Appendix D

<u>COPELAND BOROUGH COUNCIL</u>

TREASURY MANAGEMENT STRATEGY STATEMENT (TMSS), MINIMUM REVENUE PROVISION POLICY STATEMENT AND ANNUAL INVESTMENT STRATEGY 2021/22

1. INTRODUCTION

Background

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

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 any 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 could involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.

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

CIPFA defines treasury management as:

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

Copeland's Portfolio and Investment Strategy

Copeland Borough Council currently holds an average investment portfolio of approximately £45 million. The majority of this money is working capital or held in a combination of provisions and revenue and capital reserves and is earmarked for various purposes. However, the range of funds can be much higher at the start of the financial year depending on cash flow movements and the receipt of an advance payment of a full year business rates by the Council's largest ratepayer (approximately £30 million). Most of this large cash balance at the start of the year does not belong to the Council. It is invested in a range of maturities to facilitate the requirement to pay over regular amounts of the advance funding to the Government and County Council in accordance with the agreed schedule of payments.

The main principle governing the Council's investment criteria is the security and liquidity of its investments, with yield (or return) then being considered. The Council's counterparty list is derived from the minimum credit ratings set in conjunction with our Treasury Management Advisors, Link Asset Services. This list limits the Council to use the counterparties for investment that are at or above the minimum criteria approved. Should the criteria be set too low then the Council would be open to risk; if set too high it could make it difficult to place funds. The TMSS sets out the overall policy parameters, with officers using their judgement within the parameters set as required.

Wherever possible, and within the security limits, the Council maximises interest by fixed term investments with the banks for up to a year and up to the maximum limits set out in the strategy. At peak cash inflow times the Council has c. £60 million to invest. The Council aims for diversification through the use of other counterparties who meet our minimum criteria and through the use of pooled investment vehicles, Money Market Funds. These are highly secure, liquid institutions with the yield being generally lower because of the flexibility of instant access to funds. This, in turn reduces the average investment interest rate achieved compared to longer term fixed rate deposits. The objective continues to be that we achieve a rate above the 7 Day LIBID (London Interbank Bid Rate – the rate at which banks bid to borrow) as a benchmark.

Members should note that the limits that are presented throughout this report have been discussed with the Council's treasury management advisors and are deemed acceptable for the current risk appetite.

Reporting Requirements

Capital Strategy

The CIPFA 2017 Prudential and Treasury Management Codes require all local authorities to prepare a capital strategy which will provide the following:

- a high-level long term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services;
- an overview of how the associated risk is managed; and
- the implications for future financial sustainability.

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.

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.

c. An annual treasury report – This is a backward looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Treasury Management Strategy for 2021/22

The strategy for 2021/22 covers two main areas:

Capital issues

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

Treasury management issues

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

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.

Training

The CIPFA Code requires the responsible officer (the S151 Officer) to ensure that members with responsibility for treasury management receive adequate training in treasury management.

Treasury Management Consultants

The Council uses Link Group, Treasury solutions as its external treasury management advisors but recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon the external service providers.

The Council 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.

2. THE CAPITAL PRUDENTIAL INDICATORS 2021/22 – 2023/24

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans are reflected in the prudential indicators, which are designed to assist member's overview and confirm capital expenditure plans.

Capital expenditure

The first prudential indicator is a summary of the Council's draft capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts, the full details of which are elsewhere on the agenda for consideration. The following table summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

Capital expenditure £000's	2020/21 Forecast	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Total in the capital programme	**1,955**	**9,215**	**18,224**	**10,500**	**5,000**
Financed by:					
Capital receipts	1,200	1,683	2,132	0	0
Capital grants	657	6,219	5,575	0	0
Revenue	98	198	198	0	0
Borrowing (net of MRP)	0	1,050	10,319	10,500	5,000
Total	**1,955**	**9,215**	**18,224**	**10,500**	**5,000**

The above financing need excludes other long term liabilities, such as leasing arrangements which already include borrowing instruments.

The Council's borrowing need (the Capital Financing Requirement - CFR)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure which has not immediately been paid for will increase the CFR.

In any event, the CFR does not increase indefinitely as it is required to be paid off over time from the annaul Minimum Revenue Provision. MRP is a statutory annual revenue charge which reduces the borrowing need broadly in line with each asset's life, and so charges the economic consumption of capital assets as they are used.

The CFR includes any other long term liabilities (e.g. finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to borrow separately.

£000's	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Capital Financing Requirement					
Total CFR	**2,995**	**4,045**	**14,364**	**24,864**	**29,864**
Movement in CFR	0	1,050	10,319	10,500	5,000
Movement in CFR represented by					
Net financing need for the year (above)	120	1,212	10,894	11,495	6,195
Less MRP and other financing movements	-120	-162	-575	-995	-1195
Movement in CFR	**-**	**1,050**	**10,319**	**10,500**	**5,000**

**Note the MRP will include finance lease annual principal payments*

Core funds and expected investment balances

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year-end balances for each resource and anticipated day-to-day cash flow balances.

Year End Resources	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Fund balances / reserves	11.92	8.16	6.90	2.72	-1.54
Capital receipts	4.39	2.60	0.47	-	-
Provisions	1.56	1.56	1.56	1.56	1.56
Other					
Total core funds	**17.26**	**12.32**	**8.93**	**4.28**	**0.02**
(Under) / Over borrowing	2.64	2.64	-7.68	-18.18	-23.18
Working capital	1.38	1.38	1.38	1.38	1.38
Expected investments	**21.28**	**16.34**	**2.63**	**-12.52**	**-21.78**

Cash supporting Balances will be used to fund the Council's borrowing requriement (ie internal borrowing) until 2022/23 when the Council may be required to externalise some or all of the borrowing depending on the financial position at the time (i.e. undertake external borrowing).

Minimum Revenue Provision (MRP) policy statement

The Council must approve a prudent MRP, although there are a variety of options as to how the amount is calculated. Government regulations require the full Council to approve an MRP Statement, describing which option is to be followed, in advance of each year.

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

- Asset life method – MRP will be based on the estimated life of the assets, in accordance with the regulations. This option provides for a reduction in the borrowing need over the asset's estimated life.

Repayments of PFI or Finance Leases are allowable to use as a proxy for the above methods. The reduction in the CFR above is as a result of the PFI and finance lease MRP.

Affordability prudential indicators

The previous paragraphs and Section 3 cover the overall capital and control of borrowing prudential indicators, but within the prudential framework the Council is also required assess the affordability of capital investment plans. This provides an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators in respect of the actual and estimated ratio of financing costs to its net revenue stream.

Ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

%	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Ratio	1%	2%	7%	12%	15%

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

3. BORROWING

The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

Current portfolio position

The Council's debt portfolio contains one remaining Market Loan of £5 million which will mature on 1st February 2042. The rate is fixed at 7.55% with interest payments of £377,500 a year. The status of this loan is continually assessed to determine whether better terms can be obtained. Currently, it is better to leave the loan in its present form, as the penalty for repaying early would be prohibitive. This was estimated at £5.577m (on top of the £5m debt repayment) on 3 January 2019. The costs of redemption therefore outweigh any benefit and this will remain the case for as long as cpmparative rates remain significantly below the rate payable on the loan.

In the event of a need to borrow further, the Section 151 Officer has delegated power, under Section D of Part 2 of the Scheme of Delegation, to undertake the most appropriate form of borrowing depending on prevailing interest rates. Such a decision would be reported to the appropriate decision making body at the soonest opportunity.

The Council's treasury portfolio position at 31 March 2020 summarised below with forward projections. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the CFR), indicating an over-borrowed position.

TREASURY PORTFOLIO				
	31.03.20 Actual	31.03.20 Actual	31.01.21 Current	31.01.21 Current
Treasury Investments	£000	%	£000	%
Banks	14,970	51.28	14,970	36.18
Money market funds	14,222	48.72	26,401	63.82
Total Treasury Investments	**29,192**	**100.00**	**41,371**	**100.00**
Treasury External Borrowing				
LOBOs	5,000	100.00	5,000	100.00
Total External Borrowing	**5,000**	**100.00**	**5,000**	**100.00**
Net Treasury Investments/(Borrowing)	**24,192**		**36,371**	

£000's	**2019/20 Actual**	**2020/21 Estimate**	**2021/22 Estimate**	**2022/23 Estimate**	**2023/24 Estimate**
External Debt					
Debt at 1 April	5,000	5,000	5,000	5,000	5,000
Expected change in Debt	0	-	-	12,521	21,783
Other long-term liabilities (OLTL)	4,984	0	0	0	0
Actual gross debt at 31 March	**9,984**	**5,000**	**5,000**	**17,521**	**26,783**
The Capital Financing Requirement	2,995	4,045	14,364	24,864	29,864
(Under) /over borrowing	**6,989**	**955**	**-9,364**	**-7,343**	**-3,081**

** decrease in long term liabilities relates to expected end of PFI scheme*

Within the range of prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2021/22 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Council's current indebtedness covers both the PFI and external debt, which exceeds the CFR. Essentially, this results from the Council's Large Scale Voluntary Transfer of the housing stock. As the Council cannot currently repay the £5 million loan economically, this is allowed, as an exception, by the prudential indicator above and will be corrected at the earliest practicable time.

Treasury Indicators: limits to borrowing activity

The operational boundary. This is the limit which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR (capital financing requirement), but may be lower or higher depending on the levels of actual debt. It is to be used solely as a guideline figure.

Operational Boundary £000's	**2019/20**	**2020/21**	**2021/22**	**2022/23**	**2023/24**

	Actual	Estimate	Estimate	Estimate	Estimate
Debt	5,000	5,000	5,000	17,521	26,783
Other long term liabilities	4,984	300	300	300	300
Total	**9,984**	**5,300**	**5,300**	**17,821**	**27,083**

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

Members are asked to approve the following authorised limit (which is based in part on the CFR projections):

Authorised Limit £000's	**2019/20 Actual**	**2020/21 Estimate**	**2021/22 Estimate**	**2022/23 Estimate**	**2023/24 Estimate**
Debt	9,000	9,000	9,000	9,000	9,000
Other long term liabilities	8,000	8,000	8,000	8,000	8,000
Total	**17,000**	**17,000**	**17,000**	**17,000**	**17,000**

Prospects for Interest rates

The Council has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives the interest rate view.

Link Group Interest Rate View 9.11.20
These Link forecasts have been amended for the reduction in PWLB margins by 1.0% from 26.11.20

	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
5 yr PWLB	0.80	0.80	0.80	0.80	0.90	0.90	0.90	0.90	0.90	1.00	1.00	1.00	1.00
10 yr PWLB	1.10	1.10	1.10	1.10	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.30	1.30
25 yr PWLB	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80	1.80	1.80	1.80
50 yr PWLB	1.30	1.40	1.40	1.40	1.40	1.50	1.50	1.50	1.50	1.60	1.60	1.60	1.60

The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its subsequent meetings to 16th December, although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently think that such a move would do more damage than good and that more quantitative easing is the favoured tool if further acction becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected in the near-term as economic recovery is expected to be only gradual and, therefore, prolonged. These forecasts were based on an assumption that a Brexit trade deal would be agreed by 31.12.20: as this has now occurred, these forecasts do not need to be revised.

There was much speculation during the second half of 2019 that bond markets were in a bubble which was driving bond prices up and yields down to historically very low levels. The context for that was a heightened expectation that the US could have been heading for a recession in 2020. In addition, there were growing expectations of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China, together with inflation generally at low levels in most countries and expected to remain subdued. Combined, these conditions were conducive to very low bond yields. While inflation targeting by the major central banks has been successful over the last thirty years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers. This means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. The consequence of this has been the gradual lowering of the overall level of interest rates and bond yields in financial markets over the last 30 years. Over the year prior to the coronavirus crisis, this has seen many bond yields up to 10 years turn negative in the Eurozone. In addition, there has, at times, been an inversion of bond yields in the US whereby 10 year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities.

Gilt yields had therefore already been on a generally falling trend up until the coronavirus crisis hit western economies during March 2020. After gilt yields spiked up during the financial crisis in March, we have seen these yields fall sharply to unprecedented lows as investors panicked during March in selling shares in anticipation of impending recessions in western economies, and moved cash into safe haven assets i.e. government bonds. However, major western central banks took rapid action to deal with excessive stress in financial markets during March, and started massive quantitative easing purchases of government bonds: this also acted to put downward pressure on government bond yields at a time when there has been a huge and quick expansion of government expenditure financed by issuing government bonds. Such unprecedented levels of issuance in “normal” times would have caused bond yields to rise sharply. Gilt yields and PWLB rates have been at remarkably low rates so far during 2020/21.

As the interest forecast table for PWLB certainty rates above shows, there is expected to be little upward movement in PWLB rates over the next two years as it will take economies, including the UK, a prolonged period to recover all the momentum they have lost in the sharp recession caused during the coronavirus shut down period. From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment, (as shown on 9th November when the first results of a successful COVID-19 vaccine trial were announced). Such volatility could occur at any time during the forecast period.

Investment and borrowing rates

- Investment returns are likely to remain exceptionally low during 2021/22 with little increase in the following two years.
- Borrowing interest rates fell to historically very low rates as a result of the COVID crisis and the quantitative easing operations of the Bank of England: indeed, gilt yields up to 6 years were negative during most of the first half of 20/21. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years. The unexpected increase of 100 bps in PWLB rates on top of the then current margin over gilt yields of 80 bps in October 2019, required an initial major

rethink of local authority treasury management strategy and risk management. However, in March 2020, the Government started a consultation process for reviewing the margins over gilt rates for PWLB borrowing for different types of local authority capital expenditure. (Please note that Link has concerns over this approach, as the fundamental principle of local authority borrowing is that borrowing is a treasury management activity and individual sums that are borrowed are not linked to specific capital projects.) It also introduced the following rates for borrowing for different types of capital expenditure: -
  - **PWLB Standard Rate** is gilt plus 200 basis points (G+200bps)
  - **PWLB Certainty Rate** is gilt plus 180 basis points (G+180bps)
  - **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
  - **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
  - **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)
- As a consequence of these increases in margins, many local authorities decided to refrain from PWLB borrowing unless it was for HRA or local infrastructure financing, until such time as the review of margins was concluded.
- On 25.11.20, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates; the standard and certainty margins were reduced by 1% but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three year capital programme. The new margins over gilt yields are as follows: -.
  - **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
  - **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)
  - **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
  - **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
  - **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)
- **Borrowing for capital expenditure.** As Link's long-term forecast for Bank Rate is 2.00%, and all PWLB rates are under 2.00%, there is now value in borrowing from the PWLB for all types of capital expenditure for all maturity periods, especially as current rates are at historic lows. However, greater value can be obtained in borrowing for shorter maturity periods so the Council will assess its risk appetite in conjunction with budgetary pressures to reduce total interest costs. Longer-term borrowing could also be undertaken for the purpose of certainty, where that is desirable, or for flattening the profile of a heavily unbalanced maturity profile.
- While the Council will not be able to avoid borrowing to fund new capital expenditure, to replace maturing debt and the rundown of reserves, there will be a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost. The Council will therefore run down spare cash balances before considering long term borrowing.

The s151 officer will monitor the balance of short term investment rates and longer term borrowing rates to minimise any adverse impact on the budget.

Borrowing Strategy

The Council is currently maintaining an over-borrowed position. This means that borrowing is available to fund capital expenditure. Where capital expenditure increases the need to borrow then surplus cash balances will be used initially (internal borrowing) and only when there is a need to borrow externally will this decision be made. However, other considerations would factor into this decision including:

- If it was felt that there was a significant risk of a sharp FALL in borrowing rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then borrowing may be postponed;
- if it was felt that there was a significant risk of a much sharper RISE in borrowing rates than that currently forecast, perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity, or a sudden increase in inflation risks, then the portfolio position will be re-appraised.

Any decisions will be reported to the Executive at the next available opportunity.

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. Any associated risks will be approved and reported through the standard reporting method.

Debt rescheduling

As short term borrowing rates will generally be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, as stated earlier in 3, the current cost of repaying the £5 million debt is prohibitive.

The reasons for any rescheduling to take place would include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhancing the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Any rescheduling decision made by the Section 151 Officer will be reported to Members, at the earliest opportunity.

New financial institutions as a source of borrowing and / or types of borrowing

Currently the PWLB Certainty Rate is set at gilts + 80 basis points for both HRA and non-HRA borrowing. However, consideration may still need to be given to sourcing funding from the following sources for the following reasons:

- Local authorities (primarily shorter dated maturities out to 3 years or so – still cheaper than the Certainty Rate).
- Financial institutions (primarily insurance companies and pension funds but also some banks, out of spot or forward dates where the objective is to avoid a “cost of carry” or to achieve refinancing certainty over the next few years).
- Municipal Bonds Agency (possibly still a viable alternative depending on market circumstances prevailing at the time).

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

4. ANNUAL INVESTMENT STRATEGY

Investment policy

The Council's investment policy has regard to the following: -

- MHCLG's Guidance on Local Government Investments ("the Guidance")
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the Code")
- CIPFA Treasury Management Guidance Notes 2018

The Council's investment priorities will be security first, portfolio liquidity second and then yield, (return). The above guidance from the MHCLG and CIPFA place a high priority on the management of risk. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -

1. Minimum acceptable **credit criteria** are applied in order to generate a list of highly creditworthy counterparties.

2. **Other information**: ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate.

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

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

    - **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year.
    - **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year.

5. **Non-specified investments limit**. The Council has determined that it will limit the maximum total exposure to non-specified investments as being 50% of the total investment portfolio.

6. **Lending limits**, (amounts and maturity), for each counterparty will be set.

7. **Transaction limits** are set for each type of investment.

8. This authority will set a limit for the amount of its investments which are invested for **longer than 365 days**.

9. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating**.

10. This authority has engaged **external consultants** to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.

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

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

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

Creditworthiness policy

The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and
- It has sufficient liquidity in its investments. For this purpose, it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

The Section 151 Officer 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.

Credit rating information is supplied by our treasury advisors, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating Watches (notification of a likely change), rating Outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating Watch applying to a counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.

The criteria for providing a pool of high quality investment counterparties (both specified and non-specified investments) is:

- Banks 1 **-** good credit quality – the Council will only use banks which:
  i. are UK banks; or
  ii. are non-UK and domiciled in a country which has a minimum sovereign long term rating of AAA

  and have, as a minimum, the following Fitch, Moody's and Standard and Poor's credit ratings (where rated):
  i. Short term – F1
  ii. Long term – A-

- Banks 2 – Part nationalised UK bank – Royal Bank of Scotland. This bank can be included provided it continues to be part nationalised or they meet the ratings in Banks 1 above.
- Banks 3 – The Council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.
- Bank subsidiary and treasury operation - The Council will use these where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above.
- Money market funds – AAA
- Short dated bond funds (LVBFss)*
- UK Government (including gilts and the DMADF)
- Local authorities, parish councils etc.
- Supranational institutions
- Property Funds**

* Low Volatility Bond Funds are similar to the current MMF's and should allow marginally higher returns. These funds invest slightly longer than the current liquid MMF's and access to monies is usually over a 1 or 2 day notice period, rather than immediately. Officers will consult with our advisers over their introduction.

**Property Funds are longer term investments and although are not currently used by the Council the option may be used in future financial years. Officers will consult with our advisers over their introduction and are subject to an additional report.

A limit of 50% of the whole portfolio will be applied to the use of non-specified investments.

Country and sector considerations - Due care will be taken to consider the country, group and sector exposure of the Council's investments.

The Council currently limits its investments to UK countries, but should that change the Council has determined that it will only use approved counterparties from countries (excluding the UK) with a minimum sovereign credit rating of AAA from Fitch. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

In addition:

- no more than 50% of the whole portfolio will be placed with any non-UK country at any time;
- limits in place above will apply to a group of companies;
- sector limits will be monitored regularly for appropriateness.

Time and monetary limits applying to investments. The time and monetary limits for institutions on the Council's counterparty list are as follows (these will cover both specified and non-specified investments):

Institution Limits	Fitch Long term Rating (or equivalent)/ Fund Rating	Money Limit £	Time Limit
Banks 1 higher quality	AA-	£5m	3yrs
Banks 1 medium quality	A-	£5m	100 days
Banks 2 – part nationalised	-	£10.1m**	1yr
Limit 3 category – Council's banker (not meeting Banks 1)	-	£10k	1 day
DMADF	AA	unlimited	6 months
Local authorities	N/A	£5m	1yr
Money market funds (SNAV, VNAV and LNAV)	AAA	£10m*	liquid
Enhanced money market funds	AAA	£5m / 10%	liquid

**Per Fund*

*** This is set at £10.1m, rather than £10m to to allow an overnight balance on the Council's NatWest currrent account of £100k, when circumstances require. The present procedure that ensures that the current account balance remains around £5k overnight will remain. However, any income that is received after the dealing is complete for the day will be unable to be invested the same day and needs to be invested the next working day. The additional £100k allows this flexibility in day to day treasury operations. Details of any receipt transaction in excess of £100k (that has been credited to the current account after the dealing is complete) is reported within the next scheduled Treasury Report to Executive.*

Creditworthiness

Although the credit rating agencies changed their outlook on many UK banks from Stable to Negative during the quarter ended 30.6.20 due to upcoming risks to banks' earnings and asset quality during the economic downturn caused by the pandemic, the majority og ratings were affirmed due to the continuing strong credit profiles of major financial institutions, including UK banks. However, during Q1 and Q2 2020, banks made provisions for *expected* credit losses and the rating changes reflected these provisions. As we move into future quarters, more information will emerge on *actual* levels of credit losses. (Quarterly earnings reports are normally announced in the second half of the month following the end of the quarter.) This has the potential to cause rating agencies to revisit their initial rating adjustments earlier in the current year. These adjustments could be negative or positive, although it should also be borne in mind that banks went into this pandemic with strong balance sheets. This is predominantly a result of regulatory changes imposed on banks following the Great Financial Crisis. Indeed, the Financial Policy Committee (FPC) report of 6th August revised down their expected credit losses for the UK banking sector to "somewhat less than £80bn". It stated that in its assessment, "banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC's central projection". The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC's projection, with unemployment rising to above 15%.

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

CDS prices

Although bank CDS prices (these are market indicators of credit risk) spiked upwards at the end of March / early April 2020 due to the heightened market uncertainty and ensuing liquidity crisis that affected financial markets, they have returned to more average levels since then. Nevertheless, prices are still elevated compared to end-February 2020. Pricing is likely to remain volatile as uncertainty continues. However, sentiment can easily shift, so it will remain important to undertake continual monitoring of all aspects of risk and return in the current circumstances. Link monitor CS prices as part of their creditworthiness service to local authorities and the Council has access to this information via its Link-provided Passport portal.

Investment strategy

In-house funds. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. Where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.
- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

Investment returns expectations.
Bank Rate is unlikely to rise from 0.10% for a considerable period. It is very difficult to say when it may start rising so it may be best to assume that investment earnings from money market-related instruments will be sub 0.50% for the foreseeable future.

The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows (the long term forecast is for periods over 10 years in the future):

2020/21	0.10%
2021/22	0.10%
2022/23	0.10%
2023/24	0.10%
2024/25	0.25%
Long term later years	2.00%

- The overall balance of risks to economic growth in the UK is probably now skewed to the upside, but it is subject to major uncertainty due to the virus and how quickly successful vaccines may become available and widely administered to the population. It may also be affected by what, if any, deal with the UK agrees as part of Brexit.
- There is relatively little UK domestic risk of increase or decreases in Bank Rate and significant changes in shorter term PWLB rates. The Bank of England has effectively ruled out the use of negative interest rates in the near term and increases in Bank Rate are likely to be some years away given the underlying economic expectations. However, it is always possible that safe haven flows, due to unexpected domestic developments and those in other major economies, or a return of investor confidence in equities, could impact gilt yields, (and so PWLB rates), in the UK.

Negative investment rates

While the Bank of England said in August / September 2020 that it is unlikely to introduce a negative Bank Rate, at least in the next 6 -12 months, and in November omitted any mention of negative rates in the minutes of the meeting of the Monetary Policy Committee, some deposit accounts are already offering negative rates for shorter periods. As part of the response to the pandemic and lockdown, the Bank and the Government have provided financial markets and businesses with plentiful access to credit, either directly or through commercial banks. In addition, the Government has provided large sums of grants to local authorities to help deal with the COVID crisis; this has caused some local authorities to have sudden large increases in cash balances searching for an investment home, some of which was only very short term until those sums were able to be passed on.

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

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

Investment treasury indicator and limit - total principal funds invested for greater than 365 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end. The Council is asked to approve the treasury indicator and limit: -

Maximum principal sums invested for longer than 365 days	
Principal sums invested > 365 days	£20m

End of year investment report

At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report which is presented at the same time as the Outturn reports.

APPENDIX D1: Approved countries for investments

AAA

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

APPENDIX D2: Treasury management scheme of delegation

(i) Full Council

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.

(ii) Boards/committees/council/responsible body

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;
- approving the selection of external service providers and agreeing terms of appointment.

(iii) Body/person(s) with responsibility for scrutiny

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

APPENDIX D3: The treasury management role of the section 151 officer

The S151 (responsible) officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance
- submitting regular treasury management policy reports
- submitting budgets and budget variations
- receiving and reviewing management information reports
- reviewing the performance of the treasury management function
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- ensuring the adequacy of internal audit, and liaising with external audit
- recommending the appointment of external service providers
- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money
- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources
- ensuring that members are adequately informed and understand the risk exposures taken on by an authority
- ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above