EXECUTIVE BOARD DECISION

REPORT OF:	Executive Member for Finance and Governance
LEAD OFFICERS:	Director of Finance and Customer Services
DATE:	12th March 2020

PORTFOLIO/S AFFECTED:	Finance and Governance
WARD/S AFFECTED:	All
KEY DECISION:	**YES** ☒ **NO** ☐

SUBJECT: TREASURY MANAGEMENT STRATEGY REPORT 2020/21

1. EXECUTIVE SUMMARY

1.1 Treasury risk management 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 Treasury Management Code) which requires the Council 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.

2. RECOMMENDATIONS

It is recommended that the Executive Board:

2.1 Approves the proposed Treasury Management Strategy for 2020/21, detailed in Appendix 1, including the proposed Treasury Management Indicators.

3. BACKGROUND

3.1 Treasury management is the management of the Council's cash flows, borrowing and investments, and the associated risks. The Council borrows and invests 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 are therefore central to the Council's prudent financial management.

3.2 Investments held for service purposes or for commercial profit are considered in the Capital Strategy report, approved by Finance Council in February 2020.

4. RATIONALE

4.1 The Council is required to approve a Treasury Management Strategy before the start of each financial year. It must also set Treasury and Prudential Indicators and a policy for determining a "prudent" level of Minimum Revenue Provision for repayment of debt, which is consistent with the Council's Medium Term Financial Strategy (MTFS).

5. KEY ISSUES

5.1 Working within the regulatory and professional frameworks, the Council considers and agrees an annual Treasury Management Strategy before the start of each year. This is followed up with a mid-year Strategy Review, considered alongside the Annual Outturn Report, summarising the position for the previous financial year. The key requirements for the Council are to maintain its two investment priorities, the security of capital and the liquidity of investments.

6. POLICY IMPLICATIONS

6.1 The policy implications arising from the Treasury Management Strategy are contained within the overall Budget Strategy of the Council.

7. FINANCIAL IMPLICATIONS

7.1 The financial implications arising from the Treasury Management Strategy are also contained within the overall Budget Strategy of the Council.

8. LEGAL IMPLICATIONS

8.1 Under the Local Government Act 2003, the Council is required to have regard to CIPFA's *Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes.*

9. RESOURCE IMPLICATIONS

9.1 None as a direct consequence of this report.

10. EQUALITY AND HEALTH IMPLICATIONS

Please select one of the options below. Where appropriate please include the hyperlink to the EIA.

Option 1 ☒ Equality Impact Assessment (EIA) not required – the EIA checklist has been completed.

Option 2 ☐ In determining this matter the Executive Member needs to consider the EIA associated with this item in advance of making the decision.

Option 3 ☐ In determining this matter the Executive Board Members need to consider the EIA associated with this item in advance of making the decision.

11. CONSULTATIONS
11.1 The issues raised in this report have been discussed previously with Audit and Governance Committee and Treasury Management Group.

12. STATEMENT OF COMPLIANCE
The recommendations are made further to advice from the Monitoring Officer and the Section 151 Officer has confirmed that they do not incur unlawful expenditure. They are also compliant with equality legislation and an equality analysis and impact assessment has been considered. The recommendations reflect the core principles of good governance set out in the Council's Code of Corporate Governance.

13. DECLARATION OF INTEREST
All Declarations of Interest of any Executive Member consulted and note of any dispensation granted by the Chief Executive will be recorded in the Summary of Decisions published on the day following the meeting.

VERSION:	**1.0**

CONTACT OFFICER:	**Jody Spencer-Anforth (Ext 507748)**
DATE:	28th February 2020
BACKGROUND PAPER:	None

TREASURY MANAGEMENT STRATEGY 2020/21

1 Introduction

1.1 The Authority both borrows and invests 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 risk are therefore central to the Council's Treasury Management Strategy.

1.2 Treasury risk management for local authorities 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 each authority 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.

1.3 Investments held for service purposes or for commercial profit are considered in a different report, the Capital Strategy.

1.4 Should the assumptions on which this report is based change significantly, it may be necessary to seek approval to a revised Treasury Management Strategy. Such circumstances could include, for example, a large unexpected change in interest rates, or in the Authority's capital programme or in the level of investments made or borrowing required.

2 Economic Context, Credit Outlook and Interest Rates

2.1 The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Authority's treasury management strategy for 2020/21. The General Election has removed some uncertainty within the market, however following the Withdrawal Bill, uncertainties around the future trading relationship with the EU remain.

2.2 Inflation, as measured by the Consumer Price Inflation (CPI) Index, increased to 1.8% year-on-year in January 2020, up from 1.3% in December 2019. This is still below the Bank of England's target level of inflation of 2%. Unemployment rates remain historically low. The 3-month average annual growth rate for pay excluding bonuses was at 3.2% in December 2019, however, adjusting for inflation this means real wages were only up by 1.8%.

2.3 Domestic inflationary pressures have abated, as domestic gas and electricity price freezes have taken effect until 2020. The price of oil has fallen through the year, despite a rise in prices in December 2019. The limited inflationary pressure from real wages will likely keep inflation below the Bank of England target of 2%.

2.4 The UKs GDP growth was flat in the final quarter of 2019 falling by 0.5% from the previous 3 months with the annual rate falling further below its trend rate to 1.1% from 1.2%. Looking ahead, the Bank of England's Monetary Policy Report (formerly the Quarterly Inflation Report) forecasts economic growth to pick up during 2020 as Brexit-related uncertainties gradually fade and provide a boost to business investment helping GDP reach 1.4% in Q1 2021, 1.6% in Q1 2022 and 2.0% in Q1 2023.

2.5 The Bank of England maintained the Bank Rate at 0.75% in January. Despite keeping rates on hold, MPC members did confirm that if Brexit uncertainty drags on or global growth fails to recover, they are prepared to cut interest rates as required. Moreover, the downward revisions to some of the growth projections in the Monetary Policy Report suggest the Committee may now be less convinced of the need to increase rates even if Brexit related uncertainty declines.

2.6 The US economy has continued to perform relatively well compared to other developed nations; however, the Federal Reserve has started to unwind its monetary tightening through 2019. The Federal Reserve has also cut interest rates to stimulate growth as GDP has started to fall.

2.7 The fallout from the US-China trade war continues, which risks contributing to a slowdown in global economic activity. Recent suggestions have been an initial compromise and potential unwinding of tariffs; however, this can change quickly. Slow growth in Europe, combined with changes in leadership at the European Central Bank and International Monetary Fund has led to a change of stance in 2019. Quantitative easing has continued and been extended.

2.8 The recent Bank of England stress tests assessed all seven UK banking groups. The tests scenarios include deep simultaneous recessions in the UK and global economies that are more severe overall than the global financial crisis, combined with large falls in asset prices and a separate stress of misconduct costs. All seven banks passed the test on both a CET1 ratio and a leverage ratio basis. Major banks have steadily increased their capital for many years now. However, there are a number of shortcomings in the Bank's approach; timeliness as the results are over 11 months of out date when they are published, being based on end-2018 balance sheets; ringfencing, as the tests ignore the restrictions on transferring capital between ringfenced "retail" banks and non-ringfenced "investment" banks within the larger groups and; coverage – the tests should be expanded to cover a wider range of UK banks and building societies. The Bank of England will seek to address some of these issues in 2020, when Virgin Money/Clydesdale will be added to the testing group and separate tests will be included of ringfenced banks.

2.9 Challenger banks hit the news headlines in 2019 with Metro Bank and TSB Bank both suffering adverse publicity and falling customer numbers.

2.10 Looking forward, the outcome of trade negotiations with the EU and potential of a global recession remain the major risks facing banks and building societies in 2020/21 and a cautious approach to bank deposits remains advisable.

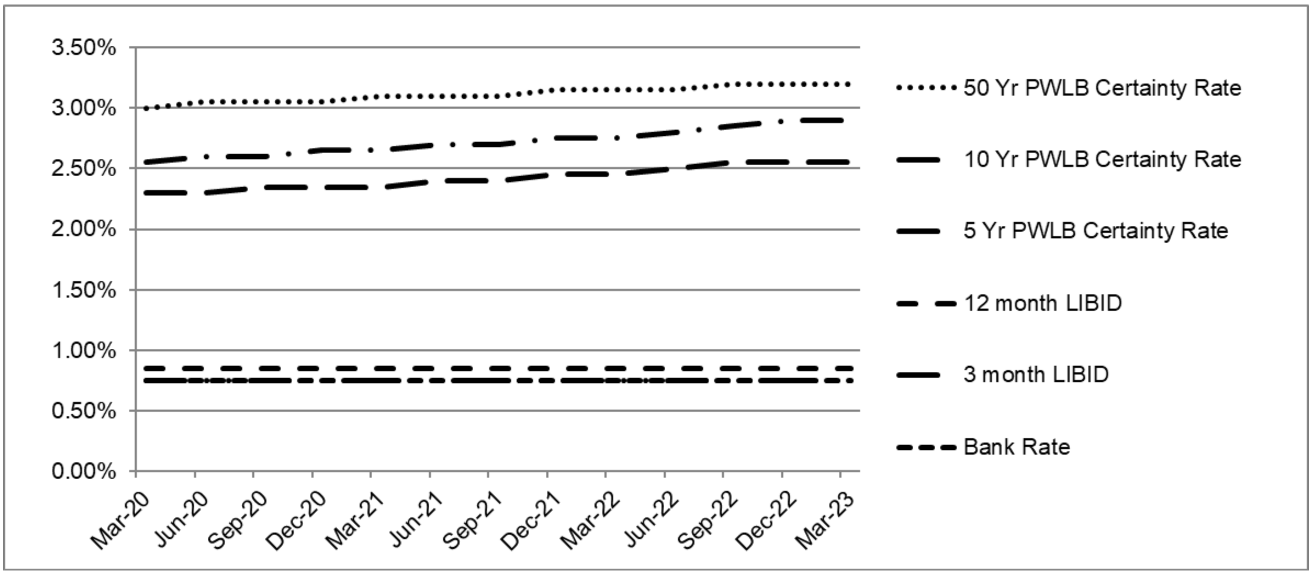
2.11 The Authority's treasury management adviser Arlingclose is forecasting that Bank Rate will remain at 0.75% until the end of 2022. The risks to this forecast are deemed to be significantly weighted to the downside, particularly given the continuing uncertainty regarding Brexit and the continuing global economic slowdown.

2.12 The Council's latest interest rate forecast, reflecting advice from Arlingclose, is shown below.

The PWLB rates relate to potential long term borrowing, and the LIBID (London Interbank Bid Rate) to short term borrowing and investment.

This is a realistic view of potential rates, however it must be recognised that there is significant uncertainty and risks to both the upside and downside. While assumptions are that some agreement is reached on future trading arrangements before the UK's transition period ends, there is still the possibility that this may not be the case still hangs over economic activity.

As such, the risks to the interest rate forecast are considered firmly to the downside.



For the purpose of setting the budget for 2020/21, it was assumed that:

- any new investments would be at low rates, averaging around 0.6%,
- short-term borrowing would be available at an average of around 1.0% and
- new long-term loans would be available, if required, at rates around 3.0%.

3 Borrowing Strategy

3.1 At the end of December 2019 the Council held around £272.2 M of borrowing:

	£M
Short Term Debt – maturing 19/20	25.0
Short Term Debt – maturing 20/21	17.0
Long Term Debt	152.0
Lancashire County Council (LCC) Debt	14.4
Debt re PFI arrangements	63.8
	272.2
This was offset by investments of:	18.4
Net borrowing (gross borrowing less investment)	253.8
If LCC and PFI debt are excluded, net borrowing	175.6

3.2 The Council's CFR (Capital Financing Requirement) is the key measure of the Council's borrowing **need** in the long term. It is

the accumulated need to borrow **to finance capital spend** (not funded from grants, etc.)

LESS the accumulated Minimum Revenue Provision (MRP) charges already made - councils must make a prudent MRP charge in their accounts, to finance their debt –

LESS any capital receipts applied to finance outstanding debt.

The CFR tends to increase if capital spend financed from borrowing exceeds MRP.

3.3 Forecast changes in CFR and borrowing needs are shown in the table below

	31.3.19 Actual £m	31.3.20 Estimate £m	31.3.21 Forecast £m	31.3.22 Forecast £m	31.3.23 Forecast £m
General Fund CFR	297.2	299.4	307.3	298.0	289.8
Less: CFR re Other debt liabilities *	-85.3	-84.8	-84.3	-83.8	-83.2
Loans CFR	**211.9**	**214.6**	**223.0**	**214.3**	**206.6**
Less: External borrowing **	-154.1	-149.9	-150.7	-146.8	-143.2
Internal borrowing	**57.8**	**64.6**	**72.4**	**67.5**	**63.4**
Less: Usable reserves ***	-40.1	-32.6	-30.7	-28.7	-28.7
Plus/Minus: Working capital	-1.2	3.2	29.0	-10.1	-10.4
Remaining Net borrowing NEED	**16.5**	**35.2**	**70.6**	**28.7**	**24.3**

Net borrowing NEED addressed by		
Short Term borrowing	**41.0**	**84.0**
Treasury Investments	**-24.5**	**-48.8**

* CFR regarding PFI liabilities and transferred debt that form part of the Council's total debt
** only loans to which the Council is committed over the longer term
*** includes schools balances and grants received in advance of need

The Council's usable reserves and working capital allow less borrowing to be taken than would otherwise be required. This is sometimes termed internal borrowing.

The Council's "Loans CFR" initially increases, due to the levels of prudential borrowing under its Capital Programme plans. Thereafter, unless the level of prudential borrowing is increased beyond current plans, it will start to fall in later years, as the level of MRP being made would then be larger than the increase in CFR resulting from additional spend financed from borrowing.

3.4 CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that total debt should be lower than the highest forecast CFR over the next three years. The Council expects to comply with this recommendation during 2020/21.

3.5 The authority will continue to need to take borrowing in support of funding its capital programme. The chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required.

3.6 Given the significant cuts to public expenditure and in particular to local government funding, the proposed 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 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. By doing so, the Council can reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

3.7 The benefits of internal and 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 2020/21 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

3.8 The Authority has previously raised much of its long-term borrowing from the PWLB, but the government increased PWLB rates by 1% in October 2019 making it now a relatively expensive option.

3.9 One alternative option is that the Council may arrange forward starting loans during 2020/21, 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. The authority will continue to maintain a flexible approach to borrowing.

3.10 In addition, the Council may take further short-term loans to cover cash flow requirements.

3.11 The approved sources of long-term and short-term borrowing will be:

- Public Works Loan Board (PWLB) and any successor body
- 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 Lancashire County Council Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

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

The Authority has previously raised much of its long-term borrowing from the PWLB but it continues to investigate other sources of finance, such as local authority loans and bank loans, which may be available at more favourable rates.

3.12 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.

3.13 The Council still has £13 M of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. These options may be exercised during 2020/21; whilst it is unlikely that the options will be exercised in the current low interest rate environment, there remains an element of refinancing risk. The Authority may take the option to repay LOBO loans at no cost if it has the opportunity to do so. It is not currently expected that the Council will take any further LOBO loans - however in order to allow for some flexibility, the Council will limit its total exposure to LOBO loans to £25 M.

3.14 The UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. Blackburn with Darwen BC was one of a number of local authorities investing in the Agency to help to establish it. It plans to issue bonds on the capital markets and lend the proceeds to local authorities.

This would be a more complicated source of finance than the PWLB for two reasons:

(a) borrowing authorities may be required to provide bond investors with a joint and several guarantee over the very small risk that other local authority borrowers default on their loans and
(b) 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 Municipal Bonds Agency will be subject to a separate report to Executive Board.

4 Investment Strategy

4.1 On a day to day basis the Council can hold significant surplus funds representing income received in advance of expenditure requirements, in addition to balances and reserves held. In the past 12 months, the Council's investment balance has ranged from £15 to £50 million, reflecting in particular the profiles of capital spending, grant funding, short term borrowing levels and long term debt repayments.

4.2 Both the CIPFA Code and the MHCLG Guidance require the Council to invest its funds prudently, and to have regard to the **security** and **liquidity** of its investments before seeking the highest rate 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 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.

4.3 If the UK enters into a recession in 2020/21, there is a small chance that the Bank of England could 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. This situation already exists in many other European countries. 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.

4.4 The Council uses a cash flow model to determine the period for which funds may prudently be committed. The forecast is compiled on a prudent basis, to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Furthermore, a prudent level of funds is maintained in 'instant access' investments, to cover most likely eventualities. However to mitigate risk further, it is possible to borrow funds to cover short-term needs.

4.5 Given the increasing risk and very low returns from short-term unsecured bank investments, the Authority aims to diversify into secure higher yielding asset classes during 2020/21. This is especially the case for amounts estimated to be available for longer-term investment. All of the Authority's surplus cash is currently invested in short-term unsecured bank deposits and money market funds along with fixed term deposits with other local authorities and the Debt Management Office (DMO). This diversification will represent a change in strategy over the coming year.

4.6 In order to prioritise the security of investments, the Council sets limits on the amounts placed with different institutions and as to the duration of the investment. This is to maintain a diversified investment portfolio and to align amounts and durations of investments to the perceived risks associated with different counterparties.

4.7 When deteriorating financial market conditions give cause for concern, the Council will further restrict its investments to those institutions of higher credit worthiness and reduce the duration of its investments to seek 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 (via the DMO or invested in government treasury bills for example) or with other local authorities. This may reduce the level of investment income earned, but will protect the principal sum invested.

4.8 The Council uses credit ratings from all the three main rating agencies (Fitch Ratings Ltd, Moody's Investors Service Ltd and Standard & Poor's Financial Services LLC) to assess the risk of loss of investments. The lowest available credit rating will be used to determine credit quality. In order to make the limits straightforward to manage, limits are based on the Long-term ratings, as these ratings are those that address credit risk directly. Long-term ratings are expressed on a scale from AAA (the highest quality) through to D (indicating default). Ratings of BBB- and above are described as investment grade.

The ratings are obtained and monitored by the Council's Treasury Advisers, Arlingclose, who will notify the Council of changes as they occur.

4.9 Credit ratings are a significant factor in assessing the creditworthiness of organisations however the Council understands that they are not perfect predictors of investment default. Full regard will be given to other available information on the credit quality of banks and building societies, including credit default swap prices, financial statements, information on potential government support and other market information. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the specified criteria.

4.10 Investment limits are applied at the point at which new investments are made. They are set at cautious levels, allowing for the fact that circumstances may change while investments run their course

It is proposed that if the investment criteria for a counterparty are no longer met, then:

- no new investments will be made,
- any existing investments that can be recalled at no cost will be recalled and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

4.11 Where a credit rating agency announces that it is actively reviewing an organisation's credit ratings with a view to downgrading, and as a result it is likely to fall below the specified minimum criteria, then no further investments other than into instant access accounts will be made 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.

Where a credit rating agency awards a different rating to a particular class of investment instrument as opposed to the credit rating of the counter-party as a whole, the Council will base its investment decisions on the instrument credit rating rather than the counterparty credit rating.

4.12 Investment Criteria for 2020/21

The proposed criteria are at essentially the same levels as were agreed for last year. The distinctions previously applied in MHCLG Investment Guidance between Specified and Non-Specified Investments have changed, so those categories are no longer reflected in the proposed limits. It is proposed that the Council may invest its surplus funds with any of the counterparty types in the table immediately below, subject to the cash and time limits shown AND to other limits also set out successively below.

Approved Investment Counterparties	Cash Limit	Time Limit
Banks and Building Societies – Secured		
long-term credit ratings no lower than AA- (or equivalent)	£5M each	364 days
long-term credit ratings no lower than AA (or equivalent)	£4M each	364 days
long-term credit ratings no lower than A- (or equivalent)	£3M each	364 days
Banks and Building Societies – Unsecured		
long-term credit ratings no lower than AA- (or equivalent)	£5M each	9 months
long-term credit ratings no lower than AA (or equivalent)	£4M each	6 months
long-term credit ratings no lower than A- (or equivalent)	£3M each	4 months
The Council's **current account banker** – provided long-term credit rating no lower than BBB- (or equivalent)	£3M each	next day
Corporates or **Registered Providers** with long-term credit ratings no lower than A- (or equivalent)	£3M each	4 months
Unrated institutions, such as building societies	£nil	n/a
Company Shares where no direct service benefit arising, for prudent management of its financial affairs	£100,000	n/a
Pooled Funds and Real Estate Investment Trusts (incl. money market funds)		
long-term credit ratings no lower than A- (or equivalent)	£5M each	n/a
unrated or long-term credit ratings under A- (or equivalent)	£4M each	n/a
UK Government	No limit	364 days
Other Government with long-term credit ratings no lower than A- (or equivalent)	£5M each	364 days
UK Local Authorities* (irrespective of credit rating)	£5M each	364 days
* as defined in the Local Government Act 2003		

Other Investment Limits	Cash Limit
Any single organisation, except the UK Central Government	£5M each
UK Central Government	unlimited
Any group or organisations under the same ownership	Group or overall limit same as would be set for parent company
Foreign Countries – limited to those with sovereign credit rating of AA+ or better (from all agencies)	£5M each
UK investments will not be limited by the UK's sovereign credit rating	
Foreign investment limits will not apply to investment in pooled funds which may be domiciled overseas. Sovereign credit rating criteria and foreign country limits will also not apply to investments in multilateral development banks (e.g. the European Investment Bank and the World Bank)	
Registered providers and registered social landlords	£5M in total
Unsecured investments with building societies	£6M in total
Money market funds	£20M in total

4.13 Secured and Unsecured Investments

Unsecured Investments include 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.

Unsecured investments with banks rated below A- (but no lower than BBB-) will be restricted to overnight deposits with the Council's Current Account bank, if applicable. A high level of monitoring of the credit-worthiness of the Current Account banker will be maintained if its ratings fall this low and this option will not be taken up if there are serious concerns.

In addition to investment balances, the Council may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be monitored and minimised, so far as practicable. 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.

Secured Investments include covered bonds and other collateralised arrangements with banks and building societies. Such investments are secured on the bank's assets, which limits potential losses in the unlikely event of insolvency and means that they 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 highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits.

4.14 Investment in Other Government, Corporate and Registered Providers

Other Government – this covers loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in and there is an insignificant risk of insolvency.

Corporates – this covers loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in but are exposed to the risk of the company going insolvent.

Registered Providers – this covers loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing, formerly known as Housing Associations. These bodies are tightly regulated by the government and, as providers of public services, they retain a likelihood of receiving government support if needed.

4.15 Unrated Institutions

To allow the option to invest in the Municipal Bonds Agency, and to continue to retain the option to invest in other unrated counterparties, it is proposed to set the limits as set out in 4.12 above.

4.16 Pooled Funds (including Money Market Funds)

Pooled Fund investments are investments in diversified investment vehicles consisting of any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee.

The regulatory environment for pooled funds has changed how money market funds operate. The Council has had regular advice from its Treasury Adviser on the risk position for pooled funds, as the proposals have been enacted, and will continue to monitor the position for such funds.

Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts.

Pooled funds whose value changes with market prices, and/or have a notice period, will be used for longer investment periods.

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Authority 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 Authority's investment objectives will be monitored regularly.

4.17 Real Estate Investment Trusts

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. Investments in REIT shares cannot be withdrawn but can be sold on the stock market to another investor.

4.18 Strategy for 2020/21

Cash flow surpluses can be considered as falling into three categories -

(a) **Short-term funds** that are required to meet cash flows occurring in the next month or so, and for which the preservation of capital and liquidity is therefore of paramount importance. Generating investment returns is of limited concern here, although should not be ignored. Instant access AAA-rated money market funds and bank deposit accounts will be the main methods used to manage short-term cash.

(b) **Medium-term funds** that may be required in the next one to twelve months will be managed concentrating on security, with less importance attached to liquidity but a slightly higher emphasis on yield. The majority of investments in this period will be in the form of fixed term deposits with banks and building societies. A spread of counterparties and maturity dates will be maintained to maximise the diversification of credit and interest rate risks.

(c) **Long-term funds** that are not required to meet any liquidity need and can be invested with a greater emphasis on achieving higher returns. Security remains fundamental however, as any losses from defaults will impact on the total return. Liquidity is of lesser concern, although it should still be possible to sell investments with due notice if large cash commitments arise unexpectedly. This is where a wider range of instruments, including structured deposits, certificates of deposit, gilts, corporate bonds and pooled funds in bond, equity and property funds, which could be used to diversify the portfolio.

The overall Investment Strategy will be to prioritise security of funds and maintain a mix of short-term (largely instant access) and medium-term investments to generate investment income as market conditions permit. As the Council expects to have funds available for long-term investment, the Council will consider its options for such funds, including potential investment in additional pooled funds.

With short-term interest rates still significantly lower than long-term rates, due consideration will also be given to continuing to use surplus funds to defer making long-term borrowing or even make early repayments of long-term borrowing. In addition to the savings on the interest rate differential, this strategy will also reduce the Council's exposure to credit risk and interest rate risk. In the context of the borrowing strategy, it is likely that most investments will continue to be in instant access and short term deposits, to manage the Council's liquidity.

The counterparty limits set out above, do allow for a wider range of investment opportunities to be taken up than have been used by the Council to date. Should the circumstances arise under which this would be appropriate, this would allow an increased diversification of the overall portfolio and in some instances, increase the security of investments made. The take up of any new investment opportunities will be closely managed by TMG, following advice given by the Council's Treasury Management Advisers.

5 Budget Implications

5.1 Excluding PFI costs (which are offset by Government grant funding), the budget for debt interest payable in 2020/21 is £6.9 million (including the interest element of payments to LCC for debt managed on our behalf), reflecting:

(a) £6.0 million interest payable, at an average interest rate of around 4.0%, on the long-term debt portfolio (forecast to average £152 million over the year),

(b) up to £0.9 million for short-term borrowing, at interest rates averaging 1.0%.

Projected investment income in 2020/21 is around £110,000, based on an average investment portfolio of circa £18 million, and interest rates averaging 0.6%.

If actual levels of investments and borrowing and/or actual interest rates differ from those forecast, performance against budget will be correspondingly different.

6 Using Derivatives

6.1 A derivative is a financial instrument whose value is derived from changes in the value of an asset or an index. Local authorities (including this Council) have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. deals agreed for future dates) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans).

Section 1 of the Localism Act 2011 included a general power of competence that removes the uncertain legal position over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment). The CIPFA Code requires authorities to clearly detail their policy on the use of derivatives in the annual strategy.

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 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.

6.2 Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. 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 Treasury Management Indicators

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

Refinancing Risk - Maturity Structure of Borrowing

This indicator is set to control the Council's exposure to refinancing risk - i.e. to prevent too much debt maturing at any one time, with a risk the Council will have to refinance at the rates then prevailing. The limits for up to 24 months continue to be relaxed to allow for a higher level of short term borrowing.

The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	Upper	Lower
Under 12 months	50%	0%
12 months and within 24 months	30%	0%
24 months and within 5 years	30%	0%
5 years and within 10 years	30%	0%
10 years and above	95%	25%

This indicator applies to the financial years 2020/21, 2021/212, and 2022/23, from the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment. Where there is a prospect that a LOBO may be called, this has been reflected in setting these limits.

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 total principal sum invested to final maturities beyond the period end will be:

	2020/21 £M	2021/22 £M	2022/23 £M
Limit on principal invested beyond year end	7.0	5.0	3.0

The Indicators above are "standard" Treasury Management Indicators that are generally adopted by local authorities, in line with individual circumstances. These indicators have not directly addressed the key treasury priorities of Security and Liquidity, though these issues are already closely tracked throughout the year. However, working in conjunction with the Council's Treasury Advisers, options for the formal monitoring of performance in regard to these priorities remain under consideration.

Interest Rate Risk

CIPFA has withdrawn the previous recommendation for standard indicators for Upper Limits on Fixed and Variable Interest Rate Risk. Nonetheless, this Council recognises that it must have regard to the risk that fluctuations in interest rates could create an unexpected burden on its finances, and will therefore continue to monitor its exposure to Fixed and Variable Interest

Rate Risk. In addition, without setting a formal limit, this Council will also monitor, on an ongoing basis, the potential impact of a 1% change in interest rates on its current borrowing and investment portfolio.

The upper limits on fixed and variable rate interest rate exposures, expressed as an amount of net principal borrowed will be:

	2020/21 £M	2021/22 £M	2022/23 £M
Upper limit on Fixed Interest rate exposures	267.2	247.7	227.4
Upper limit on Variable Interest rate exposures	116.4	107.2	97.6

8 Other Matters

Markets in Financial Instruments Directive (MiFID)

The Authority has opted up to professional client status with its providers of financial services, including advisers, brokers and some 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 Director of Finance and Customer Services believes this to be the most appropriate status.

9 Other Options Considered

The MHCLG Investment Guidance and the CIPFA Code of Practice do not prescribe any particular treasury management strategy for local authorities to adopt.

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	Reduced risk of losses from credit related defaults
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
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 will 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 will 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 will be less certain

The Director of Finance and Customer Services, having consulted with the Executive Member for Finance and Governance, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness.