Treasury Management Strategy Statement (TMSS) 2022-23 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 ongoing impact on the UK from coronavirus, together with higher inflation, 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.

2.1 The Bank of England (BoE) increased Bank Rate to 0.25% in December 2021 while maintaining its Quantitative Easing programme at £895 billion. The Monetary Policy Committee voted 8-1 in favour of raising rates, and unanimously to maintain the asset purchase programme. The Bank revised down its estimates for Q4 GDP growth to 0.6% from 1.0%. Inflation was projected to be higher than previously forecast, with CPI likely to remain above 5% throughout the winter and peak at 6% in April 2022.

2.2 UK Consumer Price Inflation (CPI) for November 2021 was 5.1% year on year, up from 4.2% in the previous month. Core inflation, which excludes the more volatile components, rose to 4.0% year on year from 3.4%. The most recent labour market data for the three months to October 2021 showed the unemployment rate fell to 4.2% while the employment rate rose to 75.5%.

2.3 Gross domestic product (GDP) grew by 1.3% in Q3 2021, compared to a gain of 5.5% in the Q2. The annual rate rose to 6.6% from 23.6%. Q4 growth is expected to be soft.

GDP growth in the euro zone increased by 2.2% in calendar Q3 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 4.9% year-on-year in November, the fourth 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%.

2.4 The US economy expanded at an annualised rate of 2.1% in Q3 2021 slowing sharply from gains of 6.7% and 6.3% in the previous two quarters. The Federal Reserve maintained the Fed Funds rate at between 0% and 0.25%. The Fed also provided strong indications that interest rates are likely to increase at a faster pace in 2022, with three 0.25% movements now expected.

2.5 **Credit outlook**: Credit default swap (CDS) prices for the larger UK banks have remained low and steadily fallen back throughout the year up until mid-November when the emergence of Omicron has caused them to rise modestly. Recent removal of coronavirus-related business support measures by the government means the full impact on the bank balance sheet may not be known for some time. 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 and even making a handful of rating upgrades.

2.6 Looking forward, the potential for bank losses from bad loans remain as government and central bank support starts to be removed remains a risk. The Council's choice of counterparties is based on recommendations from the Arlingclose central list of institutions and sovereigns.

2.7 **Interest rate forecast:** The Authority's treasury management advisor Arlingclose is forecasting that Bank Base Rate will continue to rise in Q1 2022 to subdue inflationary pressures. Arlingclose interest rate forecast indicate a rise again but increases will not be to the extent predicted by financial markets.

2.8 Gilt yields are expected to remain broadly at current levels over the medium-term, with 5,10, 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.

2.9 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 2022-23 will be made at an average rate range of 0.10% - 0.40% depending on duration and future Bank of England rate rises, and that new long-term loans will be borrowed at an average rate of 2.5%.

On 31st December 2021, the Authority held £72m of borrowing and £316m 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	2020-21 Actual (draft) £m	2021-22 Current £m	2022-23 Forecast £m	2023-24 Forecast £m	2024-25 Forecast £m
1	General Fund CFR	332.466	378.419	395.802	406.121	426.452
2	HRA CFR	133.279	165.843	221.922	267.000	303.325
3	**Total CFR** *(Line 1+2)*	**465.745**	**544.262**	**617.724**	**673.121**	**729.777**
4	Less: Other debt liabilities *	(56.357)	(53.483)	(49.059)	(44.637)	(40.213)
5	**Borrowing CFR** *(Line 3-4)*	**409.388**	**490.779**	**568.665**	**628.484**	**689.564**
6	Less: External Borrowing **	(71.534)	(69.872)	(68.709)	(68.709)	(68.709)
7	**Internal Borrowing / (Over Borrowing)** *(Line 5-6)*	**337.854**	**420.907**	**499.956**	**559.775**	**620.855**
8	Less: Usable reserves	(638.306)	(588.300)	(588.300)	(588.300)	(588.300)
9	Less: Working capital	(96.900)	(96.900)	(96.900)	(96.900)	(96.900)
10	**(Treasury Investments)/New Borrowing** *(Line 7-8-9)*	**(397.352)**	**(264.293)**	**(184.244)**	**(125.425)**	**(64.345)**
11	**Net Investments** *(Line10-6)*	**(325.818)**	**(194.421)**	**(116.535)**	**(56.716)**	**(4.364)**

* *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 on 31 March 2021 was £338m and forecast internal borrowing on 31 March 2022 is £500m.

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 2022-23.

3.3 The table below shows the Council's existing investment and debt portfolio on 31 December 2021.

Existing Investment & Debt Portfolio Position

£m	31.12.2021 Actual Portfolio £m	31.12.2021 Average Rate %
External Borrowings: • Public Works Loans Board • Other Loans	54.03 17.50	2.64 4.34
Total External Borrowings	**71.53**	**3.05**
Other Long-Term Liabilities: • Private Finance Initiative • Leases	29.35 27.00	
Total Other Long-Term Liabilities	**56.35**	
Total Gross External Debt	**127.88**	
Treasury Investments: • Banks & Building Societies (unsecured) • Government • Local Authority • Money Market Funds • Cash-Plus Funds • Strategic Pooled Funds	15.00 20.00 55.00 150.50 20.0 56.0	0.25 0.09 0.55 0.04 0.57 **5.78**
Total Treasury Investments	**316.50**	**1.17**
Net Debt	**188.62**	

4 Borrowing Strategy

4.1 The Authority currently holds £71.53m 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 £769.8m (2024-25).

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 but minimise credit risk. This amount includes the Council's strategic investment portfolio of £56m, which is not planned to be liquidated over this period, and a liquidity balance of £20m, to maintain sufficient liquidity.

Table 2: Liability benchmark

	31.3.21 Actual £m	**31.3.22 Estimate £m**	**31.3.22 Revised Estimate £m**	**31.3.23 Forecast £m**	**31.3.24 Forecast £m**	**31.3.25 Forecast £m**
Borrowing CFR	409.388	569.649	490.779	568.665	628.484	689.564
Less: Usable reserves	(638.306)	(334.700)	(588.300)	(588.300)	(588.300)	(588.300)
Less: Working capital	(96.900)	(96.900)	(96.900)	(96.900)	(96.900)	(96.900)
Plus: Minimum investments *(Strategic Pooled Funds)*	76.000	76.000	76.000	76.000	76.000	76.000
Liability benchmark	**(249.818)**	**(214.049)**	**(118.421)**	**(40.5350)**	**19.284**	**80.364**

The liability benchmark suggests the Council will require a minimum level of borrowing in 2023-24 of £19m, to maintain the minimum investment level of £76m 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 as well as level of internal cash.

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 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 be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

4.5 By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of (internal/short-term) 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. The Authority's treasury adviser will assist with this 'cost of carry' and breakeven analysis if need be. 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.

4.6 The Authority therefore seeks to strike a balance between using internal resources, cheap short-term loans (currently available at around 0.15% - 0.60%) and long-term fixed rate loans where the future cost is known but higher. 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. there are several other factors that the Council needs to consider when setting its borrowing strategy.

4.7 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 £587m over the next 3 financial years (2022-23 to 2024-25). This plan is for the programme to be partly funded by borrowing of £90m in the General Fund for 2022-23 to 2024-25 and £149m 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	2020-21 Actual (draft) £m	2021-22 Estimate £m	2022-23 Forecast £m	2023-24 Forecast £m	2024-25 Forecast £m
Non-HRA	104.113	157.964	191.221	97.012	56.391
HRA	60.741	73.457	107.510	81.403	53.554
Total	**164.854**	**231.421**	**298.731**	**178.415**	**109.945**

4.8 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, pension funds 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.

4.9 If necessary, 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.

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

4.11 **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

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

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

4.13 **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.

4.14 **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.

4.15 **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 Treasury 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 £200 million and £340 million a lot of which has been due to increase in reserve and covid and related grants.

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:** Although this has not been the case, the COVID-19 pandemic increased the risk that the Bank of England will set its Bank Rate at rates below 0.10%, should this had been the case, this was expected 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 2022-23. The Council continues to maintain its current strategy of investing surplus cash in short-term unsecured bank deposits, money market funds, strategic pooled funds, cash plus 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 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 **Environmental Social and Governance (ESG):** The Mayor declared a climate emergency in March 2019 and the Authority has committed to become a net zero carbon council by 2025 and a net zero carbon borough by 2045 or sooner. The Authority as an ethical investor will consider where possible the environmental, social and governance issues (ESG) criteria to guide their engagement with corporate bodies. Each of the Authority's fund managers are at difference stages and influence the council can bring as a pooled fund investor is minimal. Investments will be in accordance with counterparty and creditworthiness as detailed in 5.8 below. The Authority as required will take necessary advice from its treasury adviser and use its investments to promote ESG factors without compromising on security, liquidity, and yield.

5.7 **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

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 during decision making. 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.

5.8 **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.

5.9 **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.

5.10 **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.

5.11 **Registered Providers:** Loans to, and bonds issued by or 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.

5.12 **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 times. It is worth noting that in the event of very significant economic crashes when Central Banks reduce rates to the extent that rates become negative, MMFs will become Variable Net Asset Values and / or accumulating funds.

5.13 **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.

5.14 **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.

5.15 **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.

5.16 **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.

5.17 **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 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.

5.18 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.

5.19 **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.

5.20 **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.

5.21 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

5.22 **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 new market 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 **Long-term Treasury management investments 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	2022-23	2023-24	2024-25
Limit on principal invested beyond year end/ no fixed maturity date	£200m	£150m	£100m

7 <u>Related Matters</u>

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 **External Funds:** From time to time, the Authority may hold funds on behalf of other bodies will be separated where possible from the Authority's cash via separate bank accounts or separate ledger codes. Where possible interest will be apportioned, and appropriate impairment losses applied as necessary.

7.8 **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 <u>Financial Implications</u>

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, having consulted with the treasury advisers Arlingclose, the Cabinet Member for Resources and Corporate Leadership Team 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 global recovery from the pandemic has entered a more challenging phase. The resurgence in demand has led to the expected rise in inflationary pressure, but disrupted factors of supply are amplifying the effects, increasing the likelihood of lower growth rates ahead. The advent of the Omicron variant of coronavirus is affecting activity and is also a remainder of the potential downside risks.

- CPI inflation rate rose to 5.1% for November and will rise higher in the near term. While the transitory factors affecting inflation are expected to unwind over time, policymakers' concern is persistent medium term price pressure.

- Longer-term government bond yields remain relatively low despite the more hawkish signals from the Bank of England and the Federal Reserve. Investors are concerned that significant policy tightening in the near term will slow growth and prompt the need for looser policy later.

- The rise in Bank Rate despite the Omicron variant signals that the MPC will act to bring inflation down whatever the environment indicating the that economic outlook will be challenging but signals from policymakers suggest their preference is to tighten policy unless data indicates a more severe slowdown.

Forecast:

- Arlingclose expects Bank Rate to rise to 0.50% in Q1 2022, but then remain there. Risks to the forecast are initially weighted to the upside but becoming more balanced over time. This forecast remains below the market forward curve.

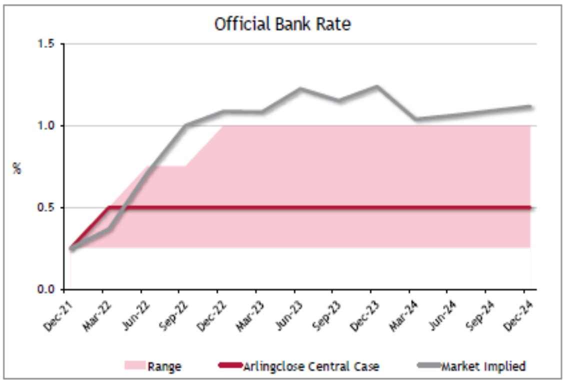
- Gilt yields will remain broadly flat from current levels. Yields have fallen sharply at the longer end of the yield curve, but expectations of a rise in Bank Rate have maintained short term gilt yields at higher levels.

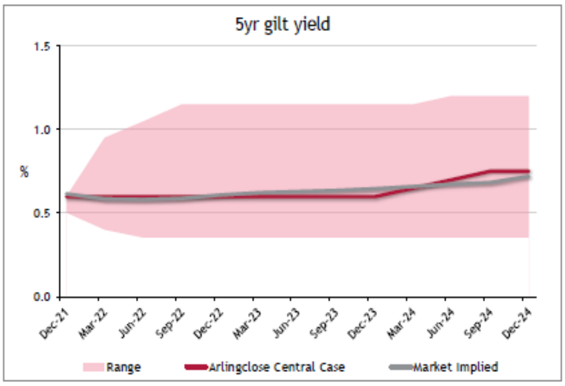
- Easing expectations for Bank Rate over time could prompt the yield curve to steepen, as investors build in higher inflation expectations.

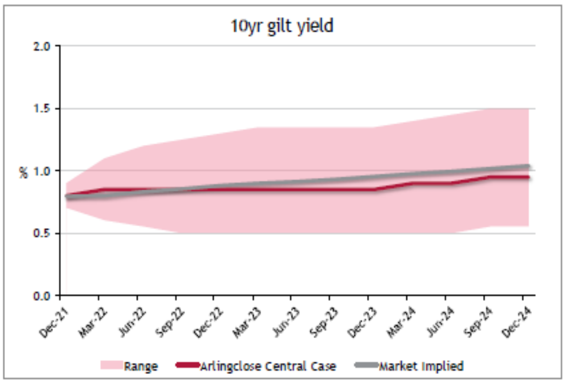
- The risks around the gilt yield forecasts vary. The risk for short- and medium-term yield is initially on the upside but shifts lower later. The risk for long-term yields is initially on the upside but shifts lower later. The risk for long-term yields is weighted to the upside.

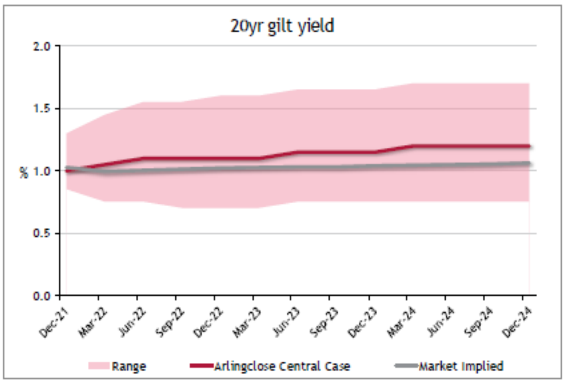
	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Official Bank Rate													
Upside risk	0.00	0.00	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk	0.00	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
3-month money market ra													
Upside risk	0.05	0.05	0.25	0.35	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.25	0.55	0.55	0.60	0.60	0.60	0.60	0.65	0.65	0.65	0.65	0.65	0.65
Downside risk	0.00	-0.25	-0.25	-0.30	-0.30	-0.30	-0.30	-0.35	-0.35	-0.35	-0.35	-0.35	-0.35
5yr gilt yield													
Upside risk	0.00	0.35	0.45	0.55	0.55	0.55	0.55	0.55	0.55	0.50	0.50	0.45	0.45
Arlingclose Central Case	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.65	0.70	0.75	0.75
Downside risk	-0.10	-0.20	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.30	-0.35	-0.40	-0.40
10yr gilt yield													
Upside risk	0.10	0.25	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.55	0.55	0.55
Arlingclose Central Case	0.80	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.90	0.90	0.95	0.95
Downside risk	-0.10	-0.25	-0.30	-0.35	-0.35	-0.35	-0.35	-0.35	-0.35	-0.40	-0.40	-0.40	-0.40
20yr gilt yield													
Upside risk	0.30	0.40	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	1.00	1.05	1.10	1.10	1.10	1.10	1.15	1.15	1.15	1.20	1.20	1.20	1.20
Downside risk	-0.15	-0.30	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45
50yr gilt yield													
Upside risk	0.25	0.30	0.40	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.70	0.75	0.80	0.85	0.90	0.95	1.00	1.05	1.05	1.10	1.10	1.15	1.15
Downside risk	-0.15	-0.30	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45

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
%
Dec-21
Mar-22
Jun-22
Sep-22
Dec-22
Mar-23
Jun-23
Sep-23
Dec-23
Mar-24
Jun-24
Sep-24
Dec-24
Range
Arlingclose Central Case
Market Implied


5yr gilt yield
1.5
1.0
0.5
0.0
%
Dec-21
Mar-22
Jun-22
Sep-22
Dec-22
Mar-23
Jun-23
Sep-23
Dec-23
Mar-24
Jun-24
Sep-24
Dec-24
Range
Arlingclose Central Case
Market Implied


10yr gilt yield
2.0
1.5
1.0
0.5
0.0
%
Dec-21
Mar-22
Jun-22
Sep-22
Dec-22
Mar-23
Jun-23
Sep-23
Dec-23
Mar-24
Jun-24
Sep-24
Dec-24
Range
Arlingclose Central Case
Market Implied


20yr gilt yield
2.0
1.5
1.0
0.5
0.0
%
Dec-21
Mar-22
Jun-22
Sep-22
Dec-22
Mar-23
Jun-23
Sep-23
Dec-23
Mar-24
Jun-24
Sep-24
Dec-24
Range
Arlingclose Central Case
Market Implied