Treasury Management Strategy Statement (TMSS) 2021-22 **Appendix A**

1. Introduction

1.1 Treasury management is the management of the Authority’s cash flows, borrowing and investments, and the associated risks. The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk is therefore central to the Authority’s prudent financial management.

1.2 Treasury risk management in the Authority 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 Authority to approve a treasury management strategy before the start of each financial year. This report fulfils the Authority’s legal obligation under the *Local Government Act 2003* to have regard to the CIPFA Code.

1.3 Investments held for service purposes or for commercial profit are considered in the Investment Strategy Report included with this TMSS report.

1.4 This TMSS forms part of the authority’s overall budget strategy and financial management framework.

2 External Context

Economic background: The impact on the UK from coronavirus, lockdown measures, the rollout of vaccines as well as the new trading arrangements with the European Union (EU) will remain major influences on the Authority’s treasury management strategy for 2021-22.

2.1 The Bank of England (BoE) maintained Bank Rate at 0.10% in November 2020 and extended its Quantitative Easing programme by £150 billion to £895 billion. The Monetary Policy Committee voted unanimously for both, but with no mention of the potential future use of negative interest rates. According to the latest forecasts, the Bank expects the UK economy to shrink by 2% in Q4 2020 before growing by 7.25% in 2021.

2.2 UK Consumer Price Inflation (CPI) for November 2020 was 0.3% down from 0.7% in the previous month. Core inflation, which excludes the more volatile components, fell to 1.1% from 1.5%. The most recent labour market data for the three months to October 2020 showed the unemployment rate rose to 4.9% while the employment rate fell to

75.2%. Both measures are expected to deteriorate further due to the ongoing impact of coronavirus on the jobs market.

2.3 GDP rebounded by 16.0% in the Q3 2020 having fallen by 18.8% in Q2; the annual rate rose to -8.6% from -20.8%. All sectors grew quarter-on-quarter, especially in construction. Monthly GDP estimates have shown the economic recovery slowing down and remains well below its pre-pandemic peak. Looking ahead, the BoE's November Monetary Policy Report forecasts economic growth will rise in 2021 with GDP reaching 11% in Q4 2021, 3.1% in Q4 2022 and 1.6% in Q4 2023, but this did not include the impact of the new lockdown.

2.4 The US economy contracted at an annualised rate of 31.4% in Q2 2020 and then rebounded by 33.4% in Q3. The Federal Reserve maintained the Fed Funds rate at between 0% and 0.25% and announced a change to its inflation targeting regime to a more flexible form of average targeting. The Fed also provided strong indications that interest rates are unlikely to change from current levels over the next three years.

2.5 Former vice-president Joe Biden won the 2020 US presidential election. Mr Biden is making tackling coronavirus his immediate priority and will also be reversing several executive orders signed by his predecessor and take the US back into the Paris climate accord and the World Health Organisation.

2.6 **Credit outlook**: Credit default swap (CDS) prices for the larger UK banks have steadily fallen back to almost pre-pandemic levels. Although uncertainty around COVID-19 related loan defaults led to banks making huge provisions (billions) for potential losses in the first half of 2020, thereby drastically reducing profits, reported impairments for Q3 were much reduced in some institutions. Bank profitability is therefore likely to be significantly lower than in previous years.

2.7 Looking forward, the potential for bank losses to be greater than expected when government and central bank support starts to be removed remains a risk. The credit ratings for many UK institutions were downgraded following downgrades to the sovereign rating.

2.8 **Interest rate forecast:** The Authority's treasury management advisor Arlingclose is forecasting that Bank Base Rate will remain at 0.10% until at least the end of 2024. The risks to this forecast are deemed weighted to the downside as the BoE and UK government continue to react to the coronavirus pandemic and the Brexit transition period ends. The BoE extended its asset purchase programme to £895 billion in November while keeping Bank Rate on hold. However, further interest rate cuts to zero, or possibly negative, cannot yet be ruled out.

2.9 Gilt yields are expected to remain very low in the medium-term while short-term yields are likely to remain below or at zero until such time as the BoE expressly rules out the chance of negative interest rates or growth/inflation prospects improve. The central case is for 10-year and 20 year to rise to around 0.60% and 0.90% respectively over the time horizon. The risks around the gilt yield forecasts are judged to be broadly balanced between upside and downside risks, but there will almost certainly be short-term volatility due to economic and political uncertainty and events.

2.10 A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix A1.

3 Local Context

For the purpose of setting the Council's budget and MTFS, it has been assumed that new treasury investments in 2021-22 will be made at an average rate range of 0.01% - 0.20%, and that new long-term loans will be borrowed at an average rate of 2%.

As at 31st December 2020, the Authority held £72.289m of borrowing and £234m of treasury investments. Forecast changes in these sums are shown in the balance sheet analysis in Table 1 below.

Table 1: Balance Sheet Summary

Line	£m	2019-20 Actual £m	2020-21 Estimate £m	2021-22 Forecast £m	2022-23 Forecast £m	2023-24 Forecast £m
1	General Fund CFR	303.597	338.423	401.563	433.151	451.718
2	HRA CFR	108.394	138.286	220.555	249.871	244.375
3	**Total CFR** *(Line 1+2)*	**411.991**	**476.709**	**622.118**	**683.022**	**696.093**
4	Less: Other debt liabilities *	(58.651)	(55.838)	(52.469)	(48.593)	(44.067)
5	**Borrowing CFR** *(Line 3-4)*	**353.340**	**420.871**	**569.649**	**634.429**	**652.026**
6	Less: External Borrowing **	(72.289)	(71.534)	(69.872)	(68.709)	(68.709)
7	**Internal Borrowing / (Over Borrowing)** *(Line 5-6)*	**281.051**	**349.337**	**499.777**	**565.720**	**583.317**
8	Less: Usable reserves	(492.800)	(458.200)	(334.700)	(268.000)	(268.000)
9	Less: Working capital	(46.001)	(91.400)	(71.400)	(71.400)	(71.400)
10	**(Investments)/New Borrowing** *(Line 7-8-9)*	**(257.750)**	**(200.263)**	**93.677**	**226.320**	**243.917**
11	**Net Investments** *(Line10-6)*	**(185.461)**	**(128.729)**	**163.549**	**295.029**	**312.626**

* *leases and PFI liabilities that form part of the Authority's total debt*

*** shows only loans to which the Authority is committed*

3.1 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 Authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing. Actual internal borrowing at 31 March 2020 was £281m and forecast internal borrowing at 31 March 2021 is £349m.

3.2 CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Authority expects to comply with this recommendation during 2020-21.

3.3 The table below shows the Council's existing investment and debt portfolio at 31 December 2020.

Existing Investment & Debt Portfolio Position

£m	31.12.2020 Actual Portfolio £m	31.12.2020 Average Rate %
External Borrowings: • Public Works Loans Board • Other Loans	 54.8 17.5	 2.72 4.34
Total External Borrowings	**72.3**	**3.12**
Other Long-Term Liabilities: • Private Finance Initiative • Leases	 31.5 27.2	
Total Other Long-Term Liabilities	**58.7**	
Total Gross External Debt	**117.3**	
Treasury Investments: • Banks & Building Societies (unsecured) • Government (including local authorities) • Money Market Funds • Cash-Plus Funds • Strategic Pooled Funds	 15.0 107.0 36.0 20.0 56.0	 0.15 0.36 0.01 0.20 2.50
Total Treasury Investments	**234.0**	**1.01**
Net Debt	**116.7**	

4 Borrowing Strategy

4.1 The Authority currently holds £72.289m of loans, as part of its strategy for funding previous years' capital programmes. The Authority may borrow to pre-fund future years' requirements by borrowing in advance of need, providing this does not exceed the authorised limit for borrowing of £652m (2023-24).

4.2 **Liability benchmark:** To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as Table 1 above, but that cash and investment balances are kept to a minimum level of £75m at each year-end. This amount includes the Council's strategic investment portfolio of £55m, which is not planned to be liquidated over this period, and a liquidity balance of £20m, to maintain sufficient liquidity.

Table 2: Liability benchmark

	31.3.20 Actual £m	31.3.21 Estimate £m	31.3.22 Forecast £m	31.3.23 Forecast £m	31.3.24 Forecast £m
Borrowing CFR	**353.340**	**420.871**	**569.649**	**634.429**	**652.026**
Less: Usable reserves	(492.800)	(458.200)	(334.700)	(268.000)	(268.000)
Less: Working capital	(46.001)	(91.400)	(71.400)	(71.400)	(71.400)
Plus: Minimum investments *(Strategic Pooled Funds)*	75.000	75.000	75.000	75.000	75.000
Liability benchmark	**(110.461)**	**(53.729)**	**238.549**	**370.029**	**387.626**

The liability benchmark suggests the Council will require a minimum level of borrowing in 2021-22 of £239m, to maintain the minimum investment level of £75m at year end. The actual level of borrowing at year end depends on whether the Council's spending plans proceed as planned and on the actual timing of borrowing.

4.3 **Objectives:** The Authority'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 Authority's long-term plans change is a secondary objective.

4.4 **Strategy:** The Authority's other objective when borrowing is to achieve a low but certain cost of finance whilst retaining flexibility should plans change in future. These objectives are often conflicting, and the Authority therefore seeks to strike a balance between cheap short-term loans (currently available at around 0.05% - 0.20%) and long-term fixed rate loans where the future cost is known but higher (PWLB certainty rates currently range from 0.67% to 1.71%). There are several factors that the Council needs to consider when setting its borrowing strategy.

4.5 As shown in the table below, the Council is planning to significantly increase its capital expenditure over the next 3 years; the provisional capital programme is £627m over the next 3 financial years (2021-22 to 2023-24). This plan is for the programme to be partly funded by borrowing of £150m in the General Fund for 2021-22 to 2023-24 and £120m in the HRA for the same period. The plan is for the rest of the programme to be funded by other sources including payments from developers (CIL and Section 106), capital receipts and revenue contributions (the HRA). However, in previous years, the capital programme has had major slippage, including the current year.

Table demonstrating Capital Expenditure

Capital Expenditure	**2019-20 Actual £m**	**2020-21 Estimate £m**	**2021-22 Forecast £m**	**2022-23 Forecast £m**	**2023-24 Forecast £m**
Non-HRA	**128.144**	**119.390**	**199.192**	**128.691**	**67.588**
HRA	**57.121**	**77.401**	**151.601**	**79.494**	**-**
Total	**185.265**	**196.791**	**350.793**	**208.185**	**67.588**

4.6 The above increasing capital programme is taking place at a time when interest rates are historically low and indeed the Bank of England interest rate may well be cut further to zero or negative; rates have been at historical lows for almost a decade. Interest rates reached a peak of 13.875% in the 1990s, then fell to 6% in 2000, and ranged between 6% - 3.75% from 2000 – 2007, before being cut to 0.5% in 2009. Rates have fallen from 0.75% to 0.10% since then.

4.7 The Authority had 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. On 25 November 2020, the government responded to the PWLB consultation by cutting the rate for all new Standard Rate loans from 1.80% to 1% (100 bps). 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.

4.8 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.

4.9 The Authority may additionally borrow short-term loans to cover unplanned cash flow shortages. The Council is developing its borrowing strategy. Rates are currently low and the Council wants to be prepared for the point at which rates move unfavourably.

4.10 **Sources of borrowing:** 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
- any other UK public sector body
- UK public and private sector pension funds (except the London Borough of Tower Hamlets Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

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

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

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

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

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

5 Investment Strategy

5.1 The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Authority's treasury investment balance has ranged between £180 million and £340 million.

5.2 **Objectives:** The CIPFA Code requires the Authority to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority'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 Authority 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.

5.3 **Negative interest rates:** The COVID-19 pandemic has increased the risk that the Bank of England will set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. Since investments cannot pay negative income, negative rates will be applied by reducing the value of investments. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

5.4 **Strategy:** Given the increasing risk and very low returns from short-term unsecured bank investments, the Authority aims to explore opportunities to further diversify into more secure and/or higher yielding asset classes during 2021-22. Most of the Authority's surplus cash remains invested in short-term unsecured bank deposits, money market funds and local authority deposits.

5.5 **Business models:** Under the new IFRS 9 standard, the accounting for certain investments depends on the Authority's "business model" for managing them. The Authority 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.

5.6 **Approved counterparties:** The Authority may invest its surplus funds with any of the counterparty types in Table 3 below, subject to the limits shown.

Table 3: Recommended investment counterparties and limits

Sector	Time limit	Counterparty limit	Sector limit
The UK Government	50 years	Unlimited	n/a
Local authorities & other government entities *(subject to checks on their balance sheet position depending on duration)*	25 years	£30m	Unlimited
Secured investments *	25 years	£30m	Unlimited
Banks (unsecured) *	13 months	£15m	Unlimited
Building societies (unsecured) *	13 months	£15m	£30m
Registered providers (unsecured) *	5 years	£15m	£75m
Money market funds *	n/a	£30m	Unlimited
Strategic pooled funds*	n/a	£30m	£150m
Real estate investment trusts	n/a	£30m	£75m
Other investments *	5 years	£15m	£30m

This table must be read in conjunction with the notes below

**There are currently no plans to invest further in strategic pooled funds*

Minimum Credit rating: Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating is not 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. This is monitored on a regular basis in liaison with our Advisors.

For entities without published credit ratings, investments may be made where external advice indicates the entity to be of similar credit quality following an external credit assessment.

5.7 **Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK 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.

5.8 **Secured Investments:** These are 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.

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

5.10 **Registered Providers:** Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are tightly regulated 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.

5.11 **Money Market Funds (MMFs): 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 Authority will exercise due care by diversifying its liquid investments various providers, to ensure access to cash at all time. It is worth noting that in the event rates become negative during this current pandemic and with the Brexit outcome, MMFs will become Variable Net Asset Values and / or accumulating funds.

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

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

5.14 **Other Investments:** 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 Authority's investment at risk.

5.15 **Operational Bank Accounts:** The Authority may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services to any UK bank with credit ratings not 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 £2m if it falls below the minimum bank credit rating referred to in 5.6. 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 Authority maintaining operational continuity.

5.16 **Risk Assessment and Credit Ratings**: Credit ratings are obtained and monitored by the Authority's treasury advisers, who will notify changes in ratings as they occur. 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:

- 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.

5.17 Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "negative watch") which may make it 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.

5.18 **Other information on the security of investments**: The Authority understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Authority'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.

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 Authority will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent 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 Authority'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.

5.19 **Investment limits**: In order that no more than approximately 25% of available reserves for credit losses will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £30 million. A group of banks under the same ownership will be treated as a single organisation for limit purposes.

5.20 Limits are also placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table demonstrating Additional Investment limits

	Cash Limit
Any group of pooled funds under the same management	£75m per manager
Negotiable instruments held in a broker's nominee account	£75m per broker
Foreign countries	£30m per country

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

The Authority will spread its liquid cash over at least four providers (e.g. bank accounts and money market funds) to ensure that access to cash is maintained in the event of operational difficulties at any one provider.

6 Treasury Management Indicators

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

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

Credit risk indicator	Target	Minimum
Portfolio average credit rating	A	A-

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

Liquidity risk indicator	Target
Total cash available within 3 months	£20m

6.4 **Interest rate exposures**: This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates will be:

Interest rate risk indicator	Limit
Upper limit on one-year revenue impact of a 1% rise in interest rates	£2m
Upper limit on one-year revenue impact of a 1% fall in interest rates	£2m

6.5 The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.

6.6 **Maturity structure of borrowing:** This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing will be:

Refinancing rate risk indicator	**Upper limit**	**Lower limit**
Under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	60%	0%
5 years and within 10 years	75%	0%
10 years and within 20 years	100%	0%
20 years and within 30 years	100%	0%
30 years and within 40 years	100%	0%
40 years and above	100%	0%

6.7 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.

6.8 **Principal sums invested for periods longer than a year:** The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

Price risk indicator	**2021-22**	**2022-23**	**2023-24**
Limit on principal invested beyond year end	£150m	£125m	£100m

7 Related Matters

7.1 The CIPFA Code requires the Authority to include the following in its treasury management strategy.

7.2 **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).

7.3 The Authority 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 Authority is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be considered 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.

7.4 Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria, assessed using the appropriate credit rating for derivative exposures. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

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

7.6 **Housing Revenue Account:** On 1st April 2012, the Authority notionally split each of its existing long-term loans into General Fund and HRA pools. In the future, new long-term loans borrowed will be assigned in their entirety to two pools. Interest payable and other costs/income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged/credited to the respective revenue account. Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. This balance will be measured each month and interest transferred between the General Fund and HRA at the Authority's average interest rate on investments, adjusted for credit risk.

7.7 **Markets in Financial Instruments Directive (MiFID)**: The Authority 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 Authority's treasury management activities, the Chief Financial Officer believes this to be the most appropriate status.

8 Financial Implications

8.1 The budget for investment income in 2021-22 is £1.6m, based on prudent assumptions made for the returns on the Council's various treasury investments including the pooled fund portfolio and term deposits and cash rates. The budget for debt interest payable in 2021-22 is £2.359m which includes growth of £0.109m being agreed as part of the Council's 2021-24 Medium Term Financial Strategy. If actual levels of investments and borrowing, or actual interest rates, differ from that forecast, performance against budget will be correspondingly different.

9 Other Options Considered

9.1 The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Financial Officer 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

Appendix A1 – Arlingclose Economic & Interest Rate Forecast December 2021

Underlying assumptions:

- The medium-term global economic outlook has improved with the distribution of vaccines, buy the recent upsurge in coronavirus cases has worsened economic prospects over the short term.
- Restrictive measures and further lockdowns are likely to continue in the UK and Europe until the majority of the population is vaccinated by the second half of 2021. The recovery period will be strong thereafter, but potentially longer than previously envisaged.
- Signs of a slowing UK economic recovery were already evident in UK monthly GDP and PMI data, even before the second lockdown and Tier 4 restrictions. Employment is falling despite an extension to support packages.
- The need to support economic recoveries and use up spare capacity will result in central banks maintaining low interest rates for the medium term.
- Brexit, whatever the outcome of current negotiations, will weigh on UK activity. The combined effect of Brexit and the after-effects of the pandemic will dampen growth relative to peers, maintain spare capacity and limit domestically - generated inflation. The Bank of England will therefore maintain loose monetary conditions for the foreseeable future.
- Longer-term yields will also remain depressed, anchored by low central bank policy rates, expectations for potentially even lower rates and insipid inflation expectations. There is a chance yields may follow a slightly different path in the medium term, depending on investor perceptions of growth and inflation, the development of vaccines or if the UK leaves the EU without a deal.

Forecast:

- Arlingclose expects Bank Rate to remain at the current 0.10% level.

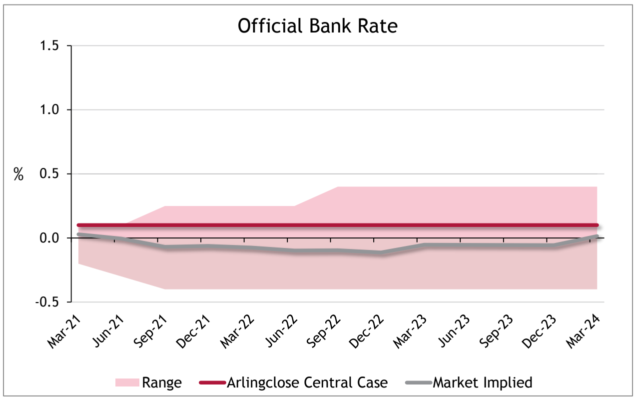
- Our central case for Bank Rate is no change, but further cuts to zero, or perhaps even into negative territory, cannot be completely ruled out, especially with likely emergency action in response to a no-deal Brexit.

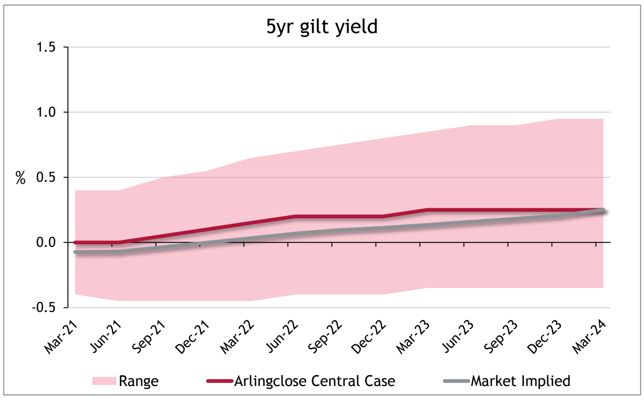
- Gilt yields will remain low in the medium term. Shorter term gilt yields are currently negative and will remain around zero or below until either the Bank expressly rules out negative Bank Rate or growth/inflation prospects improve.

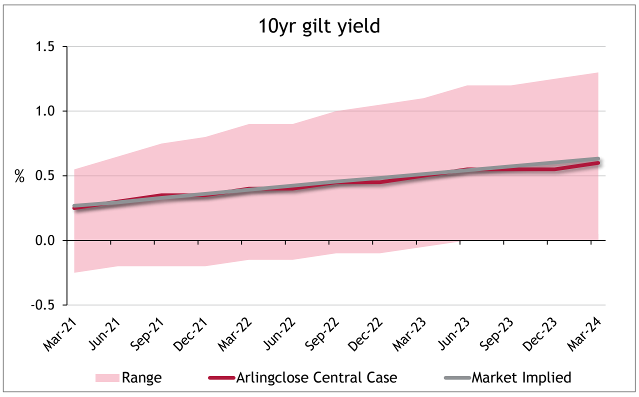
- Downside risks remain in the near term, and indeed appear heightened in the near term, as the government reacts to the escalation in infection rates and the Brexit transition period comes ends.

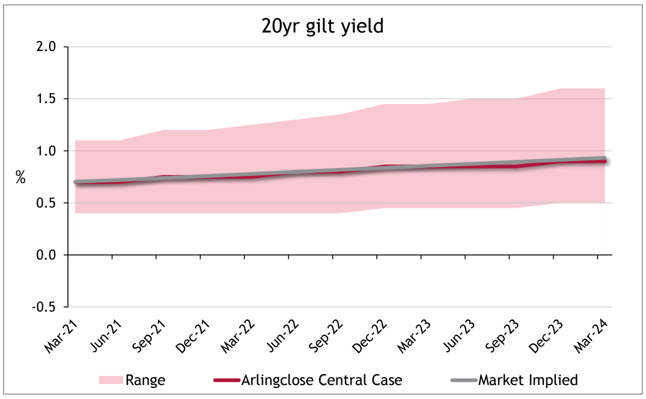
	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
Official Bank Rate													
Upside risk	0.00	0.00	0.15	0.15	0.15	0.15	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Downside risk	0.30	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
3-month money market r.													
Upside risk	0.05	0.05	0.10	0.10	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.10	0.10	0.15	0.15	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
Downside risk	0.30	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
1yr money market rate													
Upside risk	0.05	0.05	0.10	0.10	0.15	0.20	0.40	0.40	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	0.15	0.15	0.25	0.25	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Downside risk	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15
5yr gilt yield													
Upside risk	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.00	0.00	0.05	0.10	0.15	0.20	0.20	0.20	0.25	0.25	0.25	0.25	0.25
Downside risk	0.40	0.45	0.50	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60
10yr gilt yield													
Upside risk	0.30	0.35	0.40	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.25	0.30	0.35	0.35	0.40	0.40	0.45	0.45	0.50	0.55	0.55	0.55	0.60
Downside risk	0.50	0.50	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55
20yr gilt yield													
Upside risk	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.70	0.70	0.75	0.75	0.75	0.80	0.80	0.85	0.85	0.85	0.85	0.90	0.90
Downside risk	0.30	0.30	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40
50yr gilt yield													
Upside risk	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.60	0.60	0.65	0.65	0.65	0.70	0.70	0.75	0.75	0.75	0.75	0.80	0.80
Downside risk	0.30	0.30	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40

PWLB Standard Rate (Maturity Loans) = Gilt yield + 1.00%
PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%
PWLB Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%


Official Bank Rate
1.5
1.0
0.5
0.0
-0.5
%
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
Range
Arlingclose Central Case
Market Implied


5yr gilt yield
1.5
1.0
0.5
0.0
-0.5
%
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
Range
Arlingclose Central Case
Market Implied


10yr gilt yield
1.5
1.0
0.5
0.0
-0.5
%
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
Range
Arlingclose Central Case
Market Implied


20yr gilt yield
2.0
1.5
1.0
0.5
0.0
-0.5
%
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
Range
Arlingclose Central Case
Market Implied