Surrey Heath Borough Council
Executive
15 February 2022

Treasury Management Strategy Report 2022/23

Portfolio Holder: Cllr Robin Perry – Portfolio Holder for Finance
Strategic Director: Bob Watson – Strategic Director Finance
Report Author: Bob Watson – Strategic Director Finance
Key Decision: Yes
Wards Affected: All

Summary and purpose

This paper sets out the Council's Annual Treasury Management Strategy for 2022/23 for Executive to consider and recommend to Council.

Recommendation
The Executive is advised to approve and RECOMMEND to Full Council the adoption of the following:

(i) The Treasury Management Strategy for 2022/23 shown at Annexes A and B to this report;

(ii) The Treasury Management Indicators for 2022/23 at Annex C to this report;

(iii) The Minimum Revenue Provision policy statement and estimated minimum revenue provision payment table at Annex F to this report; and

(iv) The Treasury Management Policy Statement at Annex G to this report.

The Executive is advised to note the following:

(i) Investments as at 30th November 2021 shown at Annex D to this report; and

(ii) Existing Investment and Debt Portfolio shown at Annex E to this report

1. Background and Supporting Information

1.1 Treasury management is the management of the Council's cash flows, borrowing and investments, and the associated risks. The Council 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 financial risk is therefore central to the Council's prudent financial management.

1.2 The Council's portfolio of investments comprise funds available for longer term investment and short term investments sufficient to meet cash flow requirements.

2. Reasons for Recommendation

2.1 Treasury management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the 'CIPFA Code') which requires the Council to approve a treasury management strategy before the start of each financial year. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the 'CIPFA Code'.

2.2 In accordance with the DLUHC Guidance, the Council will be asked to approve any revision to the Treasury Management Strategy Statement should any of the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates, or in the Council's capital programme or in the level of its investment balance.

3. Proposal and Alternative Options

3.1 The Executive is asked the approve and recommend to Council that it adopts:

3.1.1 The Treasury Management Strategy for 2022/23 at Annex A
3.1.2 The Treasury Management Indicators for 2022/23 at Annex B
3.1.3 The Minimum Revenue Provision (MRP) Policy Statement at Annex E
3.1.4 The Treasury Management Policy Statement at Annex F

3.2 The Executive can receive or amend the report, or ask for further information.

3.3 The Executive can approve or amend the proposed recommendations to Council.

4. Contribution to the Council's Five Year Strategy

4.1 The Council's Medium Term Financial Strategy of which the Treasury Management Strategy is part supports the Council's adopted Five Year Strategy.

5. Resource Implications

5.1 The budgeted target for investment income in 2022/23 is £75,000 based on an average investment portfolio of £13 million at a weighted average interest rate of 0.58%. The budget for interest paid on debt in 2022/23 is £2.920 million, based on an average debt portfolio of £147 million and an average interest rate of 2%. If the actual level of investments and borrowing vary, or actual interest rates change from those forecast, then performance against budget will be different. The forecast position on both treasury investment earnings and debt financing will be reported in the Treasury mid-year report.

5.2 Where investment income exceeds budget, e.g. from higher risk investments including pooled funds, or debt interest paid falls below budget, e.g. from cheap short-term borrowing, then the revenue benefits will be transferred to the Interest Equalisation earmarked reserve to cover the risk of debt financing rates increasing in future years.

5.3 Financing for the corporate capital programme for 2022/23 – 2025/26 is anticipated to be funded by capital receipts and contributions, capital reserves and government grants. There is no planned increase in capital borrowing over this period.

5.4 Any changes required to the approved treasury management indicators and strategy, due to changes in economic conditions or from an increased capital programme, will be reflected in future reports for Executive and Council to consider.

6. Section 151 Officer Comments:

6.1 The Council is obliged to review and approve its Treasury Management Strategy on an annual basis and this must be set by Council as part of the annual budgetary process.

6.2 The Capital Financing Requirement (CFR), operational boundaries for debt and authorised borrowing limits are contained in the Capital Strategy that is also presented on this agenda.

6.3 Treasury Management, in particular the management of debt, is becoming an increasing important are for the Council. This can lead to financial benefits but also carries risks which need to be clearly understood.

7. Legal and Governance Issues

7.1 The Council complies with the requirements of the CIPFA Code of Practice and Treasury Management. The current relevant criteria and constraints incorporated into the Treasury Management Policy Statement are:

7.1.1 New borrowing is to be contained within the limits approved by the Council, in accordance with the CIPFA Prudential Code for Capital Finance in Local Authorities, and the Council’s prudential indicators.

7.1.2 Investments to be made in accordance with the CLG guidance on Local Council Investments, on the basis of the ratings agencies of Fitch, Moody’s and Standard & Poors credit ratings for rated institutions and as detailed in the Treasury Management Policy statement and approved schedules and practices.

7.1.3 Sufficient funds to be available to meet the Council’s estimated outgoings for any day.

7.1.4 Investment objectives are to maximise the return to the Council, subject to the overriding need to protect the capital sum.

7.1.5 The Council's response to interest rate changes is to minimise the net interest rate burden on borrowing and maximise returns from investments, subject to (7.1.1-7.1.4) above.

8. Other Considerations and Impacts

Risk Management

8.1 Poor returns on investments could lead to a reduction in income also to support the revenue budget. However, low returns on investments should mean low rates for borrowing which could offset any potential loss. There is a risk that variable interest rates on short term borrowing could rise faster than expected leading to an increase in cost and therefore leading to savings being needed elsewhere in the Council's budget.

8.2 The limits proposed in this report in respect to counterparties and investments are the overall limits for agreement by Council. However from time to time these may be tightened temporarily by the Strategic Director of Finance & Customer Services in consultation with the portfolio holder for Resources to reflect increased uncertainty and increase in perceived risk in financial institutions and the economy. This will usually be at the cost of lower returns.

8.3 The investments ratings provided by credit ratings agencies are only a guide and do not give 100% security. There is always a risk that an institution may be unable to repay its loans whatever the credit rating thereby putting the Council's investments at risk.

Annexes

Annex A – 2022/23 Treasury Management Strategy
Annex B – 2022/23 Treasury Management Strategy - Other Items
Annex C – 2022/23 Treasury Management Indicators
Annex D – Treasury Investments as at 30th November 2021
Annex E – Existing Investment and Debt Portfolio
Annex F – Minimum Revenue Policy (MRP) Statement
Annex G – Treasury Management Policy Statement

Background Papers

CIPFA Code of Practice: Treasury Management in the Public Services – 2017 Edition

Annex A

Treasury Management Strategy 2022/23

Part 1 Treasury Investment Strategy

1.1 The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. This is expected to remain at £13 million in 2022/23.

Objectives:

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

Strategy:

1.3 Given the increasing risk and very low returns from short-term unsecured bank investments, the majority of the Council's surplus cash is currently invested in money market funds and the UK Government. On the advice of our advisors Arlingclose. No changes are proposed to the 2022/23 investment strategy from that adopted in 2021/22.

Business Models:

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

Approved Counterparties:

1.5 The Council's Treasury advisors have advised that the Council may invest its surplus funds with any of the counterparty types in the table below, subject to the limits shown.

Sector	**Time limit**	**Counterparty limit**	**Sector limit**
The UK Government	50 years	Unlimited	n/a
Local authorities & other government entities	25 years	£3m	Unlimited
Secured investments *	25 years	£3m	Unlimited
Banks (unsecured) *	13 months	£2m	Unlimited
Building societies (unsecured) *	13 months	£2m	£5m
Registered providers (unsecured) *	5 years	£2m	£5m
Money market funds *	n/a	£3m	Unlimited
Strategic pooled funds	n/a	£3m	£5m
Real estate investment trusts	n/a	£3m	£?m
Other investments *	5 years	£?m	£?m

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

* Minimum Credit Rating:

1.6 Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating is no lower than A. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

1.7 For entities without published credit ratings, investments may be made either (a) where external advice indicates the entity to be of similar credit quality; or (b) to a maximum of £2m per counterparty as part of a diversified pool e.g. via a peer-to-peer platform.

Banks and Building Societies (unsecured):

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

Secured Investments:

1.9 Investments secured on the borrower's assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments.

Government:

1.10 Loans to, and bonds and bills issued or guaranteed by, national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Government are deemed to be zero credit risk due to its ability to create additional currency and therefore may be made in unlimited amounts for up to 50 years.

Registered Providers (unsecured):

1.11 Loans to, and bonds issued or guaranteed by, registered providers of social housing or registered social landlords, formerly known as housing associations. These bodies are regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

Money Market Funds:

1.12 Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the Council will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

Strategic Pooled Funds:

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

Real Estate Investment Trusts (REITs):

1.14 Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.

Other Investments:

1.15 This category covers treasury investments not listed above, for example unsecured corporate bonds and company loans. Non-bank companies cannot be bailed-in but can become insolvent placing the Council's investment at risk.

Operational/Transactional Bank Accounts:

1.16 The Council may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £3 million per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity. Deposits with the Council's current account are restricted to overnight deposits.

Risk Assessment and Credit Ratings:

1.17 Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. The credit rating agencies in current use are listed in the Treasury Management Practices document. 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.

1.18 Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "negative watch") 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:

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

1.20 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government or with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

Investment Limits:

1.21 The maximum that will be lent to any one organisation (other than the UK Government) will be £3 million. A group of entities under the same ownership will be treated as a single organisation for limit purposes.

1.22 Credit risk exposures arising from non-treasury investments, financial derivatives and balances greater than £3 million in operational bank accounts count against the relevant investment limits.

1.23 Limits are also be placed on fund managers, investments in brokers' nominee accounts and foreign countries 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. Please refer to the table below:

	Cash limit
Any single organisation, except the UK Central Government	£3m each
UK Central Government	Unlimited
Any group of organisations under the same ownership	£3m per group
Any group of pooled funds under the same management	£5m per manager
Negotiable instruments held in a broker's nominee account	£10m per broker
Foreign countries	£2m per country
Registered Providers	£5m in total
Unsecured investments with Building Societies	£5m in total
Loans to unrated corporates	£2m in total
Money Market Funds	Unlimited

Part 2 Borrowing Strategy

2.1 The Council currently holds £147 million of loans, which it is using to fund its property acquisitions. The Council may borrow in advance to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £235 million however the Council will incur a cost of carry until the funds are utilised.

Objectives

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

Strategy

2.3 Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to continue to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

2.4 By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Authority with this 'cost of carry' and breakeven analysis. Its output may determine whether the Authority borrows additional sums at long-term fixed rates in 2022/23 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

2.5 The Council has previously raised the majority of its long-term borrowing from the PWLB but will consider long-term loans from other sources including banks, pensions and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Authority intends to avoid this activity in order to retain its access to PWLB loans.

2.6 Alternatively, the Authority may arrange forward starting loans, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

2.7 In addition, the Authority may borrow further short-term loans to cover unplanned cash flow shortages.

2.8 In order to manage risk on its short term borrowings, the Council has arranged fixed rate forward starting loans for £50m. These will replace the short term borrowing of the same amount and the first loan £25m was in 2021, with the second due in Feb 2022. This has enabled certainty of cost to be achieved in the future whilst taking advantage of low interest rates in the short term.

Sources of borrowing:

2.9 The approved sources of long-term and short-term borrowing are:

- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
- Any institution approved for investments (see below)
- Any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds (except Surrey County Council Pension Fund)
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local Council bond issues
- Local Enterprise Partnerships
- Any other UK public sector body

2.10 In addition, capital finance may be raised by the following methods that are not borrowing, but may still be classed as other debt liabilities:

- Leasing
- Hire Purchase
- Private Finance Initiative
- Sale and Leaseback

Annual Minimum Revenue Provision (MRP) statement:

2.11 When a Council borrows, it is required to indicate how it intends to fulfil its duty to make prudent provision for the repayment of the capital borrowed from revenue. This provision is called the Minimum Revenue Provision or MRP. Best practice guidance recommends that Authorities prepare a statement of policy on making MRP in respect of the forthcoming financial year. The Council's MRP statement will be recommended to Council by the Executive on 15th February 2022 as part of the Capital budget for 2022/23.

2.12 The recommended policy is attached in Annex F and the forecast MRP in £million is shown in the table below:

£ million	**2019/20 actual**	**2020/21 actual**	**2021/22 Forecast**	**2022/23 budget**	**2023/24 budget**
MRP Payment	2.159	2.213	2.268	2.323	2.382

Part 3 National and International Factors which influence the Treasury Strategy

3.1 The Council's treasury management advisors, Arlingclose Limited have provided us their assessment of the wider external factors that the Council's investment strategy needs to take in to account in terms of the economy, interest rates and credit outlook.

Economic background:

3.2 The ongoing impact on the UK from coronavirus, together with higher inflation, the likelihood of higher interest rates, and the country's trade position post-Brexit, will be major influences on the Authority's treasury management strategy for 2022/23.

3.3 The Bank of England (BoE) held Bank Rate at 0.10% in November 2021 and maintained its Quantitative Easing programme at £895 billion. The Monetary Policy Committee (MPC) voted 7-2 to keep rates on hold and 6-3 to maintain the asset purchase programme. Within the announcement the MPC suggested interest rates would be increased soon, but not to the 1% level expected by financial markets. Within the November 2021 Monetary Policy Report, the Bank expected consumer price index (CPI) inflation to peak at around 5% in April 2022 before falling back as the impact from higher energy prices fade and demand slows.

3.4 UK Consumer Price Inflation (CPI) for September 2021 registered 3.1% year on year, slightly down from 3.2% in the previous month. Core inflation, which excludes the more volatile components, fell to 2.9% y/y from 3.1%. The most recent labour market data for the three months to August 2021 showed the unemployment rate fell to 4.5% while the employment rate rose to 75.3%. Both measures were helped by the extension of the government's furlough scheme, but this ended in September 2021 and while this may put some pressure on the jobs market, it is not expected to be material, with the BoE forecasting unemployment will only increase modestly in Q4 2021 according to its November 2021 Monetary Policy Report but remain low overall.

3.5 In August 2021, the headline 3-month average annual growth rate for wages were 7.2% for total pay and 6.0% for regular pay. In real terms, after adjusting for inflation, total pay growth was up 4.7% while regular pay was up 3.4%. These figures should be interpreted with caution, however, as pay growth is now being impacted by base effects compared to 12 months ago when earnings were first affected by the coronavirus pandemic. Moreover, there has also been a fall in the number and proportion of lower paid jobs, helping to push up the average earnings figure.

3.6 Gross domestic product (GDP) grew by 5.5% in the second calendar quarter of 2021, compared to a fall of -1.6% q/q in the previous three months, with the annual rate jumping to 23.6% from -6.1%. Here too, base effects from 2020 have resulted in the high Q2 2021 data. Monthly GDP estimates have shown the economy is recovering, with the economy now just 0.8% below its pre-pandemic level. Looking ahead, the BoE's November 2021 Monetary Policy Report forecasts economic growth will rise by 1.5% in Q3 2021, 1.0% in Q4 2021 with the economy expected to get back to its pre-pandemic level in Q1 2022. GDP growth is now expected to be around 5% in 2022 (revised down from 6%), before slowing to 1.5% in 2023 and 1% in 2024.

3.7 GDP growth in the euro zone increased by 2.2% in calendar Q3 2021 following a gain of 2.1% in the second quarter and a decline of -0.3% in the first. Headline inflation has been strong, with CPI registering 4.1% year-on-year in October, the fourth successive month of inflation. Core CPI inflation was 2.1% y/y in October, the third month of successive increases from July's 0.7% y/y. At these levels, inflation is above the European Central Bank's target of 'below, but close to 2%', putting some pressure on its long-term stance of holding its main interest rate of 0%.

3.8 The US economy expanded at an annualised rate of 2.0% in Q3 2021, slowing sharply from gains of 6.7% and 6.3% in the previous two quarters. In its November 2021 interest rate announcement, the Federal Reserve continue to maintain the Fed Funds rate at between 0% and 0.25% but outlined its plan to reduce its asset purchase programme. Having bought $120 billion of bonds each month during the pandemic to keep interest rates low, the Fed confirmed that purchases will be scaled back, starting with a $15 billion reduction in November 2021. In terms of the timing of any interest rate hikes, Fed Chair Jerome Powell said the central bank can be patient about doing so.

Credit Outlook:

3.9 Since the start of 2021, relatively benign credit conditions have led to credit default swap (CDS) prices for the larger UK banks to remain low and have steadily edged down throughout the year to almost pre-pandemic levels. The improved economic outlook during 2021 helped bank profitability and reduced the level of impairments many had made as provisions for bad loans. However, the relatively recent removal of coronavirus-related business support measures by the government means the full impact on bank balance sheets may not be known for some time.

3.10 The improved economic picture during 2021 led the credit rating agencies to reflect this in their assessment of the outlook for the UK sovereign as well as several financial institutions, revising them from negative to stable.

3.11 Looking ahead, while there is still the chance of bank losses from bad loans as government and central bank support is removed, the institutions on the Authority's counterparty list are well-capitalised and general credit conditions across the sector are expected to remain benign. Duration limits for counterparties on the Authority's lending list are under regular review and will continue to reflect economic conditions and the credit outlook.

Interest rate forecast:

3.12 The Authority's treasury management adviser Arlingclose is forecasting that Bank Rate will rise in calendar Q2 2022 to subdue inflationary pressures and the perceived desire by the BoE to move away from emergency levels of interest rates.

3.13 Investors continue to price in multiple rises in Bank Rate over the next forecast horizon, and Arlingclose believes that although interest rates will rise, the increases will not be to the extent predicted by financial markets. In the near-term, the risks around Arlingclose's central case are to the upside while over the medium-term the risks shift towards the downside. Gilt yields had increased sharply on the back of higher inflation and anticipated central bank action, however in its November MPC meeting, the committee noted that market expectations for rates were excessive, and yields have since fallen back. Yields are expected to remain broadly at current levels over the medium-term, with the 5, 10 and 20 year gilt yields expected to average around 0.60%, 1.0%, and 1.35% respectively. The risks around the gilt yield forecast are judged to be broadly balanced in the near-term and to the downside over the remainder of the forecast horizon. As ever, there will almost certainly be short-term volatility due to economic and political uncertainty and events.

3.14 For the purpose of setting the budget, it has been assumed that no new treasury management investments will be made and that existing loans will be financed at an average rate of 2%.

Part 4 Local Context

4.1 On 30th November 2020, the Council held £147 million of borrowing and £12.5 million of treasury investments.

4.2 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. The Council's current strategy is to maintain borrowing below their underlying levels, sometimes known as internal borrowing subject to holding a minimum of £5 million.

Annex B

Treasury Management Strategy – other items
2022/23

Other Items
There are a number of additional items that the Council is obliged by CIPFA or DLUHC to include in its Treasury Management Strategy.

1. **Financial Derivatives**

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

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

Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria, assessed using the appropriate credit rating for derivative exposures. An allowance for credit risk calculated using the methodology in the Treasury Management Practices document will count against the counterparty credit limit and the relevant foreign country limit.

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

At the moment the Council does not hold any Financial Derivatives.

2. **Investment Advisers**

The Council has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues. This is monitored by holding regular meetings with the advisers to ensure that they continue to meet the Council's treasury management objectives. In addition, the Council's tender process for treasury management advice ensures value for money.

3. **Investment of Money Borrowed in Advance of Need**

The total amount borrowed will not exceed the authorised borrowing limit of £235 million. The maximum period between borrowing and expenditure is not expected to exceed two years, although the Council is not required to link particular loans with particular items of expenditure. At the moment there are no plans to borrow in advance.

4. **Other Options Considered**

The MHCLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Executive Head of Finance, having consulted the Portfolio Member, 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

Markets in Financial Instruments Directive

The Council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council’s treasury management activities, The Executive Head of Finance believes this to be the most appropriate status.

Annex C

Treasury Management Indicators 2022/23

The Council measures its exposure to treasury management risks using the following indicators. The Council is asked to approve these indicators:

1. Security – Average Credit Rating

The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio.

Credit Risk Indicator	Target
Portfolio average credit rating	A

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.

2. Liquidity: cash available within three months

The Council 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 three month period, without additional borrowing.

Liquidity Risk Indicator	Target
Total cash available within 3 months	£5m

3. Interest Rate Exposures:

This indicator is set to control the Council's exposure to interest rate risk. The Council holds investments of £10 million and variable rate borrowing of £147 million which equates to net borrowing of £137 million. The limit on one-year revenue impact of a 1% rise in interest rates has been set at £1 million. The Council has sufficient reserves in an Interest Equalisation Reserve to mitigate the impact of an interest rate rise for 2022/23.

4. Maturity Structure of Borrowing**:**

This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

Refinancing rate risk indicator	Upper	Lower
Not over 1 year	100%	0%
Over 1 but not over 2 years	100%	0%
Over 2 but not over 5 years	100%	0%
Over 5 but not over 10 years	100%	0%
Over 10 but not over 15 years	100%	0%
Over 15 but not over 20 years	100%	0%
Over 20 but not over 30 years	100%	0%
Over 25 but not over 30 years	100%	0%
Over 30 but not over 40 years	100%	0%

Over 40 years	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. This table means there is total flexibility on borrowing periods to achieve the most cost effective option.

5. Principal Sums Invested for Periods Longer than a year:

The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

Price Risk Indicator	2022/23	2023/24	2024/25
Limit on principal invested beyond year end	£2.5m	£2.5m	£2.5m

Annex D

INVESTMENTS as at 30th November 2021

	£
Debt Management Office	6,325,000
Other Local Authorities Short Term	0
Total Government	**6,325,000**
Aberdeen Standard	500,000
Blackrock	0
CCLA Public Sector Deposit Fund	700,000
Federated	0

Legal and General	0
Total Money Market Funds	**1,200,000**
CCLA Property Fund	2,266,458
Total Longer Term Investments	**2,268,458**
Total Invested (excluding the NatWest Business Reserve)	**9,793,458**
NatWest Business Reserve	2,645,487
Total Invested (including NatWest Business Reserve)	**£12,438,945**

Annex E

Existing Investment & Debt Portfolio

	30-Nov-21 Actual Portfolio £m	30-Nov-21 Average Rate %
External Borrowing:		
Public Works Loan Board - Long Term	77.20	2.59%
Local authorities - Short Term	70.00	0.15%
Total Gross External Debt	**147.20**	**1.37%**
Investments:		
Banks & Building societies	2.645	0.01%
Government – DMO	6.325	0.01%
Government - Other Local Authorities	0	0.00%
Money Market Funds	1.2	0.02%
Other Pooled Funds	2.27	4.20%
Total Treasury Investments	**12.44**	**1.06%**
Net Debt	**134.76**	**0.31%**

Annex F

Minimum Revenue Policy (MRP) Statement

1. The Secretary of State under section 21(1A) of the Local Government Act 2003 issued guidance on the calculation of MRP in February 2012 with 2012 being the first year of operation. The Council has assessed its method of MRP and is satisfied that the guidelines for its annual amount of MRP set out within this policy statement will result in its making the prudent provision that is required by the guidance.

2. For capital expenditure incurred and funded through borrowing the Council will calculate MRP using the asset life method as summarised in the table below. MRP will be based on the estimated life of the assets purchased by unsupported borrowing.

Estimated economic lives of assets	**Estimated economic life**
Asset Class	
Land and heritage assets	50 years
Buildings and services	50 years
Vehicles and Plant	10 years
IT equipment and software	5 years
Investment property	50 years
Assets for regeneration and/or under construction	0% until development complete

3. The Council will aim to minimise the impact of MRP on the General Fund by only acquiring assets with a longer rather than shorter economic life through borrowing.

4. In accordance with provisions in the guidance MRP will be charged starting in the year following the date an asset becomes operational.

5. The forecast MRP in £million is shown in the table below:

£ million	**2019/2020 actual**	**2020/21 actual**	**2021/22 forecast**	**2022/23 budget**	**2023/24 budget**
MRP Payment	2.159	2.213	2.268	2.323	2.382

Note: DLUHC has recently consulted on amendments to the policy on MRP and as such the Council may need to amend its policy dependent on forthcoming guidance from DLUHC. In this instance a report will be presented to Council as an addendum to the Treasury Outturn report.

Annex G

Treasury Management Policy Statement

The Council's financial regulations require it to create and maintain a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury activities, as a cornerstone for effective treasury management.

Definition

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.

Risk management

2. This 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 organisation, and any financial instruments entered into to manage these risks.

Value for money

3. This organisation 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.

Borrowing policy

4. The Council greatly values revenue budget stability. Short-term and variable rate loans will only be borrowed to the extent that they either offset short-term and variable rate investments or can be shown to produce revenue savings.

5. The Council will set an affordable borrowing limit each year in compliance with the Local Government Act 2003, and will have regard to the CIPFA Prudential Code for Capital Finance in Local Authorities when setting that limit. It will also set limits on its exposure to changes in interest rates and limits on the maturity structure of its borrowing in the treasury management strategy report each year.

Investment policy

6. The Council's primary objectives for the investment of its surplus funds are to protect the principal sums invested from loss, and to ensure adequate liquidity so that funds are available for expenditure when needed. The generation of investment income to support the provision of local Council services is an important, but secondary, objective.

7. The Council will have regard to the Communities and Local Government Guidance on Local Government Investments and will approve an investment strategy each year as part of the treasury management strategy. The strategy will set criteria to

determine suitable organisations with which cash may be invested, limits on the maximum duration of such investments and limits on the amount of cash that may be invested with any one organisation.