

Division(s): N/A

## **AUDIT & GOVERNANCE COMMITTEE – 13 January 2021**

### **Treasury Management Strategy Statement & Annual Investment Strategy for 2021/22**

#### **RECOMMENDATION**

1. **The Audit & Governance Committee is RECOMMENDED to endorse the Treasury Management Strategy for 2021/22 as outlined in the report;**

#### **Executive Summary**

2. The Treasury Management Strategy & Annual Investment Strategy for 2021/22 outlines the Council's risk appetite and strategic objectives in terms of its debt and investment management for the financial year 2021/22.
3. The forecast average cash balance for 2021/22 is £428m. The Council will maintain the investment in strategic pooled funds with a purchase value of £101m, with the remaining £327m being managed internally with a mixture of short, medium and long-term deposits.
4. The Bank of England Base Rate is forecast to remain at 0.10% for the foreseeable future, with heavy risk weighting to the downside.
5. UK Government Gilt yields are likely to remain below 0.75% for the foreseeable future, and the PWLB<sup>1</sup> have reinstated their certainty borrowing rates to 80 basis points over gilts.
6. With the prospect of interest rates remaining lower for longer, and cash balances being higher than previously forecast over the medium term, it is recommended to increase the long-term lending limit from £175m to £200m in 2021/22, tapering down to £150m by 2024/25.
7. Changes to the Treasury Management Strategy will be delegated to the Director of Finance in consultation with the Leader of the Council and Cabinet Member for Finance

#### **Background**

8. The Local Government Act 2003 and supporting regulations require the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.
9. The Act requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act). The Annual Investment Strategy sets out the

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<sup>1</sup> Public Works Loans Board

Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

10. Treasury management is defined as: "The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."
11. The proposed strategy for 2021/22 is based upon the views of the Council's Treasury Management Strategy Team (TMST)<sup>2</sup>, informed by market forecasts provided by the Council's treasury advisor, Arlingclose Limited.
12. It is proposed that any further changes required to the Annual Treasury Management Strategy & Annual Investment Strategy, continue to be delegated to the Director of Finance in consultation with the Leader of the Council and Cabinet Member for Finance.

### **Treasury Limits for 2021/22 to 2024/25**

13. The Authorised Borrowing Limit requires the Council to ensure that total capital investment remains within sustainable limits and that the impact upon future council tax levels is 'acceptable'.
14. The capital investment relevant to this indicator to be considered for inclusion incorporates financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years.

### **Forecast Treasury Portfolio Position**

15. The Council's treasury forecast portfolio position for the 2021/22 financial year comprises:

	<b>Principal £m</b>	<b>Average Rate %</b>
<b>Opening External Debt Balance</b>		
PWLB	285.383	4.549
LOBO	45.000	3.943
Money Market Loans	5.000	3.950
<b>TOTAL EXTERNAL DEBT</b>	<b>335.383</b>	
<u>2021/21 Average Cash Balance</u>		
Average In-House Cash	327.026	
Average Externally Managed	101.006	
<b>TOTAL INVESTMENTS</b>	<b>428.032</b>	

<sup>2</sup>Comprising the Director of Finance, Service Manager (Pensions), Head of Corporate Finance and Treasury Manager.

16. The average forecast cash balance for 2021/22 is comprised of the following:

	Average Balance £m
Earmarked Reserves	70.000
Capital and Developer Contributions	239.221
General Balances	30.000
Cashflow and Working Capital Adjustments	74.615
Provisions and Deferred Income	14.196
<b>TOTAL</b>	<b>428.032</b>

## Treasury Management Advisors

17. Arlingclose continue to provide the Council's Treasury Management Advisory Service. The current contract is due to expire on 30<sup>th</sup> April 2021. A competitive tendering exercise is being undertaken and new contract for Treasury Management Advisory Service will be awarded to the successful applicant from 1<sup>st</sup> May 2021.

## Prospects for Interest Rates

### *Economic Background – Provided by Arlingclose*

18. The impact on the UK from coronavirus, together with its exit from the European Union and future trading arrangements with the bloc, will remain a major influence on the Authority's treasury management strategy for 2021/22.

19. The Bank of England (BoE) maintained Bank Rate at 0.10% in November 2020 and also extended its Quantitative Easing programme by £150 billion to £895 billion. The Monetary Policy Committee voted unanimously for both, but no mention was made of the potential future use of negative interest rates. Within the latest forecasts, the Bank expects the UK economy to shrink -2% in Q4 2020 before growing by 7.25% in 2021, lower than the previous forecast of 9%. The BoE also forecasts the economy will now take until Q1 2022 to reach its pre-pandemic level rather than the end of 2021 as previously forecast.

20. UK Consumer Price Inflation (CPI) for September 2020 registered 0.5% year on year, up from 0.2% in the previous month. Core inflation rose to 1.3% from 0.9%. Labour market data for the three months to August 2020 showed the unemployment rate rose to 4.5% while the employment rate fell to 75.6%. Both measures are expected to deteriorate further due to the ongoing impact of coronavirus on the jobs market, particularly when job retention schemes start to be unwound in 2021, with the BoE forecasting unemployment will peak at 7.75% in Q2 2021.

21. GDP growth fell by -19.8% in the second quarter of 2020, a much sharper contraction from -2.0% in the previous three months, with the annual rate falling -21.5% from -1.6%. 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.

### *Credit outlook – Provided by Arlingclose:*

22. After spiking in late March as coronavirus became a global pandemic, credit default swap (CDS) prices for the larger UK banks have steadily fallen back to almost pre-pandemic levels. Although uncertainly around COVID-19 related loan defaults lead to banks provisioning billions for potential losses in the first half of 2020, drastically reducing profits, reported impairments for Q3 were much reduced in some institutions. However, general bank profitability in 2020 is likely to be significantly lower than in previous years.
23. The credit ratings for many UK institutions were downgraded on the back of downgrades to the sovereign rating. Credit conditions more generally though in banks and building societies have tended to be relatively benign, despite the impact of the pandemic.
24. 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, suggesting a cautious approach to bank deposits in 2021/22 remains advisable.

### *Interest rate forecast – Provided by Arlingclose:*

25. Arlingclose is forecasting that BoE Bank Rate will remain at 0.10% until at least the end of 2023. The risks to this forecast are judged to be 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 but this is not part of the Arlingclose central forecast.
26. 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 0.5% and 0.75% 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.

### *Treasury Management Strategy Team's View*

27. The Council's TMST, taking into account the advice from Arlingclose, market implications and the current economic outlook, have determined the rates to be included in the Strategic Measures budget for 2021/22 and over the medium term. TMST forecast no change in base rate over the medium term. The Bank Rate is forecast to remain at 0.10% for the medium term.
28. The TMST does not expect official bank rates to move below zero, however it remains a real risk. If bank rate did fall below zero, the council would divest from any negative yielding instant access deposits and switch to a series of short term inter local authority deposits, whilst inter local authority returns remain above, or at zero. If there are insufficient options to invest short term at a positive yield, the TMST will seek to strike a balance between short term liquidity and capital

preservation through careful cashflow forecasting whilst increasing the average duration of the investment portfolio.

29. The TMST team has agreed that based on the current portfolio of deposits and market rates, the target in-house rate of return as set out below. These rates have been incorporated into the strategic measures budget estimates:

- 2021/22 0.58%
- 2022/23 – 2025/26 0.25%

## **Borrowing Strategy**

30. It is expected that the Bank Rate will remain at 0.10% during 2021/22. Borrowing rates are forecast to be between 0.80 – 1.55% in the short to medium term, therefore the “cost of carry<sup>3</sup>” associated with the long-term borrowing compared to temporary investment returns will be significantly reduced compared to previous years.

31. The external borrowing of the Council is set to fall well below the Capital Financing Requirement due to increased capital expenditure and £106m of debt repayments by 2027/28.

32. The Council needs to borrow to finance prudential borrowing schemes. The Council’s Capital Programme Financing Principles applies capital grants, developer contributions, capital receipts and revenue contributions to fund capital expenditure before using prudential borrowing. This means that the majority of the current capital programme is fully funded without the need to take up any new borrowing.

33. Financing the Council’s borrowing requirement internally would reduce the cost of carry in the short term but there is a risk that the internal borrowing would need to be refinanced with external borrowing at a time when PWLB (or its successor) and market rates exceed those currently available.

34. The Council’s TMST have agreed that they should maintain the option to fund new or replacement borrowing up to the value of £100m of the portfolio through internal borrowing. Internal borrowing will have the effect of reducing some of the “cost of carry” of funding. Internal borrowing will also be used to finance prudential schemes.

35. The TMST will monitor the borrowing rates during the 2021/22 financial year. If changes in interest rate forecasts mean the policy to borrow internally is no longer in the short term or long-term interests of the Council, the TMST may take out new or replacement borrowing to give the Council certain of cost over the long term, and to reduce Interest Rate Risk and Refinancing Risk in the short to medium term. Any borrowing will be reported to Cabinet.

36. As the Accountable Body for OxLEP Ltd, the Council will be required to prudentially borrow £41m on their behalf for project funding from 2021/22 onwards. The borrowing will be included in the Council’s overall borrowing

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<sup>3</sup> The difference between the interest payable on borrowing on debt and the interest receivable from investing surplus cash.

requirement, using internal or external borrowing as appropriate. The loans will be repaid through the retained business rates of the enterprise zone. The TMST monitor interest rates and will consider forward borrowing on behalf of OxLEP at the end of 2020/21 if it is determined to be cost-effective.

37. If the PWLB offer any further lending rounds of the Local Infrastructure Rate, it is likely to be at a discounted interest rate of gilts + 60 basis points. The borrowing on behalf of OxLEP may be eligible as the schemes are all major infrastructure schemes.
38. The Council's chief objective when borrowing money is to strike an appropriate balance between securing low interest costs and achieving cost certainty 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.
39. The approved sources of long-term and short-term borrowing are:
  - Public Works Loan Board and any successor body
  - UK local authorities
  - any institution approved for investments (see below)
  - any other bank or building society authorised by the Prudential Regulation Authority to operate in the UK
  - UK public and private sector pension funds
  - capital market bond investors
  - special purpose companies created to enable joint local authority bond issues.

### *Borrowing for the Capital Financing Requirement*

40. The Council's Capital Financing Requirement (CFR) represents the Council's underlying need to finance capital expenditure by borrowing. The Council's CFR is currently forecast to increase over the medium-term financial plan. This is a result of the requirement to borrow on behalf of the OxLEP discussed in paragraph 35 and increased investment in the Council's Capital Programme, and the previously agreed infrastructure investment.
41. The Council's external debt is also forecast to increase over the medium-term financial plan as new external borrowing required for OxLEP projects and the infrastructure investment is forecast to exceed the rate at which existing long term debt is repaid upon maturity.

### *Borrowing Instruments*

42. The main source of borrowing for the Council is the PWLB. The borrowing rate from the PWLB is directly linked to UK Government Gilt yield. There are three rates offered by the PWLB; the standard rate, the certainty rate and local infrastructure rate, which are 100, 80 and 60 basis points over gilts, respectively.
43. The Council will apply to qualify for the certainty rate each year. If the PWLB announce further infrastructure rate programmes, the Council will apply for it if appropriate.

44. The TMST forecast for available rates from the PWLB over the medium term are as follows:

- 0.80 – 1.55% for the Certainty rate
- 0.60 – 1.35% for the Infrastructure rate

45. The Council has historically set a maximum limit of 20% of the debt portfolio to be borrowed in the form of Lender’s Option Borrower’s Option (LOBOs). It is recommended that this remain as the limit for 2021/22. As at 30 November 2020 LOBOs represent 13.4% of the total external debt.

46. The Council has four £5m LOBO’s with call options in 2021/22, three of which have two call options in year, whilst one has a single call option in year. At each call date, the lender may choose to exercise their option to change the interest rate payable on the loan. If the lender chooses to do so, the Council will evaluate alternative financing options before deciding whether or not to exercise the borrower’s option to repay the loan or to accept the new rate offered. It is likely that if the rate is changed the debt will be repaid. The TMST is also exploring early repayment of LOBO’s where there is a financial benefit to do so.

47. Other sources of funding be available to the Council include the money market, other Local Authorities and the Municipal Bond Fund. The TMST will consider all available funding sources when entering into any new borrowing arrangements.

*Arlingclose’s View on borrowing rates*

48. Arlingclose have forecast gilt yields and borrowing rates over the medium term to be as follows:

Duration	Gilt Yield %	PWLB Infrastructure Rate %	PWLB Certainty Rate %
50 year	0.60 – 0.75	1.20 – 1.35	1.40 – 1.55
20 year	0.70 – 0.85	1.30 – 1.45	1.50 – 1.65
10 year	0.30 – 0.55	0.90 – 1.15	1.10 – 1.35
5 year	0.00 – 0.25	0.60 – 0.85	0.80 – 1.05

49. Arlingclose’s forecasts have an upside variation range of between 0 and 70 basis points, and a downside variation range of between 10 and 50 basis points depending on the economic and political climate.

**Treasury Management Prudential Indicators for Debt**

**Gross and Net Debt**

50. This indicator is intended to identify where an authority may be borrowing in advance of need.

Upper Limit of net debt:	2020/21	2021/22	2022/23	2023/24	2024/25
Net Debt / Gross Debt	70%	70%	70%	70%	70%

## Upper and lower limits to maturity structure of fixed rate borrowing

51. This indicator highlights the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates and is designed to protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years.
52. It is calculated as the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate. The maturity of borrowing is determined by reference to the earliest date on which the lender can require payment.
53. LOBOs are classified as maturing on the next call date, this being the earliest date that the lender can require repayment.

Maturity structure of fixed rate borrowing during 2021/22	Lower Limit %	Upper Limit %
Under 12 months	0	20
12 months and within 24 months	0	25
24 months and within 5 years	0	35
5 years and within 10 years	5	40
10 years and above	40	95

## Annual Investment Strategy

54. The Council complies with all relevant treasury management regulations, codes of practice and guidance. The Council's investment priorities are: -
- The security of capital and
  - The liquidity of its investments
55. The Council also aims to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The borrowing of monies purely to invest or on-lend and make a return is unlawful and the Council will not engage in such activity.
56. The Treasury Management Code of Practice requires the Council to approve a Treasury Management Policy Statement. Good practice requires that this statement is regularly reviewed and revised as appropriate. Council approved the statement in February 2019. The statement has been reviewed and there are no revisions proposed.

### *Investment Instruments*

57. Investment instruments identified for use in the 2021/22 financial year are set out in the Specified and Non-Specified instrument tables below
58. Guidance states that specified investments are those requiring "minimal procedural formalities". The placing of cash on deposit with banks and building societies 'awarded high credit ratings by a credit rating agency', the use of Money Market Funds (MMFs) and investments with the UK Government and local authorities qualify as falling under this phrase as they form a normal part of day to day treasury management.



59. Money market funds (MMFs) will be utilised, but good treasury management practice prevails and whilst MMFs provide good diversification the council will also seek to diversify any exposure by using more than one MMF where practical. It should be noted that while exposure will be limited, the use of MMFs does give the council exposure to institutions that may not be included on the approved lending list for direct deposits. This is deemed to be an acceptable risk due to the benefits of diversification. The Treasury team use an online portal to provide details of underlying holdings in MMFs. This enables more effective and regular monitoring of full counterparty risk.

60. All specified investments will be sterling denominated, with maturities up to a maximum of 1 year, meeting the 'high' credit rating criteria where applicable.

<b>Specified Investment Instrument</b>	<b>Minimum Credit Criteria</b>	<b>Use</b>
Term Deposits – UK Government	N/A	In-house
Term Deposits – other Local Authorities	N/A	In-house
Debt Management Agency Deposit Facility	N/A	In-house and Fund Managers
Treasury Bills	N/A	In-house and Fund Managers
UK Government Gilts	N/A	In-house on a buy and hold basis and Fund Managers
Term Deposits – Banks and Building Societies	Short-term F1, Long-term BBB+, Minimum Sovereign Rating AA+	In-house and Fund Managers
Certificates of Deposit issued by Banks and Building Societies	A1 or P1	In-house on a buy and hold basis and Fund Managers
Money Market Funds	AAA	In-house and Fund Managers
Other Money Market Funds and Collective Investment Schemes <sup>4</sup>	Minimum equivalent credit rating of A+. These funds do not have short-term or support ratings.	In-house and Fund Managers

<sup>4</sup> I.e., credit rated funds which meet the definition of a collective investment scheme as defined in SI 2004 No 534 and SI 2007 No 573.

<b>Specified Investment Instrument</b>	<b>Minimum Credit Criteria</b>	<b>Use</b>
Reverse Repurchase Agreements - maturity under 1 year from arrangement and counterparty is of high credit quality (not collateral)	Long Term Counterparty Rating A-	In-house and Fund Managers
Covered Bonds – maturity under 1 year from arrangement	Minimum issue rating of A-	In-house and Fund Managers

61. Non-specified investment products are those which take on greater risk. They are subject to greater scrutiny and should therefore be subject to more rigorous justification and agreement of their use in the Annual Investment Strategy; this applies regardless of whether they are under one-year investments and have high credit ratings.

62. A maximum of 50% of internal investments, and 100% of external investments will be held in non-specified investments.

<b>Non-Specified Investment Instrument</b>	<b>Minimum Credit Criteria</b>	<b>Use</b>	<b>Max Maturity Period</b>
Term Deposits – other Local Authorities (maturities in excess of 1 year)	N/A	In-house	5 years
UK Government Gilts with maturities in excess of 1 year	N/A	In-house and Fund Managers	5 years in-house, 10 years fund managers
Collective Investment Schemes <sup>5</sup> but which are not credit rated	N/A	In-house and Fund Managers	Pooled Funds do not have a defined maturity date
Registered Providers	As agreed by TMST in consultation with the Leader and the Cabinet Member for Finance	In-house	5 years
OxLEP Ltd	As agreed by TMST in consultation with the Leader and the Cabinet Member for Finance	In-house	5 years
Term Deposits – Banks and Building Societies (maturities in excess of 1 year)	Short-term F1+, Long-term AA-	In-house and Fund Managers	3 years
Structured Products (e.g. Callable deposits, range accruals, snowballs, escalators etc.)	Short-term F1+, Long-term AA-	In-house and Fund Managers	3 years
Bonds issued by Multilateral Development Banks	AAA	In-house and Fund Managers	25 years
Bonds issued by a financial institution which is guaranteed by the UK Government	AA	In-house and Fund Managers	5 years in-house
Sovereign Bond Issues	AAA	In-house on a buy and	5 year in-house, 30 years fund

<sup>5</sup> Pooled funds which meet the definition of a collective investment scheme as defined in SI 2004 No 534 and SI 2007 No 573.

Non-Specified Investment Instrument	Minimum Credit Criteria	Use	Max Maturity Period
		hold basis. Fund Managers	managers
Reverse Repurchase Agreements - maturity in excess of 1 year, or/and counterparty not of high credit quality.	Minimum long term rating of A-	In-house and Fund Managers	3 years
Covered Bonds	AAA	In-house and Fund Managers	20 years

### *Changes to Instruments*

63. With the prospect of interest rate remaining low for the medium term, and with an increase in peer to peer lending rates amongst Local Authorities, it is proposed to increase the duration for deposits with other Local Authorities to 5 years (from 3 years)

### *Credit Quality*

64. The CIPFA Code of Practice on Treasury Management (2017) recommends that Councils have regard to the ratings issued by the three major credit rating agencies (Fitch, Moody's and Standard & Poor's) and to make decisions based on all ratings. Whilst the Council will have regard to the ratings provided by all three ratings agencies, the Council uses Fitch ratings as the basis by which to set its minimum credit criteria for deposits and to derive its maximum counterparty limits. Counterparty limits and maturity limits are derived from the credit rating matrix as set out in the tables at paragraphs 73 and 74 respectively.
65. The TMST may further reduce the derived limits due to the ratings provided by Moody's and Standard & Poor's or as a result of monitoring additional indicators such as Credit Default Swap rates, share prices, Ratings Watch & Outlook notices from credit rating agencies and quality Financial Media sources.
66. Notification of any rating changes (or ratings watch and outlook notifications) by all three ratings agencies are monitored daily by a member of the Treasury Management Team. Updates are also provided by the Council's Treasury Management advisors Arlingclose and reported to TMST. Appropriate action will be taken for any change in rating.
67. Where a change in the Fitch credit rating places a counterparty on the approved lending list outside the credit matrix (as set out in tables at paragraphs 75 and 76), that counterparty will be immediately removed from the lending list.
68. The Authority defines "high credit quality" organisations as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher with the Fitch ratings agency.

### *Liquidity Management*

69. The Council forecasts its cash flow to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a pessimistic

basis, with receipts under-estimated and payments over-estimated to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium term financial plan and cash flow forecast. The Council uses instant access bank deposit accounts and money market funds for balances forecast to be required at short notice to meet commitments due. The TMST will continue to monitor options available to maintain the required liquidity and will open new accounts with approved counterparties as appropriate.

### *Lending Limits*

70. In addition to the limits determined by the credit quality of institutions, the TMST apply further limits to mitigate risk by diversification. These include:

- Limiting the amount lent to banks in any one country (excluding the UK) to a maximum of 20% of the investment portfolio.
- Limiting the amount lent to any bank, or banks within the same group structure to 10% of the investment portfolio.
- Actively seeking to reduce exposure to banks with bail in risk

71. Where the Council has deposits on instant access, this balance may temporarily exceed the 10% bank or group limit. However, the limits as set out in paragraphs 73 and 74 will still apply.

72. Counterparty limits as set out in paragraphs 73 and 74, may be temporarily exceeded by the accrual and application of interest amounts onto accounts such as call accounts, money market funds or notice accounts. Where the application of interest causes the balance with a counterparty to exceed the agreed limits, the balance will be reduced when appropriate, dependent upon the terms and conditions of the account and cashflow forecast.

73. Any changes to the approved lending list will be reported to Cabinet as part of the Business Management and Monitoring Report.

74. The Council also manages its credit risk by setting counterparty limits. The matrix below sets out the maximum proposed limits for 2021/22. The TMST may further restrict lending limits dependent upon prevailing market conditions. BBB+ to BBB- ratings is included for overnight balances with the Council's bank, currently Lloyds Bank Plc. This is for practical purposes should the bank be downgraded.

LENDING LIMITS - Fitch Rating	Short Term Rating	
	F1+	F1
Long Term Rating	F1+	F1
AAA	£30m	£20m
AA+	£30m	£20m
AA	£25m	£15m
AA-	£25m	£15m
A+	£20m	£15m
A	£20m	£15m
A-	£15m	£10m
BBB+, BBB, BBB- (bank with which the Council has its bank account)	£20m	£20m

75. The Council also manages its counterparty risk by setting maturity limits on deposits, restricting longer term lending to the very highest rated counterparties. The table below sets out the maximum approved limits. The TMST may further restrict lending criteria in response to changing market conditions.

MATURITY LIMITS – Fitch Rating	Short Term Rating	
Long Term Rating	F1+	F1
AAA	3 years	364 days
AA+	2 years	364 days
AA	2 years	9 months
AA-	2 years	9 months
A+	364 days	9 months
A	9 months	6 months
A-	6 months	3 months
BBB+, BBB, BBB- (bank with which the Council has its bank account)	Overnight	Overnight

*Other institutions included on the councils lending list - Structured Products*

76. As at 30 November 2020, the Council had no structured products within its investment portfolio. Structured products involve varying degrees of additional risk over fixed rate deposits, with the potential for higher returns. It is recommended that the authority maintain the option to use structured products up to a maximum of 10% of the investment portfolio. The Council will continue to monitor structured products and consider restructuring opportunities as appropriate.

**External Funds**

77. The Council uses external fund managers and pooled funds to diversify the investment portfolio through the use of different investment instruments, investment in different markets, and exposure to a range of counterparties. It is expected that these funds should outperform the Council’s in-house investment performance over a rolling three-year period. The Council will have no more than 50% of the total portfolio invested with external fund managers and pooled funds (excluding MMFs). This allows the Council to achieve diversification while limiting the exposure to funds with a variable net asset value. And, in order to ensure appropriate diversification within externally managed and pooled funds these should be diversified between a minimum of two asset classes.

78. As at 30 November 2020, the Council had £98m (original purchase value of £101m) invested in external funds (excluding MMFs), representing 19% of the Council’s total investment portfolio. The funds have largely recovered from the low value of £90m (cause by the Covid 19 pandemic) at 31 March 2020. Whilst there is likely to be continued short term volatility in the value of the funds, they are held with a long term view, and there is no intention to divest from any of the funds at present.

79. The external funds have a higher targeted income return than in house deposits of 3.75% which has been incorporated into the medium-term financial plan.

80. The performance of the pooled funds is monitored by the TMST throughout the year against the funds' benchmarks and the in-house investment returns. The TMST will keep the external fund investments under review and consider alternative instruments and fund structures, to manage overall portfolio risk. It is recommended that authority to withdraw, or advance additional funds to/from external fund managers, continue to be delegated to the TMST.

**Investment Approach**

81. The TMST will aim to maintain the balance between medium and long-term deposits with local authorities and short-term secured and unsecured deposits with high credit quality financial institutions. Money Market Funds will continue to be utilised for instant access cash. This approach will maintain a degree of certainty about the investment returns for a proportion of the portfolio, while also enabling the Treasury Management team to respond to any increases or decreases in interest rates in the short-term.

**Treasury Management Indicators for Investments**

**Upper limit to total of principal sums invested longer than 364 days**

82. The purpose of this limit is to contain exposure to the risk of loss that may arise as a result of the Authority having to seek early repayment of the sums invested.

83. During 2020/21 the limit for longer term lending was increased from £200 to £215m to reflect the higher than forecast cash balances and to take advantage of high peer to peer lending rates. Cash balances were higher than forecast due to higher levels of Developer Contributions and slippage in the capital programme. It is proposed to maintain this limit to £215m for 2021/22, then reduce back down to £185m by 2025/26 as the average forecast balance reduces.

	2021/22 £m	2022/23 £m	2023/24 £m	2024/25 £m	2025/26 £m
Upper limit on principal sums invested longer than 364 days	215	185	185	185	185

**Other Treasury Management Prudential Indicators**

**Upper limits on fixed and variable rate interest exposures**

84. These indicators allow the Authority to manage the extent to which it is exposed to changes in interest rates.

Fixed interest rate exposure

85. Limits in the table below have been set to reflect the current low interest rate environment. The limits set out offer the Council protection in an uncertain interest rate environment by allowing the majority of the debt portfolio to be held at fixed interest rates, thus not subjecting the Council to rising debt interest.

<b>Upper limit for fixed interest rate exposure</b>	<b>2020/21</b>	<b>2021/22</b>	<b>2022/23</b>	<b>2023/24</b>	<b>2024/25</b>	<b>2025/26</b>
Net principal re fixed rate borrowing / investments	£350m	£350m	£350m	£350m	£350m	£350m

86. Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate.

#### Variable interest rate exposure

The council will maintain a zero (or negative) net variable interest rate exposure. This is maintained by insuring the Council's variable rate debt is lower than variable rate investments

87. Prudential Indicators are reported to and monitored by the TMST on a regular basis and will be reported to the Audit & Governance Committee and Cabinet in the Treasury Management Outturn Report 2020/21 and the Treasury Management Mid-Term Review 2021/22, which will be considered in July and November 2021 respectively.

### **Policy on Use of Financial Derivatives**

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

89. 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.

90. It is the view of the TMST that the use of standalone financial derivatives will not be required for Treasury Management purposes during 2021/22. The Council will only use derivatives after seeking expertise, a legal opinion and ensuring officers have the appropriate training for their use.

### **Performance Monitoring**

91. The Council will monitor its Treasury Management performance against other authorities through its membership of the CIPFA Treasury Management benchmarking club.

92. Arlingclose benchmark the performance of their clients against each other on a quarterly basis, looking at a variety of indicators including investment risk and returns.

93. Latest performance figures will be reported to the Audit & Governance Committee and Cabinet in the Treasury Management Outturn Report 2020/21, and the

Treasury Management Mid-Term Review 2021/22, which will be considered in July and November 2021 respectively.

### **Investment Training**

94. All members of the Treasury Management Strategy Team are members of CIPFA or other professional accounting body. In addition, key Treasury Management officers receive in-house and externally provided training as deemed appropriate and training needs are regularly reviewed, including as part of the staff appraisal process.
95. The Council has opted up to 'professional client' categorisation with under the second Markets in Financial Instruments Directive (MiFID II). In order to achieve this, evidence was required that the person(s) authorised to make investment decisions on behalf of the authority have at least one year's relevant professional experience and the expertise and knowledge to make investment decisions and understand the risks involved. Members of the TMST currently meet these criteria and training needs will be regularly monitored and reviewed to ensure continued compliance.

### **Financial and Legal Implications**

96. Interest payable and receivable in relation to Treasury Management activities are included within the overall Strategic Measures budget. In house interest receivable for 2021/22 is budgeted to be £1.87m
97. Dividends payable from external funds in 2021/22 are budgeted to be £3.20m.
98. Interest payable on external debt in 2021/22 is budgeted to be £14.74m.
99. There are no direct legal implications arising from this report save for the need for ongoing collaborative working between the S151 Officer and the Monitoring Office. CIPFA guidance promotes the need for consultative working and collaboration between these respective roles to promote good organisational governance.

### **Environmental Impact**

100. This report is not expected to have any negative impact with regards to the Council's zero carbon emissions commitment by 2030.
101. The Treasury Management Strategy Team (TMST) will consider investments that may make a positive contribution to the Council's carbon commitment when appropriate opportunities become available. The TMST will continue to explore Ethical, Sustainable and good Governance investment practices.
102. Where the Council has investments in externally managed funds, each of the fund managers is a signatory to the United Nations Principal for Responsible Investment.



103. The Council is undertaking a review of all of its Treasury Management investments to produce a report on how it is performing with regards to Ethical, Social and Governance (ESG) criteria.
104. Furthermore, the Council will not knowingly invest directly in organisations whose activities include practices which are inconsistent with the values of the Council or the Council's zero carbon emissions commitment by 2030.
105. The Treasury Management function is now completely paperless, and remote working is likely to remain normal for the foreseeable future.

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