Cabinet

29 January 2020

Title	Treasury Management Strategy Statement 2020/21		
Purpose of the report	To make a recommendation to Council		
Report Author	Anna Russell, Deputy Chief Accountant		
Cabinet Member	Councillor Tony Harman	**Confidential**	No
Corporate Priority	Financial Sustainability		
Recommendations	**To make a recommendation to Council to approve the proposed Treasury Management Strategy for 2020/21 as set out in this report.** **To note the updated Treasury Management Practices (TMP) and Schedules**		
Reason for Recommendation	**The Treasury Management strategy is fundamental to developing the financial sustainability of the Council.**		

1. Key issues

1.1 The Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition* (the CIPFA Code) requires the Council to approve a treasury management strategy before the start of each financial year.

1.2 In addition, the Ministry for Housing, Communities and Local Government (MHCLG) 2018 *Investments Guidance* requires the Council to approve an investment strategy before the start of each financial year, including for non-treasury investments.

1.3 This report fulfils the Council's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the MHCLG Guidance.

1.4 The Council has borrowed and invested substantial sums of money and is consequently exposed to financial risks such as loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk, defined by the Treasury Management Strategy, are therefore central to the Council's prudent financial management.

1.5 In accordance with the MHCLG Guidance, the Council could be asked to approve a revised Treasury Management Strategy Statement should the assumptions on which this report is based change significantly before the annual publication. Such circumstances would include, for example, a large unexpected changes in interest rates, in the Council's Capital Programme or in the level of its investment balances.

1.6 The Treasury Management Practices (TMP) and Schedules, included at Appendix C, set out the manner in which this Council will seek to achieve its treasury management policies and objectives and how it will manage and control those activities.

External Context - Economic background

1.7 The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Council's treasury management strategy for 2020/21. The General Election has removed some uncertainty within the market, however following the expected Withdrawal Bill, uncertainties around the future trading relationship with the EU remain.

1.8 GDP growth rose by 0.4% in the third quarter of 2019 from -0.2% in the previous three months with the annual rate falling further below its trend rate to 1.1% from 1.2%. Services, construction and production added positively to growth, by 0.5%, 1.2% and 0.1% respectively, while agriculture recorded a fall of 0.1%. Looking ahead, the Bank of England's Monetary Policy Report (formerly the Quarterly Inflation Report) forecasts economic growth to pick up during 2020 as Brexit-related uncertainties dissipate and provide a boost to business investment helping GDP reach 1.6% in Q4 2020, 1.8% in Q4 2021 and 2.1% in Q4 2022.

1.9 The headline rate of UK Consumer Price Inflation remained the same in November 2019 at 1.5% year-on-year, the same as October 2019, however continuing to fall from highs of 2.1% in July and April 2019 as accommodation services and transport continued to contribute to a level of inflation below the BOE target of 2%. Labour market data continues to be positive. The ILO unemployment rate continues to hold at historic lows at 3.8%, its lowest level since 1975. The 3-month average annual growth rate for pay excluding bonuses rose to 3.5% in November 2019 providing some evidence that a shortage of labour is supporting wages. However, adjusting for inflation this means real wages were only up by 0.9% in October 2019 and only likely to have a moderate impact on household spending.

1.10 Domestic inflationary pressures have abated, as domestic gas and electricity price freezes have taken effect until 2020. The price of oil has fallen through the year, despite a rise in prices in December 2019. The limited inflationary pressure from real wages will likely keep inflation below the Bank of England target of 2%. The Bank of England maintained Bank Rate to 0.75% in November following a 7-2 vote by the Monetary Policy Committee. Despite keeping rates on hold, MPC members did confirm that if Brexit uncertainty drags on or global growth fails to recover, they are prepared to cut interest rates as required. Moreover, the downward revisions to some of the growth projections in the Monetary Policy Report suggest the Committee may now be less convinced of the need to increase rates even if there is a Brexit deal.

1.11 The US economy has continued to perform relatively well compared to other developed nations; however, the Federal Reserve has started to unwind its monetary tightening through 2019. The Federal Reserve has cut rates three times to 1.5% - 1.75%, to stimulate growth as GDP growth has started to fall (to 2.1%).

1.12 The fallout from the US-China trade war continues which, risks contributing to a slowdown in global economic activity in 2019. Recent suggestions have been an initial compromise and potential unwinding of tariffs; however, this can change quickly. Slow growth in Europe, combined with changes in leadership at the ECB and IMF has led to a change of stance in 2019. Quantitative easing has continued and been extended.

External Context - Credit Outlook

1.13 The recent Bank of England stress tests assessed all seven UK banking groups. The tests scenarios include deep simultaneous recessions in the UK and global economies that are more severe overall than the global financial crisis, combined with large falls in asset prices and a separate stress of misconduct costs. All seven banks passed the test on both a CET1 ratio and a leverage ratio basis. Major banks have steadily increased their capital for many years now. However, there are a number of shortcomings in the Bank's approach; timeliness as the results are over 11 months of out date when they are published, being based on end-2018 balance sheets; ringfencing, as the tests ignore the restrictions on transferring capital between ringfenced "retail" banks and non-ringfenced "investment" banks within the larger groups and; coverage – the tests should be expanded to cover a wider range of UK banks and building societies.

1.14 The Bank of England will seek to address some of these issues in 2020, when Virgin Money/Clydesdale will be added to the testing group and separate tests will be included of ringfenced banks.

1.15 Challenger banks hit the news headlines in 2019 with Metro Bank and TSB Bank both suffering adverse publicity and falling customer numbers.

1.16 Looking forward, the potential for a "no-deal" Brexit and/or a global recession remain the major risks facing banks and building societies in 2020/21 and a cautious approach to bank deposits remains advisable.

External Context - Interest Rate Forecast

1.17 The Council's treasury management adviser Arlingclose is forecasting that Bank Rate will remain at 0.75% until the end of 2022. The risks to this forecast are deemed to be significantly weighted to the downside, particularly given the need for clarity on Brexit and the continuing global economic slowdown. The Bank of England, having previously indicated interest rates may need to rise if a Brexit agreement was reached, stated in its November Monetary Policy Report and its Bank Rate decision (7-2 vote to hold rates) that the MPC now believe this is less likely even in the event of a deal.

1.18 Gilt yields have risen but remain at low levels and only some very modest upward movement from current levels are expected based on Arlingclose's interest rate projections. The central case is for 10-year and 20-year gilt yields to rise to around 1.00% and 1.40% respectively over the time horizon, with broadly balanced risks to both the upside and downside. However, short-term volatility arising from both economic and political events over the period is a near certainty.

1.19 A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix A.

1.20 For the purpose of setting the budget, it has been assumed that new treasury management investments will be made at an average rate of 1.7% (3.0% excluding money market investments), and that new long-term loans will be borrowed at an average rate of 2.2%.

Local Context

1.21 On 31 December 2019, the Council held £1,085.4m of borrowing, £112.3m of treasury investments and £998.3m of non-treasury investment property. Overall, the Council holds investments of £25.2m net of borrowing. This is broken down further in Table 1 next.

Table 1: Current Investment & Debt Portfolio Position

As at 30.11.2019	Actual Portfolio	Average Rate
	£m	**%**
External Borrowing:		
Public Works Loan Board	(1,032.9)	2.3%
Local Authorities (short term)	(52.5)	1.0%
Total Gross External Debt	**(1,085.4)**	
Long-Term Investments:		
Pooled Fund Investments	34.3	5.1%
Fixed Term Loan – Housing Association	2.0	3.6%
Funding Circle	0.3	5.0%
Short-Term Investments:		
Local Authorities	15.0	1.0%
Other Investment funds	20.0	0.9%
Money Market Funds	40.7	0.7%
Total Investments	**112.3**	
Net (borrowing) / investments	(973.1)	
Non-treasury investments:		
Investment property	**998.3**	**5.0%**
Overall net investments	**25.2**	**-**

1.22 Funding Circle is a peer-to-peer lending platform which provides an alternative borrowing mechanism for small businesses. This investment was made in April 2015 and is being viewed as a diversification tool within the investment portfolio and also an economic development opportunity enabling the Council to support local businesses where demand exists.

1.23 **Minimum Revenue Provision (MRP):** The Council's Annual MRP Statement is included at Appendix B. MRP is the amount charged to revenue as required when an authority finances capital expenditure by borrowing.

1.24 Forecast changes in the capital financing requirement (CFR), investments and borrowing are shown in the balance sheet summary in Table 2 next.

Table 2: Balance sheet summary and forecast

	Actual	Forecast	Estimate	Estimate	Estimate
	31.03.2019	31.03.2020	31.03.2021	31.03.2022	31.03.2023
	£m	£m	£m	£m	£m
Investment Properties	1,024	1,078	1,089	1,100	1,112
Property Development	8	39	69	81	91
General Fund services	19	29	40	51	62
Total CFR	**1,051**	**1,146**	**1,198**	**1,232**	**1,265**
Less: External borrowing*	(1,050)	(1,143)	(1,194)	(1,225)	(1,255)
Internal borrowing	**1**	**3**	**4**	**7**	**10**
Usable reserves	(25)	(25)	(25)	(25)	(25)
Working capital	(71)	(40)	(30)	(20)	(20)
Treasury investments	95	62	51	38	35

* Shows loans to which the Council is committed, with estimates based on future plans.

1.25 The underlying need to borrow for capital purposes is measured by the CFR, while usable reserves and working capital are the underlying resources available for investment. The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

1.26 The Council has an increasing CFR due to the capital programme. This is with minimal investment, and the Council will therefore be required to borrow up to £205m over the period 2019/20 to 2022/23.

1.27 CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that an authority's total debt be lower than its highest forecast CFR over the next three years. Table 2 above shows that the Council expects to comply with this recommendation during 2020/2021 and in each of the subsequent years.

Local context - Liability benchmark

1.28 To compare the Council's actual borrowing against an alternative strategy, a liability benchmark (a measure of risk proposed by CIPFA) has been calculated showing the lowest risk level of borrowing, shown at Table 3. This assumes the same forecasts as Table 2 above, but that cash and investment balances are kept to a minimum level of £10m at each year-end to maintain sufficient liquidity but also minimise credit risk. This minimum investment reflects the Council's status as a professional client in terms of MIFD requirements (referred to at 2.53 below).

Table 3: Liability benchmark

	Actual	Forecast	Estimate	Estimate	Estimate
	31.03.2018	31.03.2019	31.03.2020	31.03.2021	31.03.2022
	£m	£m	£m	£m	£m
CFR	1,051	1,146	1,198	1,232	1,265
Less: Usable reserves	(25)	(25)	(25)	(25)	(25)
Less: Working capital	(71)	(40)	(30)	(20)	(20)
Minimum investment	10	10	10	10	10
Liability benchmark	965	1,091	1,153	1,197	1,230

1.29 The Liability benchmark indicates that the required minimum level of borrowing is forecast to be £1,153m as at 31 March 2020 after taking into account usable reserves, working capital and the minimum investment, in this case set at £10m for MIFD purposes.

2. Borrowing and Investment Strategies

Borrowing Strategy

2.1 The Council currently holds £1,085m of loans, an increase of £35m on the previous year, as part of its strategy for funding previous years' capital programmes. The Council was debt free before 2016/17, when the decision was taken to make strategic property acquisitions based on the opportunities available. The Council may also borrow on a short-term basis to fund VAT elements of property acquisitions, which are recovered from HMRC.

2.2 The revised capital programme budget for 2019/20 has been set at £102m. The Council's Authorised Borrowing Limit has been set at £1,500m in line with the change in the capital programme. This is to enable the Council to fund housing developments and place-shaping within the Borough and also to fund acquisition of investment assets that will generate an income stream to offset the revenue impacts of housing delivery projects in their development stage. Sums from investment property rental income are also set aside to increase sinking funds, which contribute towards financing of future property-related costs.

2.3 **Objectives:** The Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

2.4 **Strategy:** Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.

2.5 With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term either to use internal resources or to borrow short-term from other local authorities instead of long-term. By doing so, the Council would be able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

2.6 The benefits of internal and short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Council with this 'cost of carry' and breakeven analysis, the result of which will help determine whether the Council borrows additional sums at long-term fixed rates in 2020/21 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

2.7 The Council has previously raised long-term borrowing from the PWLB. In October 2019, the Government increased PWLB rates by 1%, making this a relatively expensive option, although still affordable. The Council will consider borrowing long-term loans from other sources including banks, pension funds and local authorities, as well as the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding, in line with the CIPFA Code.

2.8 Specifically, the Council is working with Arlingclose to identify alternative funding options for future acquisitions and development projects, and at options for diversifying the Council's debt to build a portfolio from a number of sources.

2.9 The Council will also consider forward-starting loans, where the interest rate is fixed in advance and the cash is received in later periods. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period. Forward starting loans would facilitate effective funding of major development projects such as those planned for the property portfolio.

2.10 In addition, the Council may borrow short-term when needed to cover unplanned cash-flow shortages.

2.11 **Sources of borrowing:** Approved sources of long-term and short-term borrowing are:

- Public Works Loan Board (PWLB) and any successor body
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- any other UK public sector body
- UK public and private sector pension funds (except Surrey Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

2.12 **Other sources of debt finance:** In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- leasing
- hire purchase
- Private Finance Initiative
- sale and leaseback

2.13 **Municipal Bonds Agency:** UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. The agency plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to Council.

2.14 **LOBOs:** The Council does not hold, and never has held, LOBO (Lender's Option Borrower's Option) loans, which expose borrowers to an element of refinancing risk. A LOBO lender has the option to propose an increase in the interest rate at set dates, following which the borrower would have the option to either accept the new rate or to repay the loan at no additional cost.

2.15 **Short-term and Variable Rate loans:** These loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below. Financial derivatives may be used to manage this interest rate risk (see section on Related Matters below).

2.16 **Debt Rescheduling:** The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

Investment Strategy

2.17 The Council holds significant levels of invested funds, representing income received in advance of expenditure plus balances and reserves held. Total long-term investments, increased by £15m in February 2019, are £36.6m as at the end of November 2019. This may be increased further if there are significant additional capital receipts and if it is agreed that these are to be invested. Total investments are higher throughout the financial year and are monitored closely and maintained at appropriate levels as part of managing short-term cash-flow requirements of the Council.

2.18 **Objectives:** Both the CIPFA Code and the MHCLG Guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest yield (rate of return). The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

2.19 **Negative interest rates:** If the UK enters into a recession in 2020/21, there is a small chance that the Bank of England could set Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

2.20 **Strategy:** From 2019/20, the Council will aim to maximise liquidity of funds to ensure availability for capital expenditure, in line with the Council's significant property and housing service plans from 2020/21 and beyond.

2.21 **Business models:** Under the IFRS 9 standard, accounting for certain investments depends on the Council's "business model" for managing them. The Council aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

2.22 **Approved counterparties:** The Council may invest its surplus funds with any of the counterparty types in Table 4 below, subject to the cash limits (per counterparty) and the time limits shown.

2.23 The cash limits shown have been agreed in conjunction with our treasury advisers, to enable the Council to have sufficient flexibility within the strategy being set to manage funds appropriately as they are received. This can sometimes include holding funds in advance of need in relation to making strategic acquisitions.

Table 4: Approved investment counterparties and limits

Credit Rating	Banks Unsecured	Banks Secured	Government	Corporates	Registered Providers
UK Gov	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£5m 5 years	£10m 20 years	£10m 50 years	£5m 20 years	£5m 20 years
AA+	£5m 5 years	£10m 10 years	£10m 25 years	£5m 10 years	£5m 10 years
AA	£5m 4 years	£10m 5 years	£10m 15 years	£5m 5 years	£5m 10 years
AA-	£5m 3 years	£10m 4 years	£10m 10 years	£5m 4 years	£5m 10 years
A+	£5m 2 years	£10m 3 years	£5m 5 years	£5m 3 years	£5m 5 years
A	£5m 13 months	£10m 2 years	£5m 5 years	£5m 2 years	£5m 5 years
A-	£5m 6 months	£10m 13 months	£5m 5 years	£5m 13 months	£5m 5 years
None	£1m 6 months	n/a	£5m 25 years	£1m 5 years	£5m 5 years
Pooled funds and real estate investment trusts (REITs)		£10m per fund at point of investment			

This table must be read in conjunction with the notes below.

2.24 **Credit Rating:** Investment limits are set by reference to the lowest published long-term credit rating from a selection of external rating agencies. Where available, the credit rating relevant to the specific investment or class of investment is used; otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

2.25 **Banks Unsecured:** Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

2.26 **Banks Secured:** Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment-specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

2.27 **Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

2.28 **Corporates:** Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies would only be made either following a financial or credit assessment or as part of a diversified pool in order to spread the risk widely.

2.29 **Registered Providers:** Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing and Registered Social Landlords, formerly known as Housing Associations. These bodies are tightly regulated in England by the Regulator of Social Housing. As providers of public services, they retain the likelihood of receiving government support if needed.

2.30 **Pooled Funds:** Shares or units in diversified investment vehicles consisting of any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

2.31 Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date and are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.

2.32 **Real Estate Investment Trusts:** Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties. Investments in REIT shares cannot be withdrawn but can be sold on the stock market to another investor.

2.33 **Operational Bank Accounts:** The Council may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £500,000 per bank as far as practicably possible, and, where practical issues necessitate, no more than £5m as per Table 4. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.

2.34 **Risk Assessment and Credit Ratings:** Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria, then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

2.35 Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

2.36 **Other information on the security of investments:** The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Council's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it might otherwise meet the above criteria.

2.37 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

2.38 **Investment Limits:** The maximum that will be lent to any one organisation (other than the UK Government) will be £10 million, to mitigate the risk in the case of a single default. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as shown in Table 5 below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table 5: Investment limits

	Cash limit
Any single organisation, except the UK Central Government	£10m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£25m per group
Any group of pooled funds under the same management	£25m per manager at point of investment
Negotiable instruments held in a broker's nominee account	£30m per broker
Foreign countries	£10m per country
Registered Providers	£25m in total
Unsecured investments with Building Societies	£10m in total
Loans to unrated corporates	£10m in total
Money Market Funds	£50m in total

2.39 **Liquidity management:** A cash-flow forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. The Council plans to implement a Treasury Management system in the early months of 2020. This TM system includes cash-flow forecasting software, which will enable determination of the maximum period for which funds may prudently be committed.

Treasury Management Indicators

2.40 **Interest Rate Exposures:** The Council is exposed principally to risk in terms of its exposure to interest rate movements on its borrowing and investments. The Council is heavily reliant on investment income to support expenditure and has several strategies in place for managing such risk.

2.41 The Council's treasury adviser provides analysis of market movements and assists in investment decisions based on their knowledge of current market conditions and interest rate forecasting.

2.42 The Council generally invests medium- to long-term at fixed rates. The Council currently has no variable rate investments.

2.43 Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classified as variable rate.

2.44 **Maturity Structure of Borrowing:** This indicator is set to control the Council's exposure to refinancing risk. We calculate this as the amount of fixed rate borrowing we can have maturing in each period as a percentage of total projected borrowing that is at a fixed rate. The calculation takes fixed rate to be whether the borrowing was taken out at a fixed rate for a fixed period of time, regardless of that length of time. The upper and lower limits on the maturity structure of borrowing are as shown in Table 6.

Table 6: Maturity Structure of Borrowing

	Upper	Lower
Under 12 Months	10%	0%
1 – 2 Years	15%	0%
3 – 5 Years	20%	0%
6 – 10 Years	25%	0%
10 – 20 Years	50%	0%
20 – 30 Years	75%	0%
30 – 40 Years	90%	0%
40 – 50 Years	100%	0%

2.45 Time periods start on the first day of each financial year. The maturity of borrowing is the earliest date on which the lender can demand repayment. In the case of PWLB, this is the maturity date.

2.46 This indicator allows us to have the percentage of borrowing maturing in each time period shown above, taking into account our current debt profile and providing an allowance for new borrowing, while having consideration to the capital programme.

2.47 **Principal Sums Invested for Periods Longer than 364 days:** The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end are shown in Table 7, next.

Table 7: Principal limits

Price Risk Indicator	**2020/21**	**2021/22**	**2022/2023**
Limit on principal invested beyond year end	£70m	£70m	£70m

Related Matters

2.48 The CIPFA Code requires the Council to include the following in its treasury management strategy.

2.49 **Financial Derivatives:** Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the *Localism Act 2011* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

2.50 The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward-starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

2.51 Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

2.52 In line with the CIPFA Code, the Council will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.

2.53 **Markets in Financial Instruments Directive (MIFD):** The Council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the Chief Financial Officer believes this to be the most appropriate status.

3. Financial implications

3.1 The budget for investment income in 2020/21 is £1.29m, based on an investment portfolio of £77m at an average interest rate of 1.7% (£36m at 3.0% excluding money market investments). The budget for debt interest paid in 2020/21 is £23.0m, based on an average debt portfolio of £1,085m at an average interest rate of 2.1% (2.2% long-term). The alternative approach would be to use this funding for further strategic acquisitions. If the Council finds itself in this position, a full cost-benefit analysis will be completed to determine the most advantageous approach.

3.2 Debt interest paid in 2019/20 is forecast to be £23.7m. This reflects the costs the Council is now committed to pay following strategic acquisitions completed since 2016/17 to date, for which fixed rate finance was taken from the PWLB. It should be borne in mind that the gross rental income significantly exceeds this cost, resulting in a net revenue surplus for the Council forecast to be approximately £10m (gross £50m) for 2019/20 after debt financing and set aside costs.

3.3 If actual levels of investments and borrowing, or actual interest rates, differ from those forecast, performance against budget will be correspondingly different. With further acquisition opportunities being explored, and likely to be debt-financed if taken up, additional financing costs are expected. These opportunities may not be successful, and therefore are not budgeted for in advance. However, it should be noted that the borrowing that finances the strategic acquisitions are fixed rate, and so, once established, will not change.

4. Risk considerations

4.1 The MHCLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Financial Officer, having consulted the Cabinet Member for Finance, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. The strategy has been drawn up with detailed reference to the Council's independent treasury and investment advisers, to ensure a prudent and robust approach in the strategy.

4.2 Some alternative strategies, with their financial and risk management implications, are listed below in Table 9.

Table 9: Alternative strategies

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Lower investment sums resulting in less Interest income	Lower chance of losses from credit related defaults although such losses may be greater Also less diversity increases risk of losses
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher with increased investment sums	Increased risk of losses from credit related defaults, but any such losses may be smaller Increased diversity also decreases the risk of significant loss
Borrow additional sums at long-term fixed interest rates (not in advance of need)	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default. However long-term interest costs may be more certain

Alternative	Impact on income and expenditure	Impact on risk management
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Reduced debt interest costs Less income for funding projects Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain Less resources available for capital programme which would need to be reduced

5. Timetable for implementation

5.1 Treasury management is an ongoing activity and normally there is no specific timetable for implementation.

Background papers:

Appendices: Appendix A – Arlingclose note (two pages)
Appendix B – MRP Statement
Appendix C – TMP and schedules