

## TREASURY MANAGEMENT STRATEGY 2022/23

Finance & Investment Advisory Committee - 11 January 2022

**Report of:** Deputy Chief Executive and Chief Officer - Finance & Trading

**Status:** For Decision

**Also considered by:**

- Cabinet - 10 February 2022
- Council - 22 February 2022

**Key Decision:** No

**Executive Summary:** The Local Government Act 2003 (the Act) and supporting regulations requires the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by investment guidance issued subsequent to the Act). This sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

The Annual Investment Strategy remains largely the same as for 2021/22 with the addition of Bond, Property, Equity and Multi-Asset Funds as an alternative investment option.

It should be noted that changes to the Treasury Management and Prudential Codes will take effect from 2023/24.

**This report supports the Key Aim of:** efficient management of the Council's resources.

**Portfolio Holder:** Cllr. Matthew Dickins

**Contact Officer:** Roy Parsons, Ext. 7204

**Recommendation to Finance & Investment Advisory Committee:**

That the report be noted and comments forwarded to Cabinet.

**Recommendation to Cabinet:**

That, subject to the comments of the Finance & Investment Advisory Committee, Cabinet recommend that Council approve the Treasury Management Strategy for 2022/23.

**Recommendation to Council:**

That the Treasury Management Strategy for 2022/23 be approved.

**Reason for recommendations:** To ensure that an appropriate and effective annual Treasury Management Strategy is drawn up in advance of the forthcoming financial year, which meets both legislative and best practice requirements.

**Background**

- 1 The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.
- 2 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.
- 3 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.
- 4 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.
- 5 The Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as:

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

## **Introduction**

### Reporting requirements - Capital Strategy

- 6 The CIPFA 2017 Prudential and Treasury Management Codes require all local authorities to prepare a capital strategy report, which will provide the following:
  - a high-level long term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services;
  - an overview of how the associated risk is managed; and
  - the implications for future financial sustainability.
- 7 The aim of this capital strategy is to ensure that Members fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

### Reporting requirements - Treasury Management

- 8 The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals. These reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Finance & Investment Advisory Committee.
  - a) Prudential and treasury indicators and treasury strategy (this report) -  
The first, and most important report covers:
    - the capital plans (including prudential indicators);
    - a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
    - the Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury indicators; and
    - an investment strategy (the parameters on how investments are to be managed).
  - 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.

## Treasury Management Strategy for 2022/23

9 The strategy for 2022/23 covers two main areas:

### *Capital issues*

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

### *Treasury management issues*

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

10 These elements cover the requirements of the Local Government Act 2003, the Department of Levelling Up, Housing and Communities (DLUHC) MRP Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code.

## Training

- 11 The CIPFA Code requires the responsible officer to ensure that Members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. Training was last undertaken on 14 November 2018 and further training will be arranged as required.
- 12 The training needs of treasury management officers are reviewed periodically.

## Treasury management consultants

- 13 The Council uses Link Asset Services, Treasury Solutions as its external treasury management advisors.
- 14 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 management advisors.

- 15 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 2022/23 - 2024/25**

- 16 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.

#### Capital Expenditure

- 17 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 note the capital expenditure forecasts:

Capital expenditure	2020/21 Actual £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000
Services	8,693	15,073	9,111	4,077	2,049
<b>Total</b>	<b>8,693</b>	<b>15,073</b>	<b>9,111</b>	<b>4,077</b>	<b>2,049</b>

- 18 The above financing need excludes other long term liabilities, such as PFI and leasing arrangements that already include borrowing instruments.
- 19 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 need (borrowing) although this may be funded through internal borrowing initially.

Financing of capital expenditure	2020/21 Actual £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000
Capital expenditure	8,693	15,073	9,111	4,077	2,049
<b>Financed by:</b>					
Capital receipts	8,504	4,062	639	1,556	8
Capital grants	0	2,028	2,618	1,128	1,128

<b>Financing of capital expenditure</b>	<b>2020/21 Actual £000</b>	<b>2021/22 Estimate £000</b>	<b>2022/23 Estimate £000</b>	<b>2023/24 Estimate £000</b>	<b>2024/25 Estimate £000</b>
Capital reserves	0	563	593	563	563
Mixed funding	189	420	4,211	830	350
<b>Net financing need for the year</b>	<b>0</b>	<b>8,000</b>	<b>1,050</b>	<b>0</b>	<b>0</b>

#### The Council's Borrowing Need (the Capital Financing Requirement)

- 20 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 its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.
- 21 The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each asset's life, and so charges the economic consumption of capital assets as they are used.
- 22 The CFR includes any other long term liabilities (e.g. PFI schemes and finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility by the lease provider and so the Council is not required to separately borrow for these schemes.
- 23 The Council is asked to approve the CFR projections below:

<b>Capital Financing Requirement</b>	<b>2020/21 Actual £000</b>	<b>2021/22 Estimate £000</b>	<b>2022/23 Estimate £000</b>	<b>2023/24 Estimate £000</b>	<b>2024/25 Estimate £000</b>
Services	27,515	35,230	42,944	43,708	43,422
<b>Total CFR</b>	<b>35,230</b>	<b>42,944</b>	<b>43,708</b>	<b>43,422</b>	<b>43,136</b>
<b>Movement in CFR</b>	<b>7,715</b>	<b>7,714</b>	<b>764</b>	<b>-286</b>	<b>-286</b>

Capital Financing Requirement	2020/21 Actual £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000
<b>Movement in CFR represented by:</b>					
Net financing need for the year (above)	0	8,000	1,050	0	0
<u>Less</u> MRP/VRP and other financing movements	7,715	-286	-286	-286	-286
<b>Movement in CFR</b>	<b>7,715</b>	<b>7,714</b>	<b>764</b>	<b>-286</b>	<b>-286</b>

Note:- The MRP / VRP includes finance lease annual principal payments

#### Core Funds and Expected Investment Balances

- 24 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 on-going 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.

<b>Year End Resources</b>	<b>2020/21</b>	<b>2021/22</b>	<b>2022/23</b>	<b>2023/24</b>	<b>2024/25</b>
	<b>Actual £000</b>	<b>Estimate £000</b>	<b>Estimate £000</b>	<b>Estimate £000</b>	<b>Estimate £000</b>
Fund balances / reserves	22,888	26,264	23,004	18,663	16,580
Capital receipts	8,504	4,062	639	1,556	8
Provisions	409	409	409	409	409
Other	0	0	0	0	0
<b>Total core funds</b>	<b>31,801</b>	<b>30,735</b>	<b>24,052</b>	<b>20,628</b>	<b>16,997</b>
Working capital*	9,033	9,133	9,233	9,333	9,433
Under/(over) borrowing	28,063	27,903	29,135	29,327	29,528
<b>Expected investments</b>	<b>12,771</b>	<b>11,965</b>	<b>4,150</b>	<b>634</b>	<b>-3,097</b>

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

#### **Minimum revenue provision (MRP) policy statement**

- 25 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).
- 26 DLUHC 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:
- 27 For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be based on CFR. This option provides for an approximate 4% reduction in the borrowing need (CFR) each year.
- 28 From 1 April 2008 for all unsupported borrowing (including PFI and finance leases), the MRP policy will be either:
- 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); or

- Depreciation method - MRP will follow standard depreciation accounting procedures.

These options provide for a reduction in the borrowing need over approximately the asset's life. Repayments included in PFI or finance leases are applied as MRP.

- 29 It is proposed to use the 'asset life method' in the calculation of the Council's MRP. In choosing to do so, there are two options available:
- Equal instalments - where the principal repayment made is the same in each year; or
  - Annuity - where the principal repayments increase over the life of the asset.
- 30 Of the two options, the annuity method seems to be the most suitable for the Council at this time, particularly for assets that generate income. It matches the repayment profile to how the benefits of the asset financed by borrowing are consumed over its useful life (i.e. it reflects the fact that asset deterioration is slower in the early years of an asset and accelerates towards the latter years). Interest will be greater at the beginning of the loan, at which time all of the principal is outstanding, so the amount of principal repayment is lower in the initial years. The schedule of charges produced by the annuity method results in a consistent charge of principal and interest over an asset's life, taking into account the real value of the annual charges when they fall due.
- 31 MRP commences in the financial year following that in which the expenditure is incurred, or in the year following that in which the relevant asset becomes operational. This enables an MRP "holiday" to be taken in relation to assets which take more than one year to be completed before they become operational.
- 32 MRP Overpayments - A change introduced by the revised DLUHC MRP Guidance was the allowance that any charges made over the statutory minimum 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 total VRP overpayments have been nil.

### **The Borrowing and Repayment Strategy**

- 33 The capital expenditure plans set out above provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity and the Council's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury/prudential

indicators, the current and projected debt positions and the annual investment strategy.

#### Current portfolio position

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

External debt	2020/21 Actual £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000
Debt at 1 April	5,015	4,892	12,766	12,298	11,820
Expected change in Debt	-123	7,874	-468	-478	-487
Other long-term liabilities (OLTL)	2,275	2,275	2,275	2,275	2,275
Expected change in OLTL	0	0	0	0	0
Actual gross debt at 31 March	7,167	15,041	14,573	14,095	13,608
The Capital Financing Requirement (CFR)	35,230	42,944	43,708	43,422	43,136
Under / (over) borrowing	28,063	27,903	29,135	29,327	29,528

- 35 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 2022/23 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes.
- 36 The Deputy Chief Executive and Chief Officer - Finance & Trading 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.

## Treasury Indicators: Limits to Borrowing Activity

### The operational boundary

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

Operational boundary	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000
Debt	30,000	30,000	30,000	30,000
Other long term liabilities	2,275	2,275	2,275	2,275
<b>Total</b>	<b>32,275</b>	<b>32,275</b>	<b>32,275</b>	<b>32,275</b>

### The authorised limit for external debt

- 38 This is a key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.
- 39 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.
- 40 The Council is asked to approve the following authorised limit:

Authorised limit	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000
Debt	35,000	35,000	35,000	35,000
Other long term liabilities	2,275	2,275	2,275	2,275
<b>Total</b>	<b>37,275</b>	<b>37,275</b>	<b>37,275</b>	<b>37,275</b>

## Prospects for interest rates

- 41 The Council has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Link provided the following forecasts on 20 December 2021. These are forecasts for PWLB certainty rates (gilt yields plus 80bps).

Link Group Interest Rate View 20.12.21														
	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
BANK RATE	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25
3 month ave earnings	0.20	0.30	0.50	0.50	0.60	0.70	0.80	0.90	0.90	1.00	1.00	1.00	1.00	1.00
6 month ave earnings	0.40	0.50	0.60	0.60	0.70	0.80	0.90	1.00	1.00	1.10	1.10	1.10	1.10	1.10
12 month ave earnings	0.70	0.70	0.70	0.70	0.80	0.90	1.00	1.10	1.10	1.20	1.20	1.20	1.20	1.20
5 yr PWLB	1.40	1.50	1.50	1.60	1.60	1.70	1.80	1.80	1.80	1.90	1.90	1.90	2.00	2.00
10 yr PWLB	1.60	1.70	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10	2.20	2.30
25 yr PWLB	1.80	1.90	2.00	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.40	2.40	2.50	2.50
50 yr PWLB	1.50	1.70	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.20	2.20	2.30	2.30

- 42 Appendix A draws together a number of current City views on the prospects for short term and longer fixed interest rates. Appendix B contains Link Group's latest economic background report and the risks for interest rates as at December 2021.

## Borrowing Strategy

- 43 The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement or CFR) 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.

- 44 Against this background and the risks within the economic forecast, caution will be adopted with the 2022/23 treasury operations. The Deputy Chief Executive and Chief Officer - Finance & Trading 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*, then long term borrowings will be postponed.
- *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 an acceleration in the start date and 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.

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

#### Policy on borrowing in advance of need

- 46 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.
- 47 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

- 48 Rescheduling of current borrowing in our debt portfolio is unlikely to occur as the level of debt is relatively low and there is still a very large difference between premature redemption rates and new borrowing rates.
- 49 If rescheduling were to be carried out, it will be reported to Cabinet at the earliest meeting following its action.

#### New financial institutions as a source of borrowing

- 50 Currently, the PWLB Certainty Rate is set at gilts plus 80 bps. However, consideration may still need to be given to obtaining funding from the following sources:
- Local authorities (primarily shorter dated maturities out to 3 years or so, which are still cheaper than the Certainty Rate).
  - Financial institutions (primarily insurance companies and pension funds but also some banks, out of forward dates, where the objective is to avoid a “cost of carry” or to achieve refinancing certainty over the next few years).
  - Municipal Bonds Agency.
- 51 Our advisors will keep us informed as to the relative merits of each of these alternative funding sources.

#### Affordability prudential indicators

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

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

- 53 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.

Ratio of financing costs	2020/21 Actual	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Services	1%	1%	2%	2%	2%
<b>Total</b>	<b>1%</b>	<b>1%</b>	<b>2%</b>	<b>2%</b>	<b>2%</b>

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

#### Maturity structure of borrowing

- 54 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.
- 55 Members are asked to note the following treasury indicators and limits:

<b>Maturity structure of fixed interest rate borrowing 2022/23</b>		
	<b>Lower</b>	<b>Upper</b>
Under 12 months	0%	100%
12 months to 2 years	0%	100%
2 years to 5 years	0%	100%
5 years to 10 years	0%	100%
10 years and above	0%	100%
<b>Maturity structure of variable interest rate borrowing 2022/23</b>		
	<b>Lower</b>	<b>Upper</b>
Under 12 months	0%	100%
12 months to 2 years	0%	100%
2 years to 5 years	0%	100%
5 years to 10 years	0%	100%
10 years and above	0%	100%

## **Annual Investment Strategy**

### Current investment portfolio position

- 56 The Council's treasury portfolio position at 1 December 2021 appears in Appendix C.
- 57 The Council's global investment position are shown in Appendix C including loans to other organisations.

### Loans to other organisations

- 58 The Council has loaned money to other organisations. Details appear in Appendix C.

## Investment policy - management of risk

- 59 The Department of Levelling Up, Housing & Communities (DLUHC) 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).
- 60 The Council’s investment policy has regard to the following:
- DLUHC’s Guidance on Local Government Investments (“the Guidance”)
  - CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 (“the Code”)
  - CIPFA Treasury Management Guidance Notes 2018
- 61 The Council’s investment priorities will be security first, portfolio liquidity second and then yield (return).
- 62 The above guidance from the DLUHC and CIPFA place a high priority on the management of risk. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means:-
- a) 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.
  - b) Credit 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.
  - c) 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.
  - d) 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 Appendix D 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 or have less than a year left to run to maturity if originally they were originally classified as being non-specified investments solely due to the maturity period exceeding 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.
- e) The Council has determined that it will limit the maximum total exposure to non-specified investments as being 50% of the total investment portfolio (see paragraph 68).
  - f) Lending limits (amounts and maturity) for each counterparty will be set through applying the table in paragraph 70.
  - g) This authority will set a limit for the amount of its investments which are invested for longer than 365 days (see paragraph 82).
  - h) Investments will only be placed with counterparties from countries with a specified minimum sovereign rating, (see Appendix E and paragraphs 74 and 75).
  - i) This authority has engaged external consultants, Link Group 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.
  - j) All investments will be denominated in sterling.
  - k) As a result of the change in accounting standards for 2022/23 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 on 31 March 2023.

- 62 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 83). Regular monitoring of investment performance will be carried out during the year.
- 63 The above criteria are unchanged from the current financial year.

#### Creditworthiness policy

- 64 The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that:
- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and
  - It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the

Council's prudential indicators covering the maximum principal sums invested.

- 65 The Deputy Chief Executive and Chief Officer - Finance & Trading will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.
- 66 Credit rating information is supplied by Link Group, our treasury advisors, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating Watches (notification of a likely change), rating Outlooks (notification of the longer term bias outside the central rating view) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating Watch applying to counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions
- 67 The criteria for providing a pool of high quality investment counterparties (both specified and non-specified investments) is:
- Banks 1 (Good credit quality). UK banks having, as a minimum, the following Fitch, Moody's and Standard & Poor's credit ratings (where rated):
    - i. Short Term - F1
    - ii. Long Term - A-
  - Banks 2 (Good credit quality). Non-UK banks domiciled in a country which has a minimum sovereign Long Term rating of AA- and having, as a minimum, the following Fitch, Moody's and Standard & Poor's credit ratings (where appropriate):
    - i. Short Term - F1
    - ii. Long Term - A-
  - Banks 3 (Part nationalised UK Bank - Royal Bank of Scotland). This bank can be included provided it continues to be part nationalised or it meets the rating requirements in Banks 1 above.
  - Banks 4 (The Council's own banker for transactional purposes, if it falls below the above criteria). Balances will be minimised in both monetary size and time invested.
  - Bank subsidiary and treasury operation. The Council will use these where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above.
  - Building societies. The Council will use all societies which:

- i. Meet the ratings for banks outlined above; or
  - ii. Have assets in excess of £3bn;
- or meet both criteria.
- Money Market Funds (MMFs). Minimum AAA credit rating from at least two of the three rating agencies and with a fund size in excess of £1bn. New EU regulations implemented in January 2019 changed fund valuation methodology from Constant Net Asset Valuation (CNAV) to either Low Volatility Net Asset Valuation (LVNAV) or CNAV. As a consequence, the Council approves the use of Money Market Funds that operate under CNAV (those that invest exclusively in government securities) or operate under LVNAV (all other liquidity funds)
  - Bond, Property, Equity or Multi-Asset Funds.
  - UK Government (including gilts, Treasury Bills and the DMADF).
  - Local authorities, housing associations, parish councils etc.

- 68 A limit of 50% will be applied to the use of non-specified investments.
- 69 Additional requirements under the Code require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating Watches/Outlooks) will be applied to compare the relative security of differing investment opportunities.
- 70 The time and monetary limits for institutions on the Council's counterparty list are as follows (these will cover both specified and non-specified investments):

	Fitch Long Term Rating (or equivalent)	Money and/or % Limit	Time Limit
Banks 1	A-	£7m	2 years
Banks 2	A-	£5m	2 years
Banks 3	N/A	£7m	2 years
Banks 4	N/A	£7m	1 day
Bank subsidiaries	A-	£7m	2 years
Rated building societies (assets over £3bn)	N/A	£5m	2 years
Unrated building societies (assets over £3bn)	N/A	£3m	1 year
Money Market Funds (CNAV)	AAA	£5m (per Fund)	Liquid
Money Market Funds (LVNAV)	AAA	£5m (per Fund)	Liquid
Bond, Property, Equity & Multi-Asset Funds	N/A	£5m (per Fund)	Liquid
UK Government DMADF	UK sovereign rating	£5m	6 months
Local authorities, housing associations etc	N/A	£5m (each)	2 years

71 The proposed criteria for specified and non-specified investments are shown in Appendix D.

#### Creditworthiness issues

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

73 Although bank CDS prices (these are market indicators of credit risk) spiked upwards at the end of March / early April 2020 due to the heightened market uncertainty and ensuing liquidity crisis that affected financial markets, they have returned to more average levels since then. However, sentiment can easily shift, so it will remain important to undertake continual monitoring of all aspects of risk and return in the current circumstances. Link Group monitor CDS prices as part of their creditworthiness service to local authorities.

#### Other limits

- 74 Due care will be taken to consider the exposure of the Council's total investment portfolio to non-specified investments, countries, groups and sectors.
- 75 The Council has determined that it will only use approved counterparties from the UK and from countries with a minimum sovereign credit rating of AA- from Fitch (or equivalent). The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix E. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.
- 76 In addition:
- no more than 15% of the total fund will be placed with any non-UK country at any time. The only country, other than the UK, currently approved for investment is Sweden;
  - total investment in any single institution , or institutions within a group of companies, is limited to 25% of the total fund at the time an investment is placed;

#### Investment Strategy

- 77 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).
- 78 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.
- 79 The current forecast shown above includes a forecast for a first increase in Bank Rate in May 2022, though it could come in February.

- 80 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 (based on a first increase in Bank Rate in quarter 2 of 2022):
- 2022/23 0.50%
  - 2023/24 0.75%
  - 2024/25 1.00%
  - 2025/26 1.25%
  - Later years 2.00%
- 81 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 in order to benefit from the compounding of interest.
- 82 Members are asked to note the following treasury indicator and limit. These limits are set with regard to the Council's liquidity requirements and to reduce the need for an early sale of an investment. They are based on the availability of funds after each year-end.

<b>Upper limit for principal sums invested for longer than 365 days</b>	<b>2022/23 £m</b>	<b>2023/24 £m</b>	<b>2024/25 £m</b>
Limit for principal sums invested for longer than 365 days	£10m	£10m	£10m
Current investments at 1/12/21 in excess of 1 year maturing in each year	-	-	-

#### Investment risk benchmarking

- 83 The Council will use an investment benchmark to assess the performance of its portfolio. The benchmarks will be 7 day and 3 month LIBID uncompounded for the time being. Publication of official LIBOR figures (and related LIBID calculations) will cease in 2022 and be replaced with SONIA (Sterling Overnight Index Average), which is the risk-free rate for sterling markets administered by the Bank of England.

#### End of year investment report

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

## Scheme of delegation

- 85 The guidance notes accompanying the revised Code also require that a statement of the Council's scheme of delegation in relation to treasury management is produced as part of the Annual Investment Strategy. This appears at Appendix F.

## Revision of the treasury management and prudential codes and the role of the Section 151 officer

- 86 As with the scheme of delegation mentioned in the previous paragraph, a statement of the role of the Section 151 officer is also required. This appears at Appendix G. This has been expanded to take account of the anticipated additional disclosure requirements resulting from CIPFA's review of the Treasury Management and Prudential Codes. Link Group's high level appraisal of the new codes appears at Appendix H.

## **Key Implications**

### Financial

The management of the Council's investment portfolio and cash-flow generated balances plays an important part in the financial planning of the authority. The security of its capital and liquidity of its investments is of paramount importance.

### Legal Implications and Risk Assessment Statement

Under Section 151 of the Local Government Act 1972, the Section 151 Officer has statutory duties in relation to the financial administration and stewardship of the authority, including securing effective arrangements for treasury management.

This treasury management strategy report fulfils the requirements of The Chartered Institute of Public Finance & Accountancy's Code of Practice on Treasury Management 2017.

Treasury management has two main risks :

- Fluctuations in interest rates can result in a reduction in income from investments; and
- A counterparty to which the Council has lent money fails to repay the loan at the required time.

Consideration of risk is integral in our approach to treasury management. The movement in previous years towards having a restricted lending list of better quality institutions but higher individual limits with those institutions has reduced the chances of a default. But if a default did occur, the potential loss would be greater.

These risks are mitigated by the annual investment strategy which has been prepared on the basis of achieving the optimum return on investments commensurate with proper levels of security and liquidity. However, Members

should recognise that in the current economic climate, these remain significant risks and that the strategy needs to be constantly monitored.

### Equality Assessment

The decisions recommended through this paper have a remote or low relevance to the substance of the Equality Act. There is no perceived impact on end users.

### **Conclusions**

The effect of the proposals set out in this report is to allow the Council to effectively and efficiently manage cash balances.

In line with the revised CIPFA Code of Practice on Treasury Management, the Annual Treasury Strategy Statement must be considered by Council and this is planned for its meeting on 22 February 2022.

### **Appendices**

Appendix A - Prospects for interest rates

Appendix B - Economic background and interest rate risks

Appendix C - Investment and Loan portfolio at 1 December 2021

Appendix D - Specified and non-specified investments

Appendix E - Approved countries for investments

Appendix F - Treasury management scheme of delegation

Appendix G - The treasury management role of the S151 officer

Appendix H - 2021 revised Treasury Management and Prudential Codes

### **Background Papers**

None

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**Deputy Chief Executive and Chief Officer - Finance & Trading**