can afford to borrow. This amount is termed the "authorised borrowing limit", and represents a control on the maximum level of debt. This is a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full council. It reflects the level of external debt, which, while not desired, could be afforded in a short term period of 12 months, but is not sustainable in the longer term.

Authorised Limit	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m
Gross projected debt	**354.7**	**425.5**	**455.6**	**480.5**	**487.4**	**497.2**
Total CFR	**456.2**	**516.1**	**531.7**	**541.6**	**532.4**	**525.5**
Operational Boundary	509.6 (£509.6m set at 20/21 Strategy)	526.1	541.7	551.6	542.4	535.5
Other long term liabilities	30.0	30.0	30.0	30.0	30.0	30.00
Total	**539.6**	**556.1**	**571.7**	**581.6**	**572.4**	**565.5**

	(£539.6m Set at 20/21 Strategy)					

Table 6: Authorised borrowing limit

50. **Prudential indicator 5B – operational boundary**. In addition to the "authorised borrowing limit", the operational boundary is the maximum level of debt allowed for on an ongoing operational purpose. 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.

Operational boundary	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m
Gross projected debt	**354.7**	**425.5**	**455.6**	**480.5**	**487.4**	**497.2**
Total CFR	**456.2**	**516.1**	**531.7**	**541.6**	**532.4**	**525.5**
Short term liquidity	53.4	10.0	10.0	10.0	10.0	10.0
Total	**509.6** **(£509.6m set at 19/20 Strategy)**	526.1	541.7	551.6	542.4	535.5

Table 7: Operational boundary

Prospects for interest rates

51. Current interest rates and the future direction of both long term and short term interest rates have a major influence on the overall treasury management strategy and affects both investment and borrowing decisions. To facilitate treasury management officers in making informed investment and borrowing decisions, the council has appointed the Link Group as its treasury adviser. Part of their service is to assist the council in formulating a view on interest rates. Table 9 below gives Link's central view:

	Bank rate %	PWLB borrowing rates % (including certainty rate adjustment)		
		5 year	25 year	50 year
Mar 2021	0.10	0.80	1.50	1.30
Dec 2021	0.10	0.80	1.60	1.40
Mar 2022	0.10	0.90	1.60	1.40
Dec 2022	0.10	0.90	1.70	1.50
Mar 2023	0.10	0.90	1.70	1.50
Dec 2023	0.10	1.00	1.80	1.60
Mar 2024	0.10	1.00	1.80	1.60

Table 9 – Link's interest rate forecast

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

Investment and borrowing rates

53. Investment returns are likely to remain exceptionally low during 2021/22 with very 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. 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 well over the last few years.

54. 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 different rates for borrowing for different types of capital expenditure.

55. 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.

56. 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.

57. While the Council will not be able to avoid borrowing to finance new capital expenditure, to replace maturing debt and the rundown of reserves, 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

Borrowing strategy

58. The borrowing strategy takes into account the borrowing requirement, the current economic and market environments and is also influenced by the interest rate forecast. 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 remains prudent as investment returns are low and counterparty risk is still an issue that needs to be considered. Consideration will also be given to the maturity profile of the debt portfolio so the council is not exposed to the concentration of debt being in any one year.
59. Against this background and the risks within the economic forecast, caution will be adopted with the treasury operations. The section 151 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 long and short term rates, e.g. due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.
    - if it was felt that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.
60. The HRA strategy for borrowing will be the same as the borrowing strategy described above for the whole council. The HRA Business Plan will guide and influence the overall HRA borrowing strategy.

61. All decisions will be reported to the appropriate decision making body (Executive and Audit & Governance Committee) at the next available opportunity.

Prudential Indicator 6 – Maturity of borrowing

62. Officers will monitor the balance between variable and fixed interest rates for borrowing and investments to ensure the council is not exposed to adverse fluctuations in fixed or variable interest rate movements. This is likely to reflect higher fixed interest rate borrowing if the borrowing need is high or fixed interest rates are likely to increase, a higher variable rate exposure if fixed interest rates are expected to fall. Conversely if shorter term interest rates are likely to fall, investments may be fixed earlier, or kept shorter if short term investment rates are expected to rise.

63. The balance between variable rate debt and variable rate investments will be monitored as part of the overall treasury function in the context of the overall financial instruments structure and any under or over borrowing positions. The council does not currently have any variable rate debt.

64. The upper and lower limits for the maturity structure of fixed rate borrowing are set out below (with actual split for the current financial year included for comparison). This gross limit is set to reduce the council's exposure to large fixed rate sums falling due for refinancing in a confined number of years.

Maturity structure of borrowing				
	Lower	**Upper**	**2020/21 Debt (%)**	**2020/21 Debt (£)**
Under 12 months	0%	30%	3%	£9.0m
12 months to 2 years	0%	30%	2%	£6.0m
2 years to 5 years	0%	40%	10%	£25.3m
5 years to 10 years	0%	40%	21%	£54.4m
10 years and above	30%	90%	64%	£166.8m
Total Borrowing			**100%**	**£261.5m**

Table 10: Maturity structure of borrowing at 31st December 2020

Policy on borrowing in advance of need

65. 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.

66. Borrowing in advance will be made within the constraints of the CIPFA Prudential Code that:

- It will be limited to no more than 50% of the expected increase in borrowing need (CFR) over the three year planning period; and
- The authority would not look to borrow more than 36 months in advance of need

67. 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.

Debt rescheduling

68. Debt rescheduling of current Public Works Loan Board (PWLB) borrowing in our debt portfolio is unlikely to occur as the premature repayment rates provided by the PWLB are much lower than the new borrowing rates provided by the PWLB. The PWLB premature repayment rates are approximately 10-15bps lower than gilt yields. The current low interest rate environment would mean the cost of prematurely repaying any PWLB loans would come with higher premium costs to exit any loans. It is unlikely that any debt rescheduling opportunities will occur in the year ahead but the debt portfolio will continue to be monitored for any opportunities that may prevail.

69. If rescheduling was done, it will be reported to the Executive / Audit & Governance Committee at the earliest meeting following its action.

Municipal Bond Agency

70. The establishment of the UK Municipal Bonds Agency was led by the Local Government Association (LGA) following the 2010 Autumn Statement which resulted in higher PWLB rates, greatly increasing the cost of new borrowing and refinancing. The purpose of the Agency is to deliver cheaper capital finance to local authorities. It will do so via periodic bond issues and by facilitating greater inter-authority lending. The Agency is wholly owned by 56 local authorities and the LGA. The council is a shareholder in the Agency with a total investment of £40k and will make use of this new source of borrowing as and when appropriate.

Annual investment strategy

Investment policy – management of risk

71. 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).

72. 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

73. The Council's investment priorities will be security first, portfolio liquidity second and then yield (return), and finally Ethical, Social & Governance using the FTSE4GOOD index, or any suitable alternative responsible investment index to be decided by the s151 officer, to ensure that Ethical, Social and Governance issues are considered as a fourth critieria.

74. 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:

i. 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.

ii. 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.

iii. 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.

iv. This 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 B 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.

v. Lending limits, (amounts and maturity), for each counterparty will be set through applying the matrix tables in annex B.

vi. Transaction limits are set for each type of investment.

vii. Investments will only be placed with counterparties from countries with a specified minimum sovereign rating, (see annex C).

viii. This authority has engaged external consultants, (see paragraphs 19 to 21), 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.

ix. All investments will be denominated in sterling.

x. 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. (In November 2018, the Ministry of Housing, Communities and Local Government, (MHCLG), concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years ending 31.3.23.)

75. 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 86). Regular monitoring of investment performance will be carried out during the year.

Creditworthiness policy

76. This council applies the creditworthiness service provided by the Link Group. This service employs a sophisticated modeling approach with 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

- CDS spreads to give early warning of likely changes in credit ratings
- sovereign ratings to select counterparties from only the most creditworthy countries

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

- Yellow* 5 years
- Purple 2 years
- Blue 1 year (only applies to nationalised or part nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 100 days
- No colour not to be used

**The yellow category is for UK Government debt or its equivalent (government backed securities) AAA rated funds*

78. The Link creditworthiness model uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue weighting to just one agency's ratings.
79. Typically the minimum credit ratings criteria the council use will be a short term rating (Fitch or equivalents) of F1 and 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.
80. All credit ratings are monitored on a daily basis. The council is alerted to changes to ratings of all three agencies through its use of the Link Group 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 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 councils lending list.

81. Although sole reliance is not placed on the use of this external service, as the council uses market data and market information, information on government support for banks and the credit ratings of that supporting government, the suitability of each counterparty is based heavily on advice from Link.

82. Whilst the council has determined that it will not limit investments to UK banks, due care will be taken to consider the country, group and sector exposure of the Council's investments. The Council has determined that it will only use approved counterparties from countries with a minimum sovereign rating of AA- (excluding the UK) from Fitch (or equivalent). The list of countries that qualify using this credit criteria as at the date of this report are shown in annex C. This list will be added to or deducted from by officers should ratings change in accordance with this policy.

Investment strategy

83. 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 obtainableby investing for longer periods. While most cash balances are required in order to manage 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.

84. 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 investments will be sub 0.50% for the foreseeable future.

85. For its cash flow generated balances, the council will seek to use a combination of business reserve accounts (call accounts), short notice accounts, short dated fixed term deposits and money market funds. In addition, the council will look for investment opportunities in longer dated term deals with specific counterparties that offer enhanced rates for local authority investment. All investment will be undertaken in accordance with the creditworthiness policy set out above.

86. The council will use an investment benchmark to assess the performance of its investment portfolio of 7 day LIBID rate. These benchmarks are simple guides to maximum risk, so they may be breached from time to time depending on movements in interest rates and counter party criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change.

87. **Prudential indicator 7** - total principal investment funds invested for greater than 364 days. This limits is set with regards to the council's liquidity requirements and are based on the availability of funds after each year-end. A maximum principal sum to be invested for greater than 364 days is £15m.

	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m
Maximum limit per year for Investments > 364 days	**15.0**	**15.0**	**15.0**	**15.0**	**15.0**	**15.0**

Table 11: Investments over 364 days

88. At the end of the financial year, the council will report on its investment activity as part of its annual treasury report. It should be noted that the Investment policy, creditworthiness policy and investment startegy are applicable to the council's overall surplus funds and are also applicable to the HRA.

Consultation and options

89. The treasury management function of any business is a highly technical area, where decisions are often taken at very short notice in reaction to the financial markets. Therefore, to enable effective treasury management, all operational decisions are delegated by the council to the Chief Finance Officer, who operates within the framework set out in this strategy and through the treasury management policies and practices. In order to inform sound treasury management operations the council works with its treasury management advisers, the Link Group. Link offers the council a comprehensive information and advisory service that facilitates the council in maximising its investment returns and minimise the costs of its debts.

90. Treasury management strategy and activity is influenced by the capital investment and revenue spending decisions made by the council. Both the revenue and capital budgets have been through a corporate process of consultation and consideration by the elected politicians. The revenue budget and capital budget proposals are included within this agenda.

91. At a strategic level, there are a number of treasury management options available that depend on the council's stance on interest rate movements. The report sets out the council's stance and recommends

the setting of key trigger points for borrowing and investing over the forthcoming financial year.

Council Plan

92. The treasury management strategy statement and prudential indicators are aimed at ensuring the council maximises its return on investments and minimises the cost of its debts whilst operating in a financial environment that safeguards the councils funds. This will allow more resources to be freed up to invest in the council’s priorities, values and imperatives, as set out in the Council Plan.

Implications

Financial

93. The financial implications of the treasury strategy are set out in the Financial Strategy and Capital Strategy reports also on this agenda.

Human Resources (HR)

94. There are no HR implications as a result of this report

Equalities

95. There are no equalities implications as a result of this report

Legal Implications

96. Treasury management activities have to conform to the Local Government Act 2003, the Local Authorities (Capital; Finance and Accounting) (England) Regulations 2003 (SI 2003/3146), which specifies that the council is required to have regard to the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice and also the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 (SI 2008/414), which clarifies the requirements of the Minimum Revenue Provision guidance.

Other implications

97. There are no crime and disorder, information technology or property implications as a result of this report

Risk management

98. The treasury management function is a high-risk area because of the volume and level of large money transactions. As a result of this the

Local Government Act 2003 (as amended), supporting regulations, the CIPFA Prudential Code and the CIPFA Treasury Management in the Public Services Code of Practice (the code) are all adhered to as required.

<table>
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<tr><td colspan="4"></td></tr>
<tr><td colspan="4">Wards Affected: Not Applicable</td><td></td></tr>
</table>

For further information please contact the author(s) of the report

Background papers
none

Annexes
Annex A – Interest rate forecast
Annex B – Specified and non-specified investments categories schedule
Annex C – Approved countries for investments
Annex D – Scheme of delegation and the role of the section 151 officer