# CABINET

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| **DATE** | 10 February 2021 |
| **REPORT OF** | Councillor Shreeve Deputy Leader and Portfolio Holder for Finance and Resources |
| **RESPONSIBLE OFFICER** | Sharon Wroot Executive Director for Environment, Economy and Resources |
| **SUBJECT** | Treasury Management Policy and Strategy 2021/22 |
| **STATUS** | Open |
| **FORWARD PLAN REF NO.** | CB 02/21/06 |

**CONTRIBUTION TO OUR AIMS**

Effective treasury management provides support towards the achievement of all Council Plan aims and objectives. Treasury management is an integral part of the Council's finances providing for cash flow management and financing of capital schemes.

**EXECUTIVE SUMMARY**

The Report presents the restated Treasury Policy Statement and the Treasury Management Strategy Statement (TMSS). The Strategy document is informed by guidance and advice provided by the Council's treasury advisors, Link Asset Services Ltd.

The Council's high level policies for borrowing and investments are:

- The Council's borrowing will be affordable, sustainable and prudent and consideration will be given to the management of interest rate risk and refinancing risk. The source from which the borrowing is taken and the type of borrowing should allow the Council transparency and control over its debt.
- The Council's primary objective in relation to investments remains the security of capital. The liquidity or accessibility of the Council's investments followed by the yield earned on investments remain important but are secondary considerations.

**RECOMMENDATIONS**

That Cabinet:

1) Consider this report and refer its contents to Full Council:

   - ➢ the Treasury Management Policy Statement – Appendix 1

- the Treasury Management Strategy Statement and Prudential Indicators for 2021/22 - Appendix 2
- the MRP Policy Statement – Annex 2 of Appendix 2

**REASONS FOR DECISION**

The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice for Treasury Management in Public Services (the CIPFA TM Code) and the Prudential Code require local authorities to approve their Treasury Management Strategy Statement and Prudential Indicators on an annual basis. This Authority requires the Strategy to be approved by full Council.

The Full Council will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in its TMPs.

Full Council holds responsibility for the implementation and regular monitoring of the organisation's treasury management policies and practices, and delegates the execution and administration of treasury management decisions to The Director of Finance, who will act in accordance with the organisation's policy statement and TMPs and, if he/she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.

## 1. BACKGROUND AND ISSUES

1.1. CIPFA has defined treasury management as:

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

1.2. The proposed Treasury Management Strategy Statement (TMSS) for 2021/22 is attached at Appendix 2. The Strategy has been developed in consultation with our treasury management advisors, Link Asset Services Ltd. This statement also incorporates the Investment Strategy.

1.3 Whilst the Council has appointed advisors to support effective treasury management arrangements, the Council is ultimately responsible for its treasury decisions and activity. No treasury activity is without risk. The successful identification, monitoring and control of risk is therefore an important and integral element of treasury management activities.

1.4 The Council has nominated the Audit & Governance Committee to be responsible for ensuring effective scrutiny of the treasury management arrangements.

1.5 Key points to note with specific regard to the Treasury Strategy:

- 2020 was clearly all about Covid-19. In terms of Treasury, the impacts were seen first in a removal of liquidity in the market, then the logistical considerations of managing additional support packages cash flow and finally a constant need for assessment of the ongoing economic implications. As we move into 2021/22 it is this final impact that is carried over. Counterparties, banks and Money Market Funds have coped well thus far and liquidity is no longer an issue but interest rates remain close to zero and in some cases are already negative. Whilst a negative rate environment will feel very different should it become embedded in the deposit market it is of overall benefit to the authority who are a net borrower with significant forward requirement.

- The Treasury Management Strategy covers the Council's treasury aims and principles. The Council also considers direct 'commercial' investments from time-to-time with the aim of generating financial return. Although reference is made to these type of investments in the TMSS' these transactions are guided and limited by the Capital Strategy document.

- On borrowing, as stated above the current interest rate environment offers opportunity for budget savings on debt costs. In order to realise these savings the Authority needs to access a good proportion of its future requirement now in the short-term marketplace, to lock in current rates and remove, temporarily, interest rate risk. The Authority feels this is a reasonable strategy to pursue given the need to find savings and the consensus market view that interest rates will remain low for a sufficient period to allow us opportunity to term out the borrowing in the medium term. Of course, the Council will, with the help of its Advisors, continue to monitor rates and cash flow and look to secure new long-term borrowing as short-term loans mature should the interest rate environment show signs of material upward change.

- In November the Public Works Loan Board (PWLB) reversed their 2019 1% increase in margin at which it would lend to Local Authorities. Whilst, at the same time, the PWLB introduced some restrictions on the types of activity it is willing to fund, it is not the current view of the S151 Officer that this will lead to any cessation of access to PWLB for North East Lincolnshire Council Should this change we now have proven relationships with alternative lenders in the market in order to meet our borrowing requirements

- The Minimum Revenue Provision Policy remains unchanged for the coming year.

## 2. RISKS AND OPPORTUNITIES

2.1 No Treasury activity is without risk. Specific risks include, but are not limited to, Counterparty Credit Risk (the risk of an investment not being repaid), liquidity risk (the risk that the Authority does not have its funds in the right place, at the right time and in the right amount to make it's payments as they fall due), interest rate risk (the risk that future rate movements have a revenue implication for the Authority) and reputational risk (see Section 4 below).

2.2 The attached Appendices define our approach toward mitigating these risks.

2.3 Treasury is an Authority-wide function and its environmental sustainability and equalities implications are the same as for the Council itself.

2.4 The Authority will have regard to the environmental and equality activities of its Counterparties (where reported) but

- Prioritises Security, Liquidity and Yield,
- Recognises that as large, global institutions our high-quality counterparties operate across the full range of marketplaces in which they are legally able to, and such exposures are small parts of their overall business.
- Excluding any one counterparty will likely mean others will similarly have to be avoided and thus impact the Authority's capacity to mitigate risk through diversification.

2.5 **General Data Protection Regulation 2018** – Relationships with external providers covered by the Treasury management Practices are governed by and operated in accordance with the act.

## 3. OTHER OPTIONS CONSIDERED

3.1 These are set out on Page 28 of the Treasury Management Strategy Statement (Appendix 2 to this Report).

## 4. REPUTATION AND COMMUNICATIONS CONSIDERATIONS

4.1 As you would expect, with large sums of public money involved, any treasury activity carries a high degree of reputational risk. Any losses have not just financial but also significant, ongoing resource implications for the Council.

## 5. FINANCIAL CONSIDERATIONS

5.1 As set out in the Appendices.

## 6. CLIMATE CHANGE AND ENVIRONMENTAL IMPLICATIONS

Treasury is an Authority-wide function and its climate change, environmental and sustainability implications are the same as for the Council itself.

The Authority will have regard to the environmental activities of its Counterparties (where reported) but:-

- Prioritises Security, Liquidity and Yield,
- Recognises that as large, global institutions our high-quality counterparties operate across the full range of marketplaces in which they are legally able to, and as a result climate change considerations are an increasingly important and heavily-scrutinised part of their overall business.
- Excluding any one counterparty will likely mean others will similarly have to be avoided and thus impact the Authority's capacity to mitigate risk through diversification.

## 7. CONSULTATION WITH SCRUTINY

7.1 This Report was presented to Audit & Governance Committee on 21 January 2021

## 8. FINANCIAL IMPLICATIONS

8.1 As set out in the appendix.

## 9. LEGAL IMPLICATIONS

9.1 There are no direct legal implications arising from the recommendations in this report which are not covered in the body of the report. The Council has complied with its statutory obligations arising from the Local Government Act, the Local Government Finance Act and all relevant CIPFA guidance.

## 10. HUMAN RESOURCES IMPLICATIONS

10.1 There are no immediate HR implications arising from the recommendations contained in this report.

## 11. WARD IMPLICATIONS

11.1 All wards indirectly affected.

## 12. BACKGROUND PAPERS

12.1 CIPFA Treasury Management Code and Guidance Notes

## 13. CONTACT OFFICER(S)

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Rachel Carey, Strategic Lead, Financial Planning (01472) 324633

**COUNCILLOR S. SHREEVE**

**PORTFOLIO HOLDER FOR FINANCE AND RESOURCES**

**APPENDIX 1**

**The Treasury Management Policy Statement**

1. The Council defines its treasury management activities as:

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

2. The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the Council, and any financial instruments entered into to manage these risks.

3. This Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

4. The Council's high level policies for borrowing, borrowing in advance and investments.

   - The Council's borrowing will be affordable, sustainable and prudent and consideration will be given to the management of interest rate risk and refinancing risk. The source from which the borrowing is taken and the type of borrowing should allow the Council transparency and control over its debt.

   - This organisation will only borrow in advance of need where there is a clear business case for doing so and will only do so for the current capital programme or to finance future debt maturities.

   - The Council's primary objective in relation to investments remains the security of capital. The liquidity or accessibility of the Council's investments followed by the yield earned on investments remain important but are secondary considerations.

Appendix 2

# Treasury Management Strategy Statement 2021/22

# Contents

**Key Messages:**

**We continue to mitigate risk as much as possible, primarily through the use of short-term investments with highly rated counterparties.**

**This Strategy is based on our base case that the roll out of Covid-19 vaccines allow a gradual permanent re-opening of the economy globally. At the time of writing this was still not confirmed. However the option remains to return to Council with a revised Strategy mid-year if the risk environment changes.**

**The current low interest rate environment provides opportunity for the Authority to make short-term savings in debt costs to help protect frontline services.**

# Director of Finance Overview

It is my view that the priority for Treasury Management at North East Lincolnshire Council is to protect capital rather than to maximise return. The avoidance of all risk is neither appropriate or possible but we will continue to strive for a low risk balance set against a keen responsibility for public money.

2020 was clearly all about Covid-19. In Treasury, the impacts were seen first in a rapid evaporation of liquidity in the market, followed by logistical considerations of managing additional support packages cash flow, a cratering of yields and finally a constant need for assessment of the ongoing economic implications. I am pleased to report that our Treasury Management Strategy proved its worth and, unamended, allowed the Authority sufficient flexibility to successfully manage all these challenges

As we move into 2021/22, the focus will again be on Counterparty Risk. Banks and Money Market Funds have coped well thus far and liquidity has returned to normal levels. However, the longer term impacts of Covid on the economy have still to play out and lenders' balance sheets will bear the cost. Additionally, interest rates remain close to zero and in some cases are already negative. Whilst a negative deposit rate environment will feel very different, should it become embedded, it is of overall benefit to the authority who are a net borrower with significant forward requirement.

The current interest rate environment therefore offers opportunity for budget savings on debt costs. In order to realise these savings, the Authority needs to access a proportion of its future requirement now, in the short-term marketplace, to lock in current rates and remove, temporarily, the risk of rates rising through unforeseen developments (e.g., inflationary pressures). The Authority feels this is a reasonable strategy to pursue given the need to deliver savings and the prevailing consensus market view that interest rates will remain low for a sufficient sustained period to allow us the opportunity to term out our borrowing in the medium term. Of course, the Council will, with the help of its Advisors, continue to monitor rates, and cash flow, and look to secure new long-term borrowing as short-term loans mature should the interest rate environment show signs of material upward change.

**Sharon Wroot, Director of Finance**

**January 2021**

**Key Messages:**

**Approval of an Annual Treasury Management Strategy is a Statutory requirement of the Authority.**

**The Treasury Team manages the surplus cash and borrowing of the Authority.**

**Where surplus cash is present the team will invest this with low-risk counterparties for appropriate terms to ensure that the Authority has funds in the right place, in the right size, at the right time to ensure its payments can be met as they fall due.**

**Borrowing is taken to fund the Authorities agreed capital expenditure. Care is taken to manage the cost of carry (the difference between what borrowing costs us and what it earns prior to being spent while, at the same time considering interest rate trends.**

# Introduction

The Council is required to operate a balanced budget, which broadly means that cash raised during the year will match cash expenditure. Part of treasury management's role is to ensure that this cash flow is adequately planned, with cash being available in the right amount, in the right place at the right time for when it is needed. All surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing strong liquidity initially before considering the need for adequate investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans, or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.

The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity, the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operation manages a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

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

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. The capital strategy is reported within the 2021/22 Finance and Commissioning Plan.

**Key Messages:**

**CIPFA defines treasury management as:**

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

**In addition to the Annual Treasury Strategy (agreed prior to the start of the financial year), 2 further in-year reports are provided to Council to report performance against the Strategy.**

**Scrutiny of the Authorities treasury activities is delegated to the Audit & Governance Committee.**

# Introduction (contd)

CIPFA defines treasury management as:

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

This authority has not engaged in any commercial investments primarily for yield and has no material non-treasury investments.

**Treasury Management reporting**

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

a. **Prudential and treasury indicators and treasury strategy** (this report) - The first, and most important report is forward looking and covers:
- the capital plans, (including prudential indicators);
- a minimum revenue provision (MRP) policy, (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy, (how the investments and borrowings are to be organised), including treasury indicators; and
- an investment strategy, (the parameters on how investments are to be managed).

b. **A mid-year treasury management report** – This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision, if applicable. In addition, this Council will receive quarterly update reports.

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.

**Scrutiny**

The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Audit & Governance Committee.

This report fulfils the Authority’s legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and MHCLG Guidance.

**Key Messages:**

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

- **The Treasury Strategy and Treasury Indicators report**
- **A mid-year Treasury report**
- **An annual Treasury Outturn report**

**This Strategy attempts to provide the Authority with a low risk, yet suitably flexible, approach to Treasury in a period that may be affected by as yet unknown regulatory and political changes.**

**Should circumstances change significantly, to a point where the Council's Treasury objectives are impacted a revised Strategy will be presented for approval in-year.**

# Introduction (contd.)

The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risks are therefore central to the Authority's treasury management strategy.

**Treasury Management Strategy for 2021/22**
The strategy for 2021/22 covers two main areas:

**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
- the policy on use of external service providers.

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

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

**Revised strategy:** In accordance with the MHCLG Guidance, the Authority will be asked to approve a revised Treasury Management Strategy Statement should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a stressed economic environment, or a large increase in the Authority's capital programme or in the level of its investment balance. It should be noted that no such revisions were required during the 2020/21 Covid-19 period.

**Key Messages:**

**The potential impact of political risk on financial markets remains high over the next year.**

**Our advisors, Link Asset Services predict no increase in Bank Rate to before March 2024, and only small increases in our borrowing rates over the same period.**

**Despite the relatively benign forecast for general bank rates there is still expected to be short-term volatility in gilt rates (upon which our borrowing tends to be priced).**

**With the help of our Advisors and market tools now available to us we will remain well informed as the new political landscape evolves.**

# External Context

### Prospects for interest rates

The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives their central view at the time of writing (Dec 2020).

| | Mar-21 | Jun-21 | Sep-21 | Dec-21 | Mar-22 | Mar-23 | Mar-24 |
|---|---|---|---|---|---|---|---|
| Bank Rate | 0.10% | 0.10% | 0.10% | 0.10% | 0.10% | 0.10% | 0.10% |
| 5 yr PWLB | 1.80% | 1.80% | 1.80% | 1.80% | 1.90% | 1.90% | 2.00% |
| 10 yr PWLB | 2.10% | 2.10% | 2.10% | 2.20% | 2.20% | 2.30% | 2.30% |
| 25 yr PWLB | 2.50% | 2.60% | 2.60% | 2.60% | 2.60% | 2.70% | 2.80% |
| 50Yr PWLB | 2.30% | 2.40% | 2.40% | 2.40% | 2.40% | 2.50% | 2.50% |

The coronavirus outbreak has provided huge economic shock 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 have suggested that a cut into negative territory could happen in Q1 2021. 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.

**Key Messages:**

**Investment returns are likely to remain low by historical standards during 2021/22 and over the next few years however many factors can still impact that forecast.**

**Low investment rates also means low borrowing rates. As the Authority is a net borrowers the impact of low rates is therefore beneficial overall.**

# External Context (contd).

**Upside risks to current forecasts for UK gilt yields and PWLB rates**

- UK - stronger than currently expected recovery in UK economy, especially if vaccines are administered quickly, prove effective and lead to a resumption of full economic activity across all sectors of the economy.
- The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.

**Downside risks to current forecasts include**:

- UK - further national lockdowns or severe regional restrictions during 2021.
- UK / EU trade negotiations – if cause significant economic disruption and downturn in the rate of growth.
- UK - Bank of England takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the Eurozone sovereign debt crisis.
- German minority government & general election in 2021
- Weak capitalisation of some European banks, which could be undermined further depending on extent of credit losses resultant of the pandemic.

**Geopolitical risks** In China, Iran or North Korea, but also in Europe and other Middle Eastern countries, which could lead to increasing safe haven flows.

**Investment and borrowing rates**

Subject to the influences listed above we expect rates to remain exceptionally low during 2021/22 with little increase in the following two years.

In November 2020 the Public Works Loan Board (PWLB) announced the outcome of its Consultation on future lending terms and confirmed its standard Certainty Rate would revert to 80bps above Gilts. However there are some restrictions on access and so, whilst we believe these will not be a factor for NELC, other local Authorities and alternative lenders will remain active options in meeting our overall borrowing requirement as cost effectively as possible.

**Key Messages:**

**Within the 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 its highest forecast CFR over the next three years.**

**This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes.**

**The Director of Finance reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the forecast period.**

# Local Context

As at 31.12.2020 the Authority had £151.3m of borrowing and £39m of investments. This is set out in further detail at Annex 1. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance Sheet Summary and Forecast

| | 31.3.20 Actual £m | 31.3.21 Estimate £m | 31.3.22 Forecast £m | 31.3.23 Forecast £m | 31.3.24 Forecast £m |
|---|---|---|---|---|---|
| **Total CFR** | **171.8** | 190.2 | 211.7 | 230.6 | 235.5 |
| Less: Existing External borrowing | 146.7 | 152.1 | 167.4 | 184.4 | 186.8 |
| **Borrowing shortfall** | **25.1** | **38.1** | **44.3** | **46.2** | **48.7** |
| Less: Usable reserves | 44.7 | 36.7 | 32.8 | 33.4 | 34.5 |
| Less: Working capital | 9.8 | 6.5 | 6.5 | 6.5 | 6.5 |
| **Investments(-)/New Borrowing** | **(29.4)** | **(5.1)** | **5.0** | **6.3** | **7.7** |

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment.

CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Authority forecasts that borrowing will peak at around £197m (including all existing borrowing and maintaining min £10m liquid funds) and so expects to comply with this recommendation during 2021/22 and the 2 subsequent periods. This view takes into account current commitments, existing plans, and the proposals in the 2021/22 budget report.

**Key Messages:**

**The Authority has an increasing CFR due to the capital programme, but minimal investments and will therefore needs to borrow in 2021/22. Current forecasts suggest new borrowing of £46m will be required to deliver the Council's plans.**

**In the current interest rate environment it is considered unlikely that lenders will exercise their options under our Lender Option Borrower Option (LOBO) Loans. The Authority is actively considering risk mitigation strategies to deal with the long-term uncertainty such arrangements introduce.**

**Rescheduling of current debt is unlikely to occur while rates remain near all-time lows.**

# Borrowing

The Council is currently maintaining an under-borrowed position subject to a minimum investment balance of £10m. 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 has been a prudent approach as investment returns have been low and counterparty risk is still an issue that needs to be considered, however, this strategy has a limited lifespan and only delays, rather than removes, the borrowing required to support our Capital plans.

Against this background and the risks within the economic forecast, caution will be adopted with the 2021/22 treasury operations. The Director of Finance will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- if it was felt that there was a significant risk of a sharp FALL in borrowing rates, then borrowing will be postponed.

- if it was felt that there was a significant risk of a much sharper RISE in borrowing rates than that currently forecast, perhaps arising from an 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.

All decisions on borrowing are notified through the reporting timetable set out on P5.

**Policy on borrowing in advance of need**
The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

**Debt rescheduling**
Rescheduling of current borrowing in our debt portfolio is unlikely to occur while rates remain near all-time lows and PWLB apply a spread between new borrowing and repayment rates. In the event that this should change any rescheduling will be reported through the usual reporting timetable.

**Key Messages:**

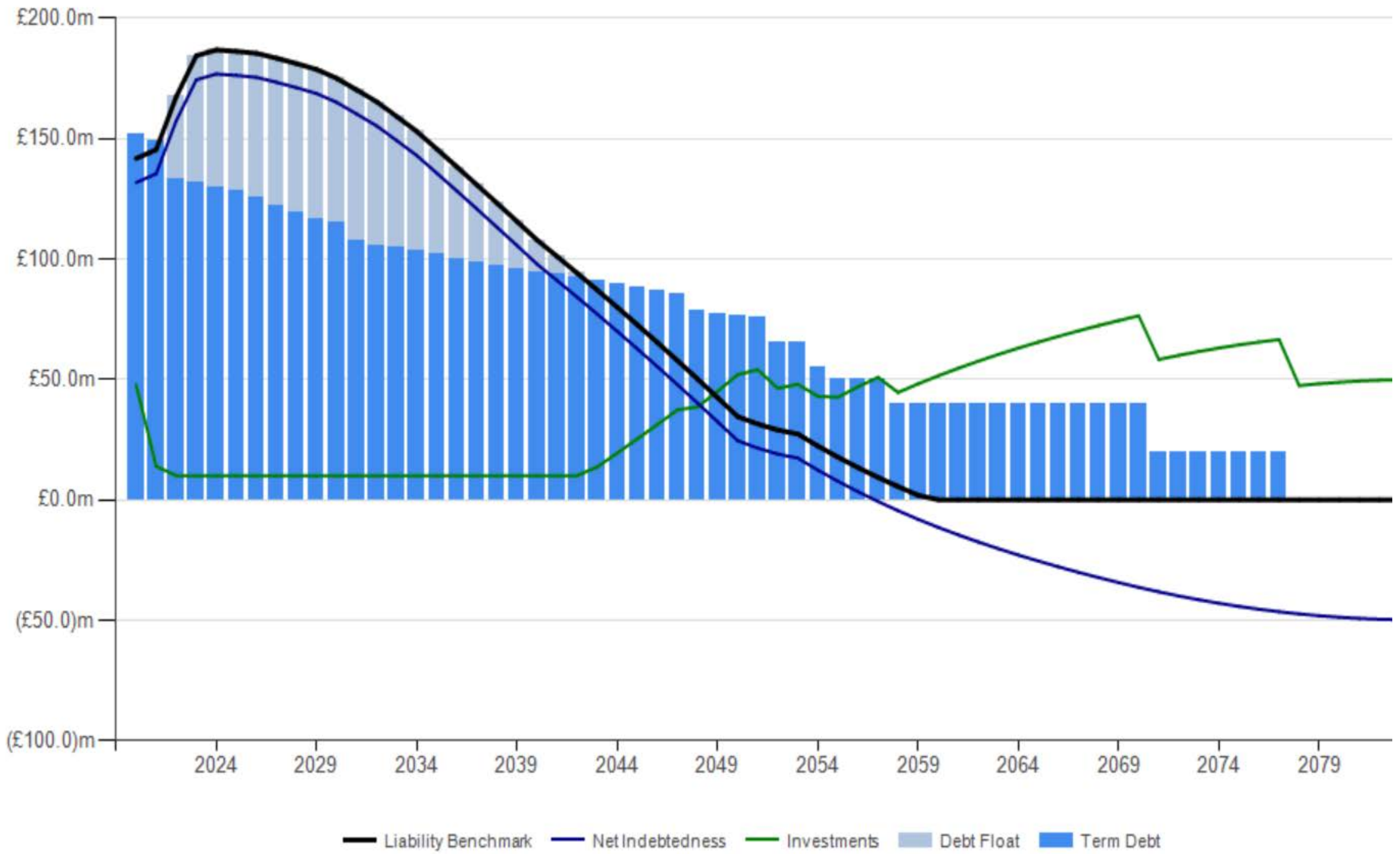
**A minimum cash balance of £10m will be maintained to ensure forecast liquidity needs are met.**

**The lightly shaded area in the Liability Benchmark chart shown here depicts the additional borrowing need the Authority currently projects – a peak requirement of £57m new loans by the end of 2023-24 – including replacement of maturing debt.**

# Borrowing Strategy

To assist with its long-term treasury strategy, the Authority uses a liability benchmark, which forecasts our need to borrow over a 60 year period. The benchmark assumes:

- future capital expenditure beyond the current programme funded by borrowing of c£6m a year
- minimum revenue provision on new capital expenditure based on an annuity profile
- income, expenditure and reserves all increase by 2.5% inflation a year



**Key Messages:**

**The Authority continues to utilise it's reserves in place of new borrowing to fund it's capital programme.**

**In November 2020 the Public Works Loan Board (PWLB) announced the outcome of its Consultation on future lending terms and confirmed its standard Certainty Rate would revert to 80bps above Gilts. However there are some new restrictions on access and so, whilst we believe these will not be a factor for NELC, we continue to view other local Authorities and alternative lenders as active options in meeting our overall borrowing requirement as cost effectively as possible.**

# Borrowing Strategy (contd)

## Our Key Objectives:

The Authority'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 Authority's long-term plans change is a secondary objective.

## Strategy: the Council will deliver on its Objectives by:

Our default strategic response to the expected (but far from certain) continuing low rate environment is to combine regular short-term borrowing transactions with occasional new longer-term borrowing at relatively steady intervals to average out the cost of borrowing whilst delivering short-term savings and also seeking to limit the cost of carry.

In November 2020 the Public Works Loan Board (PWLB) announced the outcome of its Consultation on future lending terms and confirmed its standard Certainty Rate would revert to 80bps above Gilts. However there are some new restrictions on access and so, whilst we believe these will not be a factor for NELC, we continue to view other local Authorities and alternative lenders as active options in meeting our overall borrowing requirement as cost effectively as possible.

**Key Messages:**

**Across is a list of the possible sources and types of borrowing that the Authority will consider in 2021/22.**

**This list is unchanged from 2020-21**

**All new long-term borrowing is backed by a Borrowing Decision Notice signed in advance by the S151 Officer. The Notice will cover the reason for the amount, term and source of finance among other relevant risk evaluations.**

# Borrowing Strategy (contd)

| Source of Borrowing (On Balance Sheet) | Fixed | Variable |
|---|---|---|
| PWLB | ● | ● |
| Local Authorities | ● | ● |
| Banks (UK and overseas (Sterling only) incl State-owned banks) | ● | ● |
| Pension Funds (excl. East Riding Pension Fund) | ● | ● |
| Insurance Companies | ● | ● |
| Quasi-Governmental bodies (e.g. PPF, EIB, Green Bank and similar) | ● | ● |
| **Type/Structure of Debt** | | |
| Market (long-term incl. Bond issuance) | ● | |
| Market (temporary) | ● | ● |
| Market (LOBOs) | | |
| Green Bonds | ● | |
| Local Temporary | ● | ● |
| Local Bonds | ● | |
| Local Authority Bills | ● | ● |
| Overdraft | | ● |
| Negotiable Bonds | ● | ● |
| Internal (Capital Receipts and Revenue Balances) | ● | |
| Commercial Paper | ● | |
| Repurchase Agreements | ● | |
| Medium Term Notes | ● | |
| Finance Leases | ● | ● |

**Key Messages:**

**UK Municipal Bonds Agency plc (UKMBNA) was established in 2014 by the Local Government Association as an alternative to the PWLB. In 2020 it finally issued its first two Bonds. However, our current understanding remains that this will be a more complicated source of finance than other options for two reasons: borrowing authorities will be required to provide bond investors with a proportionate 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 full Council.**

# Borrowing Strategy (contd)

The Authority has previously raised roughly half its long-term borrowing from the PWLB but continues to closely monitor other sources of finance, such as those listed above.

**Municipal Bond Agency:** UK Municipal Bonds Agency plc (UKMBNA) was established in 2014 by the Local Government Association as an alternative to the PWLB. In 2020 it finally issued its first two Bonds. However, both were single name issues of a size that could equally have been issued outside of UKMBNA. As such, we do not consider these transactions offer 'proof of concept' and our current understanding remains that this will be a more complicated source of finance than other options for two main reasons: borrowing authorities will be required to provide bond investors with a proportionate 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 full Council.

**Key Messages:**

**The Council may seek financial return from investments outside the Treasury Strategy (for example direct property purchases). Whilst the aim of security of capital and a positive return is similar to Treasury activity these investments have can have characteristics very different to what would be a typical treasury investment. As a result, such schemes are placed within the Capital Programme to ensure they are proportional to the level of the Authority's available resources and a separate Capital Strategy governs their approval process.**

**These schemes also have implications for the Authority's ability to access borrowing from PWLB so require the explicit approval of the S151 Officer.**

# Borrowing Strategy (contd)

**Borrowing for Commercial or Social Return**

In order to support frontline services as central Government funding changes over time, Councils have to consider how best they might deploy their resources, knowledge and borrowing capacity to replace lost income. The drivers, characteristics, available credit data and risks associated with such transactions will differ from one scheme to another as well as from general treasury activity. Schemes, for instance, may take into account non-financial 'social' returns alongside pure financial gain. Such activity includes loans supporting service outcomes, investments in subsidiaries, and investment property portfolios where there is a local demand from tenants not being met by private landlords.

The Authority recognises that investment in other financial assets and property primarily for financial return, taken for non-treasury management purposes, requires careful investment management. **The Authority currently has no plans to acquire assets purely for their yield.**

The Authority will ensure that all the organisation's investments are covered in the capital strategy, investment strategy or Commercial Plan, and will set out, where relevant, the organisation's risk appetite and specific policies and arrangements for non-treasury investments. It recognises that the risk appetite for these activities may differ from those in this report which relate only to treasury management.

Common across both 'commercial ' transactions and treasury investments is the need for holistic council-wide planning, robust due diligence and formal oversight processes.

The Authority will compile and maintain a schedule setting out a summary of existing material non-treasury investments, subsidiaries, joint ventures and liabilities including financial guarantees and the organisation's risk exposure. This schedule is included with the Capital Strategy report.

**Key Messages:**

**In accordance with guidance from the MHCLG and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Long Term ratings.**

# Investment Strategy

The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During 2020/21 investment balances have ranged between £37.8m and £83.0m. Balances were inflated by both our own liquidity protection measures and Central Government support programmes during the Covid-19 pandemic. Balances for 2021/22 are therefore anticipated to be somewhat lower.

## Our Key Objectives:

The primary principle governing the Council's investment criteria is the security of its investments, followed by the maintenance of liquidity. An adequate return on those constrained parameters is our final consideration. although the yield or return on the investment is also a key consideration.

## Strategy: the Council will deliver on its Objectives by:

- Maintaining a policy covering the categories of investment types it will invest in, the 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

- Setting a Minimum Liquidity level for its investments. For this purpose it will also 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.

The Director of Finance 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.

**Key Messages:**

**The Table shown lists our Approved Investment Counterparties and Limits.**

**If there were to be a disorderly Brexit, then it is possible that credit rating agencies could downgrade the sovereign rating for the UK from the current level of AA. The minimum criteria DOES NOT apply to UK Government which remains our default 'safe haven' counterparty.**

**Whilst these limits also apply to Council's own bankers in the ordinary course of business, if that bank's lowest rating falls below 'A-' balances will be maintained for operational purposes only and minimised on a daily basis. A non-investment limit of £1m will apply in such circumstances.**

# Investment Strategy (contd.)

**Approved Counterparties:** The Authority may invest its surplus funds with any of the counterparty types the Table below, subject to the cash limits (per counterparty) and the time limits shown.
The limits are derived from an assessment of Available Reserves and our Advisors general guidance.

**Table 2: Approved Investment Counterparties and Limits**

| Credit Rating | Banks Unsecured | Banks Secured | Government | Corporates | Registered Providers |
|---|---|---|---|---|---|
| UK Govt | n/a | n/a | £ Unlimited<br>50 Years | n/a | n/a |
| AAA | £3m<br>5 Years | £6m<br>20 Years | £5m<br>20 Years | £2m<br>5 years | £2m<br>20 Years |
| AA+ | £3m<br>5 Years | £6m<br>10 Years | £5m<br>10 Years | £2m<br>5 years | £2m<br>10 Years |
| AA | £3m<br>4 Years | £6m<br>5 Years | £5m<br>5 Years | £2m<br>4 years | £2m<br>5 Years |
| AA- | £3m<br>3 Years | £6m<br>4 Years | £5m<br>4 Years | £2m<br>3 years | £2m<br>4 Years |
| A+ | £3m<br>2 Years | £6m<br>3 Years | £5m<br>3 Years | £2m<br>2 years | £2m<br>3 Years |
| A | £3m<br>13 Months | £4m<br>2 Years | £5m<br>2 Years | £2m<br>13 Months | £2m<br>2 Years |
| A- | £3m<br>6 Months | £4m<br>13 Months | £4m<br>13 Months | £1m<br>6 Months | £1m<br>13 Months |
| BBB+ | £1m<br>100 Days | £1.5m<br>6 Months | £1.5m<br>6 Months | £1m<br>100 Days | £1m<br>6 Months |
| None | n/a | n/a | £5m*<br>5 Years | £0.1m<br>5 Years | £1m<br>100 Days |

Pooled Funds (Money Market Funds) - £5m Per Fund but not more than 50% of overall balances in Aggregate

*Other Local Authorities – per Authority

**Key Messages:**

**The primary principle governing the Council's investment criteria is the security of its investments. It maintains a policy covering the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and then monitoring their security.**

**The Council's investment policy has regard to the MHCLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code").**

**The Council's investment priorities will be security first, liquidity second, then return.**

# Investment Strategy (contd.)

**Risk Appetite Statement**
The guidance from the MHCLG and CIPFA places 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: -

**Credit Rating:** Credit rating information is supplied by Link Asset Services, our treasury advisors, on all active counterparties that comply with the criteria in Table 2**.** Investment limits are set by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. However, investment decisions are never made solely based on credit ratings, and other relevant factors including external advice will be taken into account.

Further operational market information will therefore 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), share price information etc will be applied to compare the relative security of differing investment counterparties.

**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. If the Authority's current account bank were to be rated BBB' unsecured balances with that bank will be minimised in both monetary size and time invested.

**Banks Secured:** Covered bonds, reverse repurchase agreements (Repo) 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. Repo/Reverse Repo is accepted as a form of securitised lending and should be based on the GMRA 2000 or GMRA 2011 (Global Master Repo Agreement). Should the Counterparty not meet our senior unsecured rating then a 102% collateralisation would be required. The acceptable collateral is as follows:

- Index linked Gilts
- Conventional Gilts
- UK Treasury bills
- Delivery By Value (DBV)
- Corporate bonds

**Key Messages:**

**Not all of these options suit our immediate requirements but in the current political environment there is a need to retain some flexibility and we continue to evaluate suitability in conjunction with our advisors.**

**Some options require the Authority to be classed as a 'Professional' counterparty under MiFID II in order to be able to access them and we have worked with counterparties to ensure access is maintained.**

**Accounting rules mean that certain financial instruments need to be valued at year end and paper gains/losses at the balance sheet date are charged to the income and expenditure account. Such instruments do not form the mainstay of our Strategy however.**

# Investment Strategy (contd.)

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.

Some secured bank investments include the option for the issuer to extend the maturity date even though this is not common practice (most Covered Floating Rate Notes operate in this fashion). When choosing such investments the Authority will apply Non-Specified Investment criteria as if the Bond were to run to its final allowable maturity date. (See P21 for more detail)

**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 an insignificant risk of insolvency.  Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

**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 will only be made as part of a diversified pool in order to spread the risk widely.

**Registered Providers:** Loans to, and bonds issued by, guaranteed by, or secured on the assets of Registered Providers of Social Housing (Housing Associations).  These bodies are tightly regulated by and, as providers of public services, retain the likelihood of receiving government support if needed.

**Pooled Funds:** Shares in diversified investment vehicles consisting of the 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 volatility may 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 could be used for longer investment periods. Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term.  These allow diversification into asset classes other than cash without the need to own and manage the underlying investments. Because Property funds have no defined maturity date and can be deemed capital expenditure, the Authority will seek guidance on the status of any fund it may consider using. The performance and continued suitability of any Fund will be monitored regularly.

Key Messages:

The Council undertakes its own active horizon-scanning of global and national economic data and trends. This work is supported by advice and reporting from our Advisors, Link Asset Services.

Proactive measures will be taken to reduce risk in the light of specific adverse data or on notification from our Advisors.

Rates are likely to remain low and so balances will be kept to a minimum practical level to avoid cost of carry.

The Authority will ensure it has sufficient liquidity across it's investment portfolio and a minimum cash balance of £10m will be maintained.

All investments will be denominated in Sterling.

# Investment Strategy (contd.)

**Risk Assessment and Credit Ratings:** Credit ratings are obtained and monitored by the Authority'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.

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.

**Other Information on the Security of Investments:** The Authority 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 and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

Given our Strategy of minimizing balances and maintaining short-duration average liquidity the Council will use The Sterling Overnight Index Average, abbreviated as SONIA uncompounded an investment benchmark to assess the performance of its investment portfolio.

**Investment returns expectations.**
Investment rates are expected to remain very low over the next few years with no changes anticipated until 2023. There is a potential for rates to go negative as the economy works its way out of Covid-19. Our Investment return forecasts for financial year ends (March) are:

- 2021/22 0.05%
- 2021/22 0.05%
- 2022/23 0.10%

Key Messages:

**For ease of operation investments are split into two categories.**

**Specified Investments are lower risk (either through counterparty credit or duration) and can be made by the Authority's dealers under the TMSS without further reference.**

**Non-Specified Investments are still approved by the TMSS but, due their intrinsic higher risk, require the prior agreement of the S151 Officer before they can be placed.**

**Should a negative rate environment materialise this will not result in any change to our desire to prioritise Security and Liquidity over Yield. Therefore, negative returns will be recorded as interest 'cost' with the principal sum remaining intact provided there is no related Credit Event.**

# Investment Strategy (contd.)

When deteriorating financial market conditions rapidly 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 metrics. In these circumstances, the Authority 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 to which these restrictions are applied will be determined by prevailing financial market conditions. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

**Negative investment rates:** Although the Bank of England said in August / September 2020 that it is unlikely to introduce a negative Bank Rate, at least in the next 6 -12 months, market expectations may Mean real World rates take a different path. Should a negative rate environment materialise this will not result in any change to our desire to prioritise Security and Liquidity over Yield. Therefore, negative returns will be recorded as interest 'cost' with the principal sum remaining intact provided there is no related Credit Event.

This authority has defined the list of types of investment instruments that the treasury management team are authorised to use.

- **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year (366 days).

The Authority defines "high credit quality" organisations and securities as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of A- or higher.

- **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.

**Non-specified Investments:** Any investment not meeting the definition of a specified investment is classed as non-specified. Due care will be taken to consider the exposure of the Council's total investment portfolio to non-specified investments, countries, groups and sectors. The Council has determined that it will limit the maximum total exposure to non-specified investments as follows:-

**Key Messages:**

**Even with the limits, systems and in-house and external knowledge banks we have in place no treasury activity is without risk we therefore set counterparty limits with a link to the authority's reserves so that no specific loss event would be catastrophic enough to jeopardise the operation of the Authority itself.**

**Limit for Long-Term Investments are unchanged for 2021/22. These limits were not used in 2020/21 but are retained to allow flexibility for placing offset deposits as part of a LOBO risk mitigation transaction known as 'Defeasement' should an opportunity present itself.**

# Investment Strategy (contd.)

**Table 3: Non-Specified Investment Limits**

| | Cash limit |
|---|---|
| Total long-term investments | £21m* |
| Total investments without credit ratings or rated below A- (excluding other Local Authorities) | £1.5m |
| Total investments (except pooled funds) with institutions domiciled in foreign countries rated below AA+ | £1.5m |
| Total non-specified investments | £24m |

*The Council has used a significant amount of internal borrowing over the last decade to fund its Capital Programme. This has created a capacity for external borrowing within current limits and Prudential Indicators. With current spending envelope challenges it makes sense for the Authority to look at how externalising this borrowing might be used to generate fiscally-derived revenue savings. Any planned use of long-term investments in this way would be subject to a sound business case and usual governance oversight (See Commercial Plan and Capital Strategy for details)

**Investment Limits:** The Authority's revenue reserves available to cover investment losses are forecast to be £18 million on 31st March 2021. In order that no more than roughly one third of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £6 million. 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 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.

**Key Messages:**

**In addition to limits on individual counterparties the Authority also operates within a number of category-based limits to promote diversification of risk.**

# Investment Strategy (contd.)

**Table 4: Investment Limits (Unchanged)**

| | Cash limit |
|---|---|
| For durations less than 366 days in any single organisation, except the UK Central Government | £6m each |
| UK Central Government | unlimited |
| Any group of organisations under the same ownership | £6m per group |
| Any group of pooled funds under the same management | £6m per manager |
| Negotiable instruments held in a Tri-party Agent/broker's nominee account | £25m per broker |
| Foreign countries (Minimum Sovereign rating AA-) | £5m per country |
| Registered Providers | £2m in total |
| Unsecured investments with Building Societies | £2m in total |
| Loans to unrated corporates | £1m in total |
| Money Market Funds | 50% of overall balances |

**Liquidity Management:** The Authority uses cash flow forecasting to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Authority's medium term financial plan and cash flow forecasts.

**IFRS 9:** 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 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.

**Key Messages:**

**A series of targets (both voluntary and centrally required) are used to facilitate budget evaluation and performance measurement.**

**These targets are generally above the minimum levels set elsewhere in the strategy and are reported on twice yearly.**

**Given the benign rate environment and the need to generate budget savings in the next few years a higher than previous ratio of short-term funding is expected to be maintained. This allows for an overall lower rate but generates interest rate risk going forward.**

# Treasury Management Indicators

The Authority measures and manages its exposures to treasury management risks using the following indicators.

**Security:** The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

| | Target |
|---|---|
| **Portfolio average credit rating** | A |

**Liquidity:** The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling one month period, without additional borrowing.

| | Target |
|---|---|
| **Total cash available within 1 month** | £10m |

**Upper limits on variable interest rate exposure**. This identifies a maximum limit for variable interest rates based upon the debt position net of investments. All borrowing due to mature within 12 months is classed as variable as renewal will be subject to any short term movement in rates.

| | 2019/20 | 2020/21 | 2021/22 | 2022/23 |
|---|---|---|---|---|
| **Upper limit on variable interest rate exposure** | £70m | £90m | £90m | £90m |

Given the benign rate environment and the need to generate budget savings in the next few years, a higher than previous ratio of short-term funding is to be maintained. This allows for an overall lower rate but generates interest rate risk going forward. This strategy will be closely monitored and adjusted should the forecast rate trajectory change materially.

Key Messages:

Maintaining a spread of maturities across our borrowing portfolio can assist with managing cash flow and re-finance risk (the risk that replacement loans are not available or that interest rate costs differ significantly from the maturing loans).

Our active investment portfolio does not lend itself to longer term investments and in the ordinary course of business deposits over 365 days wouldn't be entertained. However one option for redressing our LOBO loan risk requires a long-term matching deposit (funded by new borrowing) and so a limit is included here to cover that transaction should it be deemed of positive benefit.

# Treasury Management Indicators (contd.)

**Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;**

| | 2020/21 | 2021/22 | 2022/23 | 2023/24 |
|---|---|---|---|---|
| Upper Limit on fixed interest rate exposure | £280m | £290m | £290m | £290m |

**Maturity structure of borrowing.** These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

| | Upper | Lower |
|---|---|---|
| Under 12 months | 70% | 0% |
| 12 months and within 24 months | 30% | 0% |
| 24 months and within 5 years | 50% | 0% |
| 5 years and within 10 years | 50% | 0% |
| 10 years and within 20 years | 75% | 0% |
| 20 years and within 30 years | 75% | 0% |
| 30 years and more | 100% | 0% |

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment. Note: LOBO option dates are included as potential repayment dates, but variable rate borrowing is excluded.

**Principal Sums Invested for Periods Longer than 365 days:** The purpose of this indicator is to control the Authority'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 will be:

| | 2020/21 | 2021/22 | 2022/23 |
|---|---|---|---|
| Limit on principal invested beyond year end | £21m | £21m | £21m |
| Current investments as at 30.12.20 in excess of 1 year | 0 | 0 | 0 |

Key Messages:

**Link Asset Services were appointed as the Authority's Treasury Advisor from January 2021. Their contract runs until the end of 2024.**

**The Council recognises that responsibility for treasury management decisions remains with the organisation itself. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.**

**Members of the Audit & Governance Committee receive training annually prior to reviewing the Strategy for the following year.**

# Other Items

There are a number of additional items that the Authority is obliged by CIPFA or MHCLG to include in its Treasury Management Strategy.

**Policy on Use of Financial Derivatives:**
The Authority will not use standalone financial derivatives (such as swaps, forwards, futures and options) . 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.

**Training:** The CIPFA Code requires that the S151 officer ensures members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. Members of the Audit and Governance Committee are provided with timely training prior to reviewing the Strategy in January of each year. This training is provided by our Advisors under the terms of our contract.

The training needs of treasury management officers are periodically reviewed.

**Treasury management consultants**
The Council uses Link Asset Services, Treasury solutions as its external treasury management advisors.

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

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

**Key Messages:**

**New borrowing for the financing of Capital projects means additional cost for the Authority through higher interest payments as our existing loans are not due for repayment for many years. An appropriate budget for this added cost is incorporated in the Medium Term Financial Plan 2021/22.**

**Our main investment options continue to offer low returns but the Authority's primary concerns remain Security and Liquidity.**

# Other Items (contd)

**Investment of Money Borrowed in Advance of Need:** The Authority may, from time to time, borrow in advance of need, where this is anticipated to provide the best long term value for money. Since amounts borrowed will be invested until spent, the Authority is aware that it will be exposed to the risk of loss on the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Authority's overall management of its treasury risks.

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.

The total amount borrowed will not exceed the authorised borrowing limit of £280 million. The maximum period between borrowing and expenditure is expected to be two years, although the Authority is not required to link particular loans with particular items of expenditure.

**Financial Implications**

The budget for investment income in 2021/22 is £0.050 million. The budget for debt interest paid in 2021/22 is £5.7 million, based on an average debt portfolio of £160 million at an average interest rate of 3.6%. If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different.

Negative interest rates remain a possibility on certain investments. The Authority continues to prioritise Security and Liquidity over yield and so views negative rates only in terms of relative return compared to other options. Where the preference for Security or Liquidity dictates placing an investment against negative return the principal amount shall be deemed constant and the interest return will be accounted for separately.

**Benchmarking**

This Council will use SONIA uncompounded as an investment benchmark to assess the performance of its investment portfolio and will also evaluate its performance regularly through benchmarking reports provided by both our Treasury Management System (Treasury Live) and our Advisors, Link Asset Services. Updates will be provided to members at the half-year and outturn.

**Key Messages:**

**In arriving at it's annual Treasury Management Strategy the Authority considers the direct relationship between risk and reward on both sides of it's balance sheet.**

# Other Options Considered

The MHCLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Finance Officer, having consulted the Portfolio Holder, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

| Alternative | Impact on income and expenditure | Impact on risk management |
|---|---|---|
| **Invest in a narrower range of counterparties and/or for shorter times** | Interest income will be lower | Lower chance of losses from credit related defaults, but any such losses may be greater |
| **Invest in a wider range of counterparties and/or for longer times** | Interest income will be higher | Increased risk of losses from credit related defaults, but any such losses may be smaller |
| **Borrow additional sums at long-term fixed interest rates** | 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 |
| **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** | 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 |

**Key Messages:**

**The Local Government Act 2003 requires the Authority to have regard to the Chartered Institute of Public Finance and Accountancy's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow.**

**The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Authority has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.**

# Prudential Indicators 2021/22

**Treasury Management Indicators**
To demonstrate that the Authority has fulfilled the objectives it lays out, the Prudential Code requires the following indicators to be set and monitored each year.

**Estimates of Capital Expenditure:** The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

| Capital Expenditure and Financing | 2020/21 Revised £m | 2021/22 Estimate £m | 2022/23 Estimate £m | 2023/24 Estimate £m |
|---|---|---|---|---|
| Total Expenditure | 51.5 | 54.1 | 41.2 | 31.5 |
| Capital Receipts | 0.3 | 0.5 | 0.5 | 0.5 |
| Government Grants | 27.2 | 26.7 | 16.0 | 15.3 |
| Ring-fenced External Funding | 1.3 | 0.1 | 0.0 | 5.0 |
| Borrowing | 22.8 | 26.8 | 24.7 | 10.7 |
| Total Financing | 51.5 | 54.1 | 41.2 | 31.5 |

- Figures may not agree exactly to totals due to rounding

**Estimates of Capital Financing Requirement:** The Capital Financing Requirement (CFR) measures the Authority's underlying need to borrow for a capital purpose.

| Capital Financing Requirement | 31.03.20 Actual £m | 31.03.21 Estimate £m | 31.03.22 Estimate £m | 31.03.23 Estimate £m | 31.03.24 Estimate £m |
|---|---|---|---|---|---|
| Total CFR | 171.8 | 190.2 | 211.7 | 230.6 | 235.5 |

Key Messages:

**Although net indebtedness is forecast to increase over the next 3 years. Total debt is expected to remain below the CFR and both the Operational and Authorised Borrowing Boundaries during the forecast period.**

**The Authority continues to seek new ways of generating income to support delivery of services in the face of cuts to central government funding.**

**As borrowing arrangements typically form very long term commitments the ability, once drawn, to generate savings from this portion of out spend is very limited.**

# Prudential Indicators (contd.)

**Gross Debt and the Capital Financing Requirement:** In order to ensure that over the medium term debt will only be for a capital purpose, the Authority should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.

| £m | 2019/20 Actual | 2020/21 Estimate | 2021/22 Estimate | 2022/23 Estimate | 2023/24 Estimate |
|---|---|---|---|---|---|
| External Debt | | | | | |
| Debt at 1 April | 128.2 | 146.7 | 152.1 | 167.4 | 184.4 |
| Expected change in Debt | 43.6 | 5.4 | 15.3 | 17.0 | 2.4 |
| Other long-term liabilities (OLTL) | 0 | 0 | 0 | 0 | 0 |
| Expected change in OLTL | 0 | 0 | 0 | 0 | 0 |
| Actual gross debt at 31 March | 146.7 | 152.1 | 167.4 | 184.4 | 186.8 |
| The Capital Financing Requirement | 171.8 | 190.2 | 211.7 | 230.6 | 235.5 |
| Under / (over) borrowing | 25.1 | 38.1 | 44.3 | 46.2 | 48.7 |

**Ratio of Financing Costs to Net Revenue Stream:** This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income. As borrowing arrangements typically form very long term commitments once drawn the ability to generate savings from this portion of Council spend is very limited.

| Ratio of Financing Costs to Net Revenue Stream | 2019/20 Actual | 2020/21 Estimate | 2021/22 Estimate | 2022/23 Estimate | 2023/24 Estimate |
|---|---|---|---|---|---|
| General Fund | 3.28% | 6.91% | 7.61% | 8.10% | 8.24% |

**Key Messages:**

**Borrowing remains comfortably below control levels as a result of continued internal borrowing support for the Capital Programme.**

**Capital Prudential Indicators are included here for formal approval by Full Council**

**Changes to accounting rules for Operating leases from April 2020 will require additional debt obligations to be reflected in our prudential Indicators and limits have been increased in readiness for this change.**

**Limit levels do not commit the Authority to any increase in actual borrowing.**

# Other Prudential Indicators

**Authorised Limit for External Debt**: This is a key prudential indicator represents a control on the maximum level of borrowing. This represents a legal limit beyond which external debt is prohibited, and can only 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.

The Authorised Limit is a 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.

Council is asked to approve the following Authorised and Operational limits:

| Authorised Limit | 2020/21 £m | 2021/22 £m | 2022/23 £m | 2023/24 £m |
|---|---|---|---|---|
| Borrowing | 250 | 250 | 250 | 250 |
| Other long-term liabilities | 30 | 40 | 40 | 40 |
| Total Debt | 280 | 290 | 290 | 290 |

**Operational Boundary for External Debt:** This is the limit beyond which external debt is not normally expected to exceed. (i.e. prudent but not worst case). It links directly to the Authority's estimates of capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring. Other long-term liabilities comprise finance leases and other liabilities that are not traditional loans but still form part of the Authority's debt.

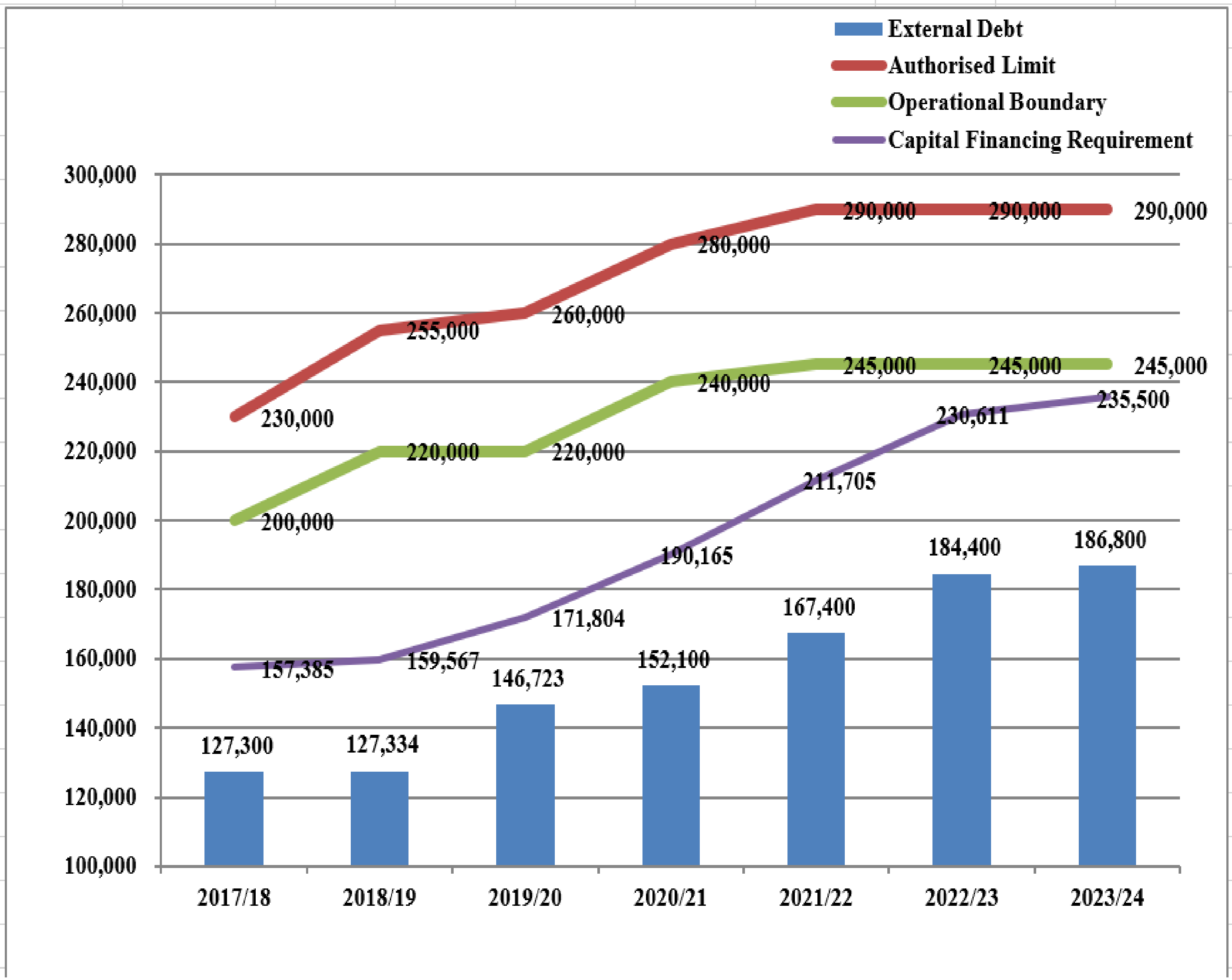
| Operational Limit | 2020/21 £m | 2021/22 £m | 2022/23 £m | 2023/24 £m |
|---|---|---|---|---|
| Borrowing | 215 | 215 | 225 | 225 |
| Other long-term liabilities | 25 | 30 | 30 | 30 |
| Total Debt | 240 | 245 | 245 | 245 |

**Adoption of the CIPFA Treasury Management Code:** The Authority adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition in February 2018.

Key Messages:

A summary of the Authority's projected borrowing set against it's Prudential Indicator Limits is shown across.

# Borrowing Prudential Indicators Summary



**Key Messages:**

**The Council has funded it's historic Capital Programme through borrowing. It also took steps to ensure liquidity at the onset of the Covid pandemic by securing funds well below the prevailing PWLB rate. This has resulted in a net indebtedness position of £112.4m as at the period end.**

**This is an decrease of £8m from end 2019, which is reflected in the current investments balance.**

# Annex 1- Existing Investment & Debt Portfolio Position

| | 31.12.2020<br>**Actual Portfolio**<br>**£m** | 31.12.2020<br>**Average Rate**<br>**%** |
|---|---|---|
| **External Borrowing:** | | |
| PWLB – Fixed Rate | **74.4** | **3.51** |
| PWLB – Variable Rate | **0.0** | **N/A** |
| Local Authorities | **16.2** | **1.00** |
| Bank Loans | **40.0** | **3.14** |
| LOBO Loans | **21.0** | **4.40** |
| **Total Gross External Debt** | 151.6 | 3.27 |
| **Investments:** | | |
| *Managed in-house* | | |
| Short-term investments | 39.2 | 0.00 |
| Long-term investments | 0.0 | N/A |
| **Total Investments** | 39.2 | |
| **Net Debt** | 112.4 | |

**Key Messages:**

**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).**

**The broad aim of the Minimum Revenue Provision is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.**

# Annex 2 – Annual Minimum Revenue Provision Statement

Where the Authority finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP). Any remaining balance is known as the Capital Financing Requirement (CFR). Although there has been no statutory minimum since 2008, the Authority is required to have regard to the Department for Communities and Local Government’s Guidance on Minimum Revenue Provision (the CLG Guidance), most recently issued in 2017.

The CLG Guidance requires the Authority to approve an Annual MRP Statement each year and also recommends a number of options for calculating a prudent amount of MRP. The following statement is the Council’s MRP policy that incorporates options recommended in the Guidance as well as prudent approaches determined locally.

The MRP on the balance of CFR relating to the period before 1st April 2008 is charged at 2% per annum.

For unsupported CFR incurred after 31st March 2008, MRP is charged over the expected useful life of the relevant assets, recognising the principal repayment on an annuity interest rate equal to the average relevant PWLB rate for the year of expenditure, starting in the year after the asset becomes operational.

MRP on purchases of (or predominantly of) freehold land will be charged over a maximum period of 50 years, unless it has structures on it with a life of more than 50 years. In which case, the land will be charged over the remaining life of the building/structures themselves. Similarly, capital expenditure on the purchase or improvement of investment property, which is not normally subject to depreciation, will be charged over 50 years. MRP on expenditure not related to fixed assets but which has been capitalised by regulation or direction will be charged over 25 years.

For assets acquired by finance leases, MRP will be determined as being equal to the element of the rent or charge that goes to write down the balance sheet liability. The Council can provide capital loans as part of its capital investment programme. MRP on loans secured against assets will be charged over the life of those assets. MRP on unsecured loans will be charged over the period of the loans.

**MRP Overpayments** - MHCLG MRP Guidance allows any charges made over the statutory MRP (Voluntary Revenue Provision/overpayments) to be reclaimed in later years if deemed necessary or prudent. The Council’s cumulative overpayment (VRP) at 1 April 2019 was £3.477m, which was reclaimed in 2019/20 and set aside to support future transformation proposals. This increased the CFR and the ongoing MRP by £0.070m, which will be budgeted for in the Council’s Medium Term Financial Plan.