Appendix A

Treasury Management Strategy Statement (2021-22)

1 Background

1.1 The Authority is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals. These reports are required to be adequately scrutinised before being recommended to Council and this role is undertaken by the Audit and Risk Management Panel. The three reports are:

- The Treasury Management Strategy Statement (TMSS)
- The Mid-Year Treasury Management Report
- The Treasury Outturn Report.

1.2 The Treasury Management Strategy Statement is the first report covering how capital expenditure, investments, borrowings and the minimum revenue provision (MRP) are to be managed, including treasury indicators.

1.3 The Mid-Year Treasury Management Report updates members with the progress of the strategy and amends indicators or policies as necessary.

1.4 The Treasury Outturn Report provides details of actual performance in the financial year compared to the estimates within the strategy.

Treasury Management Strategy Statement for 2021/22

1.5 The strategy for 2021/22 covers:

The Borrowing Strategy (Section 2)

- Current Treasury Position
- Borrowing Profile
- Treasury Management Indicators: Limits to Borrowing Activity
- Prospects for Interest Rates
- Approach to Borrowing and Interest Rate Exposure
- Maturity Structure of Borrowing
- Policy on Borrowing in Advance of Need
- Debt Rescheduling

The Annual Investment Strategy (Section 3)

- Current Treasury position
- Investment Policy
- Creditworthiness Policy
- Country and Sector considerations
- Time and Monetary Limits applying to Investments
- Approach to Investment
- Investment Returns Expectations
- End of Year Investment Report
- Policy on the Use of External Service Providers.

1.6 These elements cover the requirements of the Local Government Act 2003, the CIPFA Treasury Management Code of Practice 2017 and the revised MHCLG Investment Guidance 2018. The Treasury Policy Statement and Code of Practice are presented in Annex 6.

1.7 The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management, in particular for this authority, those members of the Audit and Risk Management Panel.

1.8 A glossary is provided as Annex 1.

2 Borrowing Strategy

Current Treasury Position

2.1 The Authority's forecast treasury portfolio position as at 31 March 2021, with forward projections is summarised in Table 1. It shows the actual external borrowing (i.e. the treasury management operations), against the underlying need to borrow for capital purposes (known as the Capital Financing Requirement - CFR).

Table 1- Capital Financing Requirement versus Borrowing

	2019-20 Estimate £'000	2020-21 Estimate £'000	2021-22 Estimate £'000	2022-23 Estimate £'000	2023-24 Estimate £'000
CFR at 31st March	**602,109**	588,689	673,620	810,079	839,167
Borrowing at 1 April	382,945	378,108	411,653	468,198	563,816
Borrowings Maturing	(4,837)	(3,455)	(3,455)	(1,382)	(6,910)
New Borrowings	0	37,000	60,000	97,000	31,849
Borrowing at 31 March	**378,108**	**411,653**	**468,198**	**563,816**	**588,755**
Delayed Borrowing	**224,001**	**177,036**	**205,422**	**246,263**	**250,413**

2.2 Within the Prudential Indicators approved by Council, there are a number of key indicators to ensure that the Authority operates its activities within well-defined limits. One of these is that the Authority needs to ensure that its debt, does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2021/2 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not, undertaken for revenue purposes.

2.3 The Director of Finance reports that the Authority complied with this indicator in the current year and does not envisage difficulties in the future.

Borrowing Profile

2.4 Table 2 shows the forecast borrowing position as at 31 March 2021.

Table 2 – Forecast Position as at 31/03/21 (comparator as at 31/03/20)

2019/20 £000	2020/21 £000	Borrowing	2019/20 %	2020/21 %
249,108	245,654	PWLB*	4.53	4.54
129,000	129,000	Banks**	4.18	4.18
378,108	**374,654**	**Total**	**4.41**	**4.42*****

* Public Works Loans Board – fixed rate maturity loans

** Mainly Lenders Option Borrowers Option (LOBO) – loans from banks that are fixed rate for a period, with an option for the lender to revise the rate and a subsequent option for the borrower to repay without penalty

*** Weighted Average Rate

2.5 The prospect of options being exercised in the near term, is currently low, however, the theoretical value of loans that could mature over the next three years is as shown in Table 3.

Table 3 – Near Term Debt Maturity

	2021/22 £000	**2022/23 £000**	**2023/24 £000**
PWLB (fixed maturity date)	3,455	1,382	6,910
LOBO (possible options)	42,000	43,500	23,500
Total	**45,455**	**44,882**	**30,410**

2.6 The debt maturity profile is presented in two formats to demonstrate the impact on refinancing if all options were exercised at their next call date:

Chart 1: All loans run to contractual maturity.
Chart 2: LOBO loan options exercised at next opportunity.

Chart 1: Debt Maturity and Rate Profile (contract term)

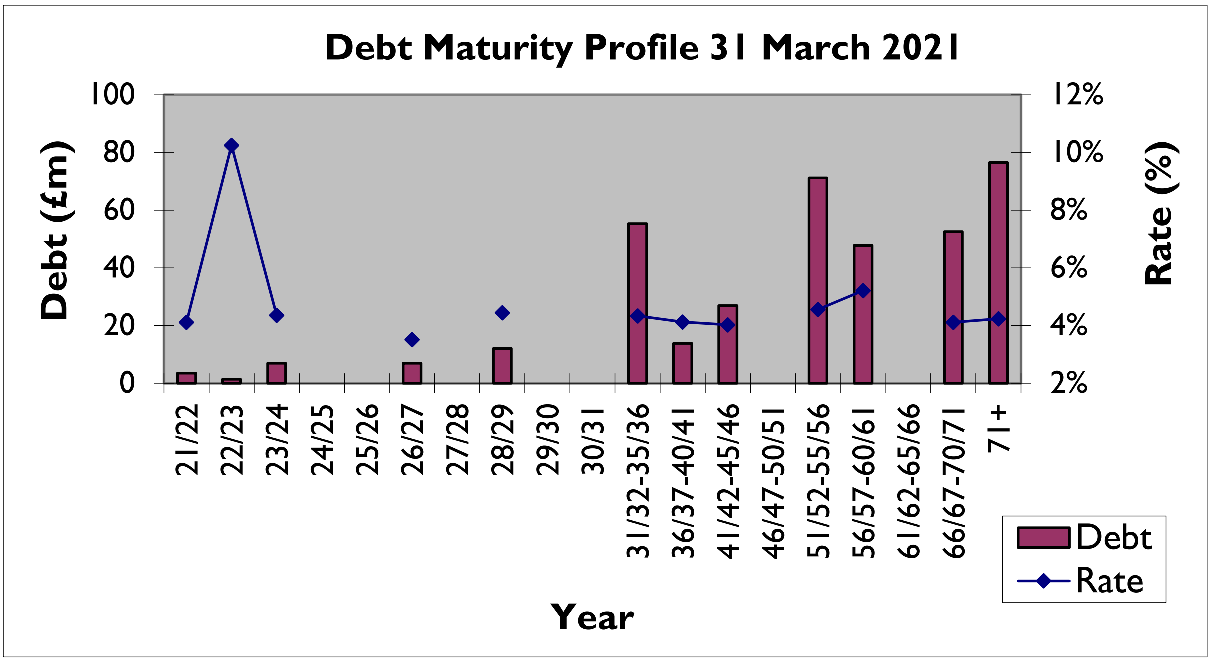
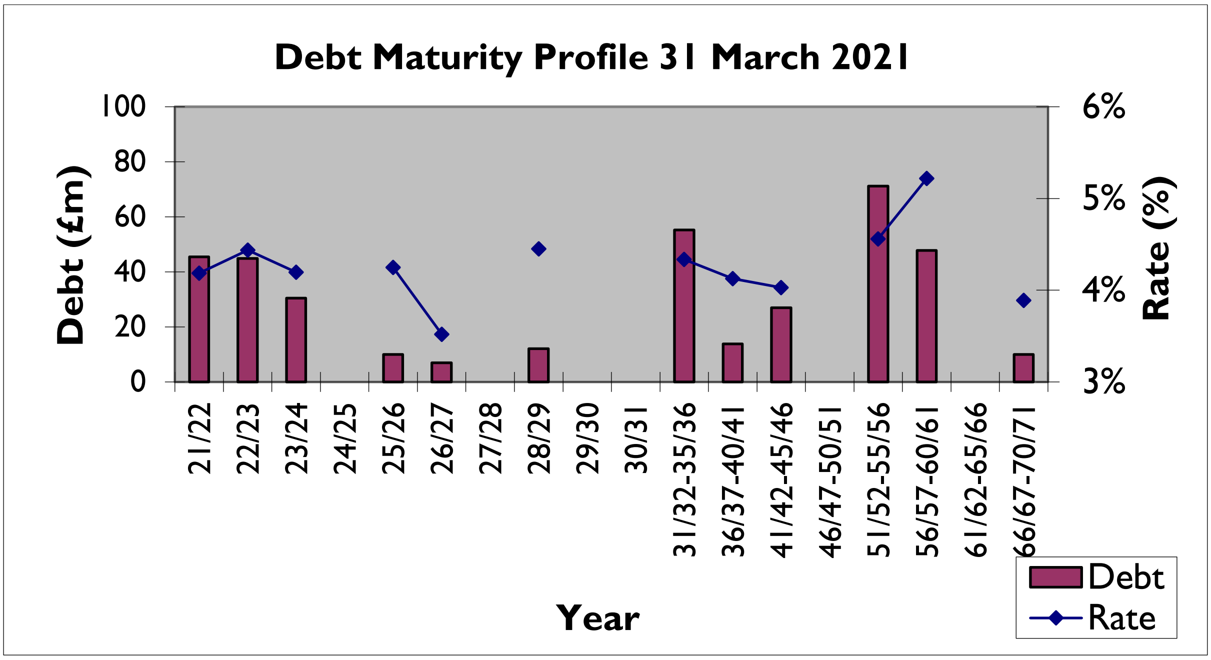


Chart 2: Debt Maturity and Rate Profile (options exercised)



Treasury Management Indicators: Limits to Borrowing Activity

2.7 With the abolition of the HRA Cap, there are now two limits in respect of borrowing in 2021/22:

- The Operational Boundary
- The Authorised Limit

2.8 The two indicators are due for approval by Council on 25 February 2021.

Prospects for Interest Rates

2.9 The Authority has Link Asset Services as its treasury advisor and part of their service is to assist in formulating a view on interest rates. Annex 2 draws together forecasts for short term (Bank Rate) and longer term fixed interest rates. Table 4 below provides a range of longer term fixed interest rate forecasts.

Table 4 – Interest Rates for Borrowing Forecasts

Year Ending	**PWLB Borrowing Rates* (%)**			
	5 years	**10 years**	**25 years**	**50 years**
March 2021	0.80	1.10	1.50	1.30
March 2022	0.90	1.20	1.60	1.40
March 2023	0.90	1.20	1.70	1.50

* "certainty" rate

2.10 The interest rate forecasts provided by Link Asset Services in table 4, are based on a Brexit trade deal being agreed by between the UK and the EU.

2.11 PWLB rates are subject to ad hoc decision by H.M. Treasury to change the margin over gilt yields that are charged in PWLB rates, such changes could be up or down. In October 2019, the margin over gilts was raise by 100bps, due to concern over some authorities borrowing actives and a consultation process was launch.

2.12 In late November 2020, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates; the standard and certainty margins were reduced by 1% but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three-year capital programme.

2.13 The long-term forecast for PWLB rates are under 2%, there is now value in borrowing from the PWLB all types of capital expenditure for all maturity periods, especially as current rates are at historic lows. The policy of internal borrowing i.e. avoiding new borrowing by running down spare cash balances is now being reviewed.

2.14 There will remain a cost of carry (the difference between higher borrowing costs and lower investment returns), to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

Approach to Borrowing and Interest Rate Exposure

2.15 The Authority's approach has been to delay borrowing. This means that the underlying need to borrow for capital purposes (the CFR), has not been fully funded with external borrowing, as cash supporting the Authority's reserves, balances and cash flow has been used as a temporary measure. This strategy has been prudented as investment returns are low and counterparty risk is still an issue that needs to be considered. The management of the level of delayed borrowing and its treatment within the General Fund and HRA is monitored.

2.16 As the Authority has effectively used the options of internal borrowing for over 8 years now, this approach is currently being reviewed in light of the step change in investment in housing related projects in the Borough. The increase in the capital spending means the internal cash balance and reserves would not be able to support future increase CFR.

2.17 Against this background and the risks within the economic forecast, caution will be adopted with the 2021/22 treasury operations. The Director of Finance will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *if it was felt that there was a significant risk of a sharp FALL in borrowing rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then borrowing will be postponed.*

- *if it was felt that there was a significant risk of a much sharper RISE in borrowing rates than that currently forecast,* perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

2.18 Any decisions will be reported through the mid-year and annual Treasury Management reports.

Maturity Structure of Borrowing

2.19 These gross limits are set to reduce the Authority's exposure to large fixed rate and variable sums falling due for refinancing at the same time.

2.20 The Council will be asked to approve the treasury indicators and limits in Annex 3.

Policy on Borrowing in Advance of Need

2.21 The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

2.22 Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

Debt Rescheduling

2.23 Rescheduling of current borrowing in our debt portfolio is unlikely to occur as the 100 bps increase in PWLB rates only applied to new borrowing rates and not to premature debt repayment rates. If rescheduling was done, it will be reported to the Council, at the earliest meeting following its action.

2.24 The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings
- helping to fulfil the treasury strategy
- enhance the balance of the portfolio (amend the maturity profile and / or the balance of volatility).

New financial institutions as a source of borrowing

2.25 Currently the PWLB Certainty Rate is set at gilts + 80 basis points for both HRA and Non-HRA borrowing. However, consideration may still need to be given to sourcing funding from the following sources for the following reasons:

- Local authorities (primarily shorter dated maturities out to 3 years– still cheaper than the Certainty Rate)
- Financial institutions (primarily insurance companies and pension funds but also some banks, out of forward dates where the objective is to avoid a "cost of carry" or to achieve refinancing certainty over the next few years)
- Municipal Bonds Agency

2.26 Our advisors will keep us informed as to the relative merits of each of these alternative funding sources.

3 Annual Investment Strategy

Current Treasury Position

3.1 The MHCLG and CIPFA have extended the meaning of "investments" to include both financial and non-financial investments. This strategy deals with financial investments, non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy, setting out where relevant, the organisation's risk appetite and specific policies and arrangements for non-treasury investments. It recognises that the risk appetite for these activities may differ from that for treasury management but common to both investments types is the need for holistic council-wide planning, robust due diligence and formal oversight.

3.2 Table 5 below shows the forecast investment position at 31 March 2021.

Table 5 – Forecast Position as at 31/03/20 (comparator as at 31/03/21)

2019/20 £m	2019/20 £m	Investments	2019/20 %	2020/21 %
137	119	Total	0.40	0.01

Investment Policy

3.3 The Authority's investment policy has regard to the MHCLG's Guidance on Local Government Investments ("the Guidance") and the 2017 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Authority's investment objectives will be, in priority order:

- **S**ecurity
- **L**iquidity
- **Y**ield.

3.4 In accordance with the above guidance from MHCLG and CIPFA and in order to minimise the risk to investments, the Authority has generated an acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies. Using the Link Asset Services ratings service and Bloomberg, counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies issue updates. This enables diversification and thus avoidance of risk.

3.5 Further, the Authority's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector in relation to the economic and political environments in which institutions operate. To this end the Authority will engage with its advisors to monitor market pricing such as Credit Default Swaps (CDS), share prices, the financial press, sources such as Bloomberg Systems LLP alongside the internet generally and overlay that information on top of the credit ratings.

3.6 The aim of the strategy is to generate a list of secure, highly creditworthy counterparties which will also enable divesification and thus avoidance of concentration risk.

3.7 Investment instruments identified for use in the financial year are defined as either 'Specified' or 'Non-Specified' Investments:

- Specified Investments are those of a high level of credit quality and subject to a maturity limit of one year.

- a Non-Specified Investment is any investment that is not 'Specified'. They are those with not as high a credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.

Creditworthiness Policy

3.8 The primary principle governing the Authority's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. The Authority will therefore ensure that:

- *it maintains a policy covering the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security and monitoring their security. This is set out in annex 4A and 4B.*
- *it has sufficient liquidity in its investments. For this purpose, it will set out procedures for determining the periods for which funds may prudently be committed. These procedures also apply to the Authority's indicators covering the maximum principal sums invested.*

3.9 The Director of Finance will maintain a counterparty list, through its use of its documented Treasury Management Practices.

3.10 Any counterparty failing to meet the criteria would be, omitted from the counterparty (dealing) list. Any rating changes or rating watches (notification of a likely change) or rating outlooks (notification of a possible longer term change) are available to officers almost immediately after they occur and this information is considered before investing.

3.11 The Authority continues to keep other products under review, including AAA rated Money Market Funds - these offer a high degree of security and instant access for investment on a daily basis.

3.12 The criteria for providing a pool of high quality investment grade counterparties (both Specified and Non-Specified investments) are as shown below (Ratings provided by Fitch):

- ***UK Government*** (including gilts, treasury bills and the DMADF)
- ***Banks 1*** - the Royal Borough will use good quality banks that are:

a) UK banks or

b) non-UK but domiciled in a country which has a minimum sovereign long-term rating of “AA-”

These banks must be of investment grade and have as a minimum, the following credit ratings:

i. Short term “F1”
ii. Long term “A-”

- ***Banks 2*** – part-nationalised UK banks: Royal Bank of Scotland
- ***Banks 3*** – the Authority’s own banker for transactional purposes
- ***Building Societies*** that meet the criteria for banks above
- ***Other*** – including Money Market Funds rated “AAA”
- ***Other (less liquid)*** – e.g. land and / or buildings.

3.13 A full list of Specified and Non-Specified products is as shown in Annex 4a and 4b. A limit of 25% will be applied to the use of Non-Specified investments.

3.14 In the case of Non-Specified investments of a less liquid nature, a smaller limit of 10% (within the overall 25%), will be applied.

3.15 Loans to 3rd parties for investment purpose would be cap to the limits set out in point 3.14, while applying the due diligence that set out in the statutory guidance on local Government investment issued by MHCLG (February 2018).

Country and Sector Considerations

3.15 Due care will be taken to consider the country, group and sector exposure of the Authority’s investments. In part, the country selection will, be driven by the credit rating of the sovereign state in Banks 1 category above.

3.16 The Authority has determined that it will use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch. The list of countries that qualify using this credit criteria as at the time of writing are shown in Annex 5. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy:

- no more than 20% will be placed with any non-UK country at any time
- limits in place above will apply to Groups of financial institutions (e.g. Bank of Scotland is part of the Lloyds Banking Group)
- sector limits will be monitored regularly for appropriateness.

Time and Monetary Limits applying to Investments

3.17 The time and monetary limits for institutions on the Royal Borough's counterparty list are as shown in Table 6 (these will cover both Specified and Non-Specified Investments, the criteria for which are as shown in Annex 4a and 4b).

Table 6– Investment Limits

Investment Limits	**Fitch L-Term Rating**	**Value Limit**	**Time Limit**
UK Government • Treasury Bills • Gilts • DMADF	n/a	Unlimited	5 years
Money Market Funds	AAA	£30m*	Liquid
Banks 1 category - high quality	A-	£30m*	5 years
Banks 2 category – part-nationalised	n/a	£30m*	5 years
Banks 3 category – The Authority's banker	n/a	n/a	1 day
Building Societies	A-	£30m*	5 years
Other	n/a	£30m*	5 years
Other (less liquid)	n/a	10% portfolio	n/a

* Per Counterparty

3.18 The proposed criteria for Specified and Non-Specified investments are as shown in Annex 4a and 4b for approval.

Approach to Investment

3.19 Investments will be made with reference to the core balance and cash flow requirements and the outlook for interest rates.

3.20 For investments of a less liquid nature, professional advice will be sought to ensure that that there is a sound business case for making the investment, which will identify security, liquidity and yield elements of the transaction alongside the risks associated with them.

Investment Returns Expectations

3.21 The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its subsequent meetings to 5th November, although some forecasters had suggested that a cut into negative territory could happen.

3.22 The Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary.

Table 7 – Interest Rate Forecasts

Year Ending	**Bank Rate** %
March 2021	0.10
March 2022	0.10
March 2023	0.10
March 2024	0.10

3.22 As shown in the forecast table above, no increase in Bank Rate is expected in the forecast table above as economic recovery is expected to be only gradual and, therefore, prolonged.

End of Year Investment Report

3.23 At the end of the financial year, the Authority will report on its investment activity as part of its Annual Treasury Management Report.

Policy on the Use of External Service Providers

3.24 The Authority uses Link Asset Services as its external treasury management advisors. It recognises that responsibility for treasury management decisions remains with the Authority itself at all times and will ensure that no undue reliance is placed upon our external service providers.

3.25 The Authority also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Authority will ensure that the terms of any appointment and the methods by which their value will be assessed are properly agreed and documented and subjected to regular review.

4 Report Appendices

4.1 The following documents are published with and form part of this report:

Annex 1 - Glossary
Annex 2 – Interest Rate Forecast 2021 - 2024
Annex 3 – Treasury Management Indicators
Annex 4 a & b – Specified & Non-Specified Investments
Annex 5 – Approved Countries for Investments
Annex 6 – Treasury Management Policy Statement