Appendix 2 - Treasury Management Strategy

Contents

Treasury Management Policy Statement, Treasury Management Strategy Statement and Annual Investment Strategy for 2021-22

Treasury Management Policy Statement

Treasury management within the Council is undertaken in accordance with the CIPFA Code of Practice for Treasury Management in the Public Services ("the TM Code").

The Council defines treasury management as:

"The management of the organisation's financial 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."

The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. The analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

The Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

The Treasury investment policy objective for this Council is the prudent investment of its treasury balances. The Council's Treasury investment priorities are security of capital and liquidity of its investments so that funds are available for expenditure when needed. Both the CIPFA Code and the MHCLG guidance require the Council to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield.

The Council's borrowing objective, being debt free and with relatively substantial resources still available for its capital investment spending plans, means that it does not intend to borrow any monies, except for short term cash flow purposes for revenue and capital commitments.

The generation of investment income to support the Council's spending plans is an important, but secondary objective. Other than income from the Council's investment in the Local Authority property Fund or other long term pooled funds, returns are generally used to fund one-off expenditure or capital investment.

Treasury Management Strategy Statement

The Council's priority is the security and liquidity of its Treasury investments in accordance with the priorities set out in the CIPFA Code and MHCLG Guidance. Whilst fundamentally risk averse, the Council accepts some modest degree of risk within the limits and counterparty restrictions set out in its Treasury Management and Investment Strategy and risk appetite statement

The Chartered Institute of Public Finance and Accountancy's '*Treasury Management in the Public Services: Code of Practice'* (the CIPFA Code) requires the Council to approve a Treasury Management Strategy (TMS) before the start of each financial year.

The Ministry for Housing, Communities and Local Government (MHCLG) also issues guidance on Local Authority Investments (the Guidance). Paragraph 21 of the Guidance makes it clear that, except for the requirement to prioritise Security, Liquidity and Yield in that order of importance, treasury management investments are managed within the principles set out within the CIPFA Code.

The Council's TMS Statement is underpinned by the CIPFA Code and Treasury Management Practices (TMPs) which provide prescriptive information as to how the treasury management function should be carried out.

In accordance with the Guidance, the Council will be asked to approve a revised Treasury Management Strategy should the assumptions on which this report is based change significantly. Such circumstances may include, for example, a large unexpected change in interest rates, or in the Council's capital programme or in the level of its investment balances.

Treasury Management and Investment Strategy 2021-22

Treasury Investments

The Authority invests its money for three broad purposes:

- because it has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure (known as treasury management investments),
- to support local public services by lending to or buying shares in other organisations (service investments), and
- to earn investment income (known as commercial investments where this is the main purpose).

As at 4 December 2020, the Council held £97m of investments as set out in table 1 below

Table 1: Investment Portfolio Position

Investments	£m	Return %*
Short term Investments (cash, call accounts, deposits)	39.0	0.16
Money Market Funds	24.0	0.04
Total Liquid Investments	63.0	0.11
External Pooled funds	34.0	3.73
Total Treasury Financial Investments	97.0	1.38
Commercial Property Investments	13.6	7.0**
Service Investments	0.4	n/a**

**returns are based on income only.*

*** based on latest complete financial year and value as at 31-3-2020*

These investments are expected to fall over the next few months due to the normal pattern of lower taxation receipts in February and March 2021. The Council's latest finalised resource projection indicates the following movements in resources, including funds available for investment, over the medium term.

Table 2: Treasury projection to 31 March 2025 (£m)

	2020 Actual	2021	2022	2023	2024	2025
Usable Reserves:						
• Earmarked and specific	9.9	9.1	8.2	8.2	8.2	8.2
• New Homes Bonus	15.2	15.5	10.7	10.6	10.5	10.3
• Asset Replacement	7.6	6.0	4.3	4.5	4.5	4.6
• Capital receipts reserve	1.9	2.9	7.5	8.1	11.3	11.4
• General Fund	15.3	11.5	9.6	9.3	9.3	9.3
Grants and contributions, including CIL and disabled facility grants	13.3	9.6	1.1	1.2	2.3	5.8
Commuted payments (s.106)	5.9	5.7	4.6	3.5	2.8	2.1
Working Capital, including collection fund balances	6.4	4.1	4.1	4.1	4.1	4.1
Total Resources	75.5	64.4	50.1	49.5	53.0	55.8
Internal investments	41.5	30.4	16.1	15.5	19.0	21.8
External Investments	34.0	34.0	34.0	34.0	34.0	34.0
Total Investments	75.5	64.4	50.1	49.5	53.0	55.8
External Debt	-	-	-	-	-	-

The above figures are based on the Councils latest resource projections and include assumptions about timing of transactions that may differ from actual delivery. CIL projections are as at September 2020.

The Council's operational boundary and authorised debt ceilings are set out in tables 6 and 7 and are set at a level that will accommodate possible short-term working capital requirements or any financial lease liabilities that will be recognised following the adoption of IFRS16 on 1 April 2022.

CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. As the Council does not expect to incur any debt (other than for temporary cash management purposes) over the next three years, the Council's CFR is forecast to be zero over this period.

Risk Appetite Statement

As a debt free authority the Council's highest priority in its treasury management function is the security of those investments in accordance with the priorities set out in the CIPFA Code. However, whilst fundamentally risk averse, the Council will accept some modest degree of risk

The Council mitigates investment risk by using different investment instruments, diversified high credit quality counterparties and with country, sector and group limits as set out in this strategy.

When investing surplus cash, the Council will not necessarily limit itself to making deposits with the UK Government and local authorities, but may invest in other bodies including certain unrated building societies and money market funds. The Council may also invest surplus funds through tradable instruments such as gilts, treasury bills, certificates of deposit, corporate bonds and pooled funds. The duration of such investments will be carefully considered to limit that risk of them having to be sold (although they may be) prior to maturity, mitigating the risk of the capital sum being diminished through price movements.

Proportionality

The Council currently builds the following sources of income from investments into its base budget as these sources of income have demonstrated an ability to provide a constant, predicable return over the medium term. The figures are presented here are a proportion of net cost of Council services.

Table 3: Proportionality of Investments

	2018-19 Actual	2019-20 Actual
Net Cost of services £m	20.0	17.5
Commercial property income £m	1.0	1.0
Proportion %	5.0	5.7

Net Cost of Services is as presented in the Council's annual financial statements. Income from Commercial properties is gross. In accordance with professional best practice the Council does not formally value rental income streams further than 12 months in advance.

Income from commercial properties is expected to remain below 10% of the Council's net cost of services.

Table 3 demonstrates the Council met its target for the last full financial year at the date this strategy was prepared. For 2020-21 (outturn) and 2021-22 (forecast), the target will continue to be set at 5% of the Council's net cost of services. The outturn for 2020-21 will be reported in the first half-yearly update in 2021-22 together with the forecast for 2021-22, which is only available after the Council has approved its budget in March 2021.

In setting this reporting threshold the Council does not intend for it to prevent the Council charging market rents or lending at market interest rates. If at any point this warning limit is exceeded, a report on the risk to the Council's overall revenue budget will be made to the Council's Corporate Governance and Audit Committee and to the Cabinet.

To mitigate the risk on front line services should commercial investments not achieve planned returns, the Council prepares its 5 year financial strategy in-line with a series of key principles. The key principles are set out in the Council's financial strategy and are available online via the published papers for the Council's Corporate Governance and Audit Committee and Cabinet.

In accordance with current MHCLG guidance, the Council will be asked to approve a revised strategy should the assumptions on which this report is based change significantly.

Treasury Investments and Borrowing

In line with the Council's Treasury Management Policy Statement, treasury management includes all the activities necessary for:

1. Cash management,
2. Liquidity planning and control; and,
3. Corporate finance, including medium and long term financing and investing.

Successfully identifying, monitoring and mitigating risk is the cornerstone of effective treasury management, although the Council acknowledges that effective treasury management also supports the achievement of business and service objectives.

The Authority typically receives its income in cash (e.g. from taxes and grants) before it pays for its expenditure in cash (e.g. through payroll and invoices). It also holds reserves for future expenditure and collects local taxes on behalf of other local authorities and central government. These activities lead to a cash surplus which is invested in accordance with the CIPFA Code.

The balance of treasury investments is expected to fluctuate between £60m and £100m during the 2021/22 financial year. The contribution that these investments make to the objectives of the Authority is to support effective treasury management activities.

The Council does not intend to borrow any monies, except for short term cash flow purposes for revenue and capital commitments.

Investment Objective

The Council's objective when investing money is to comply with the principles stated in this strategy document, striking an appropriate balance between risk and return in line with the Council's risk appetite statement.

Counterparty limits

The Council may invest its surplus funds with any of the counterparties in table 4 below, subject to the cash limits (per counterparty) and time limits shown.

The Authority's revenue reserves available to cover investment losses are forecast to be £42.1m million on 31st March 2021. This is defined as usable reserves less the Council's capital receipts reserve in table 2.

The Authority's expected average investment balance in 21-22 from Table 2 is £57m. The lowest usable reserves figure is forecast to be £32.8m (31.3.2022)

The Counterparty and sector limits below are set such that no one default will incur a loss of either:

- 10% of the Council's expected average investment balance; or,
- 15% of the Council's available reserves as defined above

Both calculations are rounded to the nearest £0.5million for the purposes of setting this limit. The Council's investment with the CCLA property fund has a higher, separate limit. Where this counterparty limits in tables 4 and 5 fall between financial years, any new limit will only apply once existing investments as at 1 April reach the end of their present deposit period.

A group of entities under the same ownership will be treated as a single organisation for counterparty limit purposes.

In addition to the limits set on individual counterparties in Table 4 below, Table 5 sets limits on any group of pooled funds under the same management.

Table 4: Approved Investment Counterparties

Sector	Time limit	Counterparty limit	Sector limit	Notes
The UK Government	25 years	Unlimited	n/a	
Local authorities & other government entities	10 years	£5m	Unlimited	
Secured investments	10 years	£5m	Unlimited	1
Banks (unsecured)	13 months	£3m	Unlimited	1,2
Building societies (unsecured)	13 months	£3m	£5m	1
Money market funds	n/a	£5m or 0.5% of fund value	Unlimited	1 3
Strategic pooled funds (excluding LAPF)	n/a	£5m	£30m	5
Strategic pooled funds (CCLA - LAPF)	n/a	£10m	£10m	5
Real estate investment trusts	n/a	£2m	£4m	5
Other investments	2 years	£3m	£5m	1, 4

Notes:

1. *Investments are subject to credit rating floors and/ or other criteria set out 'Minimum credit ratings' below*
2. *The limits for the Council's operational bank account are determined separately and set out in the relevant section below*
3. *Individual limits will be 0.5% of fund value or £5m, whichever is the smaller*
4. *Service and commercial investments will be subject to individual, separate risk assessment and are considered separately in this strategy. They are not covered by the Treasury limits in table 4*
5. *No maximum investment period is set for pooled funds and REITs as they are intended to be for the long term. The limit on strategic pooled funds does not apply to Money Market Fund investments.*

The Council sets limits on the totals to be invested in any one single entity, group of entities, or investment type. These are set out in Table 5 and apply to all treasury investments.

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

Table 5: Additional investment limits

	Cash limit
Any group of pooled funds under the same management	£15m per manager
Negotiable instruments held in a broker's nominee account	£5m per broker (1)
Foreign countries	£5m per country

1. The limit for nominee accounts does not apply to investments in Money Market Funds and their nominee companies

Counterparties

Government

Loans to, and bonds and bills issued or guaranteed by, national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Government are deemed to be zero credit risk due to its ability to create additional currency and therefore may be made in unlimited amounts for up to 50 years

Secured investments

Investments secured on the borrower's assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments

Banks and building societies (unsecured)

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

Money market funds

Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the Authority will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

Strategic pooled funds

Bond, equity and property funds that offer enhanced returns over the longer term but are more volatile in the short term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. 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

Where investments in pooled funds or other financial assets have prices or values that can vary according to fund performance and other factors, the investment limits in table 4 will operate to regulate the initial purchase cost (total initial investment) only.

Real estate investment trusts (REIT)

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.

Operational bank accounts

The Authority may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £2.5m in total across all operational accounts.

Other investments

This category covers treasury investments not listed above, for example unsecured corporate bonds and company loans. Non-bank companies cannot be bailed-in but can become insolvent placing the Authority's investment at risk.

For corporate bonds, the limits referred to in table 4 will apply to the sum of bond principal (par value) and any premium or discount paid to acquire the bond in the secondary market. The limit will exclude the accrued interest element paid to secure a secondary bond as this is recoverable on maturity of the Bond.

Risk Assessment and Credit Ratings

Credit ratings are obtained and monitored by the Council's treasury advisors, who will notify changes in the ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

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

If in the case of a decision to recall or sell an investment at a cost which is over the approved virement limits, the Council's urgent action procedure in its Constitution would be invoked by officers.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn in a timely manner will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

Minimum credit rating

Treasury investments in the sectors marked *Note 1* in table 4 will only be made with entities whose lowest published long-term credit rating is no lower than A-. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

For entities without published credit ratings, investments may be made either (a) where external advice indicates the entity to be of similar credit quality; or (b) to a maximum of £1m per counterparty; or (c) are part of a diversified pool of investments e.g. a strategic investment in an external pooled fund.

Other Information on the Security of Investments

The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008, 2011 and 2020, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions, and advice from the Council's Treasury advisor. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or with other local authorities. This may will cause investment returns to fall but will protect the principal sum invested.

Business model for holding investments

The Council aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash-flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

2nd European Union Markets in Financial Investments Directive

The Authority has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Authority's treasury management activities, this is considered to be the most appropriate status.

UK exit from the European Union

If, following the UK's exit from the European Union liquidity needs to be repatriated from EU based money market funds, the Council expects to deposit this with the Government's Debt Management Office (DMO) or UK domiciled banks.

Any decision to repatriate funds will be made by the Council's section 151 officer following consultation with the Council's Treasury Advisor.

Negative interest rates

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

Responsible Investing

As a responsible investor, the Council is committed to considering environmental, social, and governance (ESG) issues, and has a particular interest in taking action against climate change and pursuing activities that have a positive social impact.

The overriding priorities of treasury management must remain security, liquidity, and yield in that order. However, once these priorities are met preference will be given to placing investments with banks or institutions who have demonstrated a significant interest is sustainability by being a signatory to the UN Environment Finance Initiative's (UNEFI) Principles for Responsible Banking/ Investment. This requirement will not extend to investments with the UK public sector.

Before a direct investment is made with an institution that is not a participant in the above initiative, approval will be sought from the section 151 or deputy section 151 officer setting out why no reasonable alternative at that particular time is available. This 'comply or explain' approach recognises that, whilst ESG is a desirable objective for treasury investing, it must be ranked behind security, liquidity and yield.

Where the Council does not have direct control over the individual investments, (for example, for investments in money market or external pooled funds), the Council will seek to understand and evaluate the Ethical, Social and Governance policies of money market and external pooled funds when considering making an initial investment. This evaluation will include a review of any reports prepared by prospective fund managers under the UK Stewardship Code issued by the Financial Reporting Council and of the institution's commitment to the UNEFI Principles for Responsible Investment.

Liquidity Management

The Council uses purpose-built cash flow forecasting software to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the 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. To ensure adequate liquidity is maintained, 'worst case' estimates of cash flows are used when considering the Council's medium term investment position.

Borrowing

The Council is currently debt-free and has no borrowing other than that which might occur as part of routine working capital management. Under the Council's current resource projections, there are no plans to borrow to finance new capital expenditure over the medium term but this remains an option if deemed to be prudent.

If it considers it necessary to borrow money, the Council's chief objective will be to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

Short term internal borrowing (for schemes that pay back within the 5 year time frame of the capital programme) can be accommodated without incurring external interest charges, provided the resulting savings are recycled into reserves.

Longer term pay back periods will have to accommodate both the external interest and a minimum revenue provision (MRP) in accordance with the Council's MRP policy.

Borrowing would add pressure on the revenue budget as MRP and interest would become payable. The capacity to make these payments would need to be identified in advance, namely the further efficiency savings generated by the investment in the assets.

Borrowing Sources

The Council may need to borrow money in the short term to cover unexpected cash flow shortages from the following approved sources:

- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
- Any institution approved for investments
- Any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds (except the West Sussex Pension Fund)
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues
- Capital market bond investors, including via community municipal bonds
- Any other UK public sector body

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
- Sale and leaseback

The Council will, where possible, take advantage of the 20 basis points (0.20%) reduction in borrowing costs available from the Public Works Loan Board (PWLB) to those authorities who provide information on their plans for long-term borrowing and associated capital spending.

Operational Boundary for External Debt

The operational boundary is based on the Authority's estimate of most likely (i.e. prudent but not worst case) scenario for external debt. It links directly to the Authority's estimates of capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring. If these limits are breached in-year, this will trigger an exception report explaining the circumstances of the breach to Cabinet.

The limit for 'other long term liabilities' includes the Council's best estimate of finance lease liabilities that may be recognised following adoption of IFRS16 on 1 April 2022.

Table 6: Operational boundary for external debt

Operational Boundary	2020/21 £m	2021/22 £m	2022/23 £m	2023/24 £m	2024/25 £m
Borrowing	10	10	10	10	10
Other long-term liabilities	2	2	3	3	3
Total Debt	12	12	13	13	13

Authorised Limit for External Debt

The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Authority can legally owe.

The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Table 7: Authorised limit for external debt

Authorised Limit	2020/21 £m	2021/22 £m	2022/23 £m	2023/24 £m	2024/25 £m
Borrowing	20	20	20	20	20
Other long-term liabilities	5	5	5	5	5
Total Debt	25	25	25	25	25

Non-Treasury Investments

The Authority may purchase assets for investment or service delivery purposes and may also make loans and provide guarantees for service and other purposes.

The overall amount that can be committed to investments of this type will be limited by adherence to the Council's overall key financial principles approved for the relevant financial period.

Commercial Investments

The Council may invest in commercial opportunities with the intention of making a profit that will be spent on local public services.

To provide specific guidance on the enhanced scrutiny and assessment of risk required, the Council has approved an investment opportunities protocol. All decisions to make commercial investments will comply with this protocol.

The Council's investment opportunities protocol requires that:

- Acquisitions should be within the District Council's area, or sufficiently close by to be easily managed
- Priority is given to acquisitions which achieve a community or economic benefit and strengthen the local economy
- The acquisition provides an acceptable rate of return for the additional risk taken on, and will not increase the Council's ongoing revenue costs in the longer term

Where necessary, specialist advisers are employed to provide advice and act for the Council for specific transactions.

Security

The Authority will assess the risk of loss before entering into and whilst holding commercial investments by undertaking due diligence in accordance with the Council's protocol on investment opportunities.

In accordance with the Guidance, the Council assesses security for investment properties as maintaining the fair value of the investment property portfolio above the purchase price paid.

A fair value assessment for all commercial investments held by the Council has been undertaken within the last 12 months. Of the six properties owned by the Council for investment purposes, their total market value was assessed at £13.623m on 31 March 2020, significantly above the total initial purchase cost.

Within this, two of the properties had a fair value that was below the initial purchase cost. The estimated unrealised loss for one is £24,000, equivalent to less than 2% of its fair value. For the final property, the unrealised loss is £225,000 or 6.5% of the purchase cost.

Whilst it is possible that the fair value of these investment properties would not provide security against loss this would only occur if the Council were forced to sell these properties. It should also be noted that the Council has received significant rental income since these properties were first acquired and any perceived fall in value will be mitigated by the income generated to date. Property is a long term asset and the Council only invests once it is satisfied that the asset can be held over a period longer than 5 years and does not borrow to fund the purchase

The Council is satisfied that the true market value of these properties provides adequate security for the investment of public funds.

Liquidity

Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice, and can take a considerable period to sell in certain market conditions such as those that currently exist. Because of this, the Council only invests in non-treasury assets where strategic forecasts indicate the asset can be held over an appropriate timeframe.

The Council does not borrow to finance non-treasury investments and therefore has no need to generate cash to repay borrowing. It recognises that unforeseen events can occur and maintains both a short term and medium term (five year) cashflow forecast which it expects will give the Council sufficient notice of any need to liquidate any non-treasury investments.

The Council also holds significant cash and short term investment balances at any one time.

Service investments

The Council may choose to make loans or provide guarantees to local enterprises, local charities and other entities as part of a wider strategy for local economic growth and to support its Corporate Priorities.

The Council manages the risk of any loan and guarantee by ensuring that total exposure is proportionate to the Council's revenues and revenue reserves to ensure that there is adequate cover in the event of a default or call on the guarantee.

Where service loans are made, or loan facilities agreed, the total exposure will be limited to the funding approved for this purpose in advance by the Council's Cabinet.

The Authority has guaranteed the possible pension liabilities associated with TUPE and other transfers of staff from public to private sector where staff have remained within the Local Government Pension Scheme (LGPS). The provision of this guarantee was a requirement of the LGPS administering body and the risk is mitigated by a bond which is intended to cover all but the most extreme likely financial exposure.

The decision to provide any loan or guarantee will be determined in accordance with the governance arrangements established by the Council's Constitution.

Non-Specified Investments

From 2018, the additional monitoring requirements for non-specified investments are only applicable to non-treasury investments per paragraph 21 of the Guidance. The Council has a number of long term treasury investments that have previously been classified as non-specified investments but are now considered to be outside the scope of this requirement.

The Guidance defines non-specified investments as any non-treasury investment that does not meet the following criteria:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
    - the UK Government,
    - a UK local authority, parish council or community council, or
    - a body or investment scheme of "high credit quality".

The Council defines "high credit quality" organisations and securities 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+.

If the need arises to make a non-specified investment, this will comply with the investment upper limits both individually and cumulatively specified in this investment strategy in table 8, below.

Table 8: Non-Specified Investment Limits

Limits (excluding Treasury Investments)	Cash limit (£m)
Total medium and long-term investments	20
Total investments without credit ratings or rated below A- (except UK Government and local authorities)	20
Total non-specified investments	30

For clarity, these limits do NOT apply to Treasury Investments.

Risk exposure indicators
Treasury Management Indicators

The Council will use the voluntary measures set out below to measure its exposure to risk

Security and credit risk

Table 9: Security risk indicators

Measure	Target
Average Credit Score (time-weighted)	Less than the average of other District Councils (AAA=1, D=24)
Average Credit Rating (time weighted)	Maintain below the time weighted average of other District Councils
Proportion Exposed to Bail-in (%)	Less than the average of other District Councils
Fair Value of external funds	Overall positive fair value (market value less purchase consideration) over any rolling three year period

Liquidity

Officers will continue to manage the Council's treasury management investments ensuring that sufficient cash is available to accommodate known payments. In the unlikely circumstance that a large unexpected cash payment is required and the Council does not have sufficient liquidity immediately available, the Council will use its facility to borrow temporarily for cash management purposes.

Table 10: Liquidity risk indicators

Measure	Target
Proportion of investments available within 7 days (%)	Compare and explain against District Council average
Proportion available within 100 days (%)	Compare and explain against District Council average

Average days to maturity	Compare and explain against District Council average

Maturity Structure of Borrowing

As the Council is debt free it currently holds no fixed long term borrowing for which a maturity profile exists.

Principal Sums Invested for Periods Longer than 364 days

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 in response to adverse economic or market conditions or credit rating downgrades.

Table 11 sets out the upper limit for each forward financial year period for the maturing of investments for periods longer than 364 days up to their final maturities beyond the end of the financial period.

Table 11: Limits on investment periods (£m)

	2021/22	2022/23	2023/24
Limit on principal invested beyond year end	60	60	60

Market and economic risk

The Council is exposed to risk in terms of its exposure to interest rate movements on its investments, although the effects on the Council of such movements are not considered to be material as the majority of sums invested are at fixed interest rates for short periods. Of much more significance is the risk of property price movements and interest rate risk relating to the Council's investment in external pooled funds.

To measure the significance of these risks, the Council calculates the effect of a 1% change in interest rates and a 5% change in property prices on the Fair Value of the external funds when preparing its Statement of Accounts.

It will compare these figures against the individual counterparty limits set out above in table 4, which are seen as representative of a measure of the maximum amount that the council is willing to risk.

A Treasury exception will be reported to Cabinet where the interest rate risk exceeds 50% the Council's individual Counterparty limit (equivalent to £2.5m).

For comparison, as at 31 March 2020 the position was as follows.

Table 12: Exposure to economic risk (£m)

	1% change in Interest rates	5% change in equity prices	5% change in property prices
Pooled funds (£34m)	0.41	0.29	0.49

Non- Treasury Investments Indicators

The Council will use the voluntary measures set out below to measure its exposure to risk associated with non-treasury investments

Table 13: Non-Treasury investment risk indicators

Measure	Risk/ Measure
Commercial income to net service expenditure (NSE)	This indicator measures the Council's dependence on income from its commercial investments to deliver core services.
Net operating surplus	This indicator measures the contribution received from the investment portfolio at a net level (income less costs) over time.
Vacancy levels and tenant exposure	Monitoring vacancy levels (voids) to ensure the property portfolio is being managed productively.
Exposure to credit default events for loans made	This will measure the Council's exposure to loss through default for non-treasury loans made to third parties.
Market Value of commercial properties	This indicator will track the Council's ability to recover its investment in any commercial investment should the need so arise

Other Items

There are a number of additional items that the Council is obliged by CIPFA or MHCLG to include in its Treasury Management Strategy.

Policy on Use of Financial Derivatives

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.

Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the *Localism Act 2011* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

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.

Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria assessed using the appropriate credit rating for derivative exposures. An allowance for credit risk calculated using the methodology in the Treasury Management Practices document will count against the counterparty credit limit and the relevant foreign country limit.

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

Investment of Money Borrowed in Advance of Need

Although not envisaged at this stage, the Council may, exceptionally, borrow in advance of need, where this is expected to provide the best long term value for money. Any borrowing in advance of need will comply with the MHCLG Guidance.

Since amounts borrowed will be invested until spent, the Council is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Council's overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit as set out in table 7. The maximum period between borrowing and expenditure is expected to be two years, although the Council is not required to link particular loans with particular items of expenditure.

Investment Training

To address the training need of members, training will be provided to members of both Cabinet and the Corporate Governance and Audit Committee in advance of them considering the forthcoming year's strategies.

Member and officer training is an essential requirement in terms of understanding roles, responsibilities and keeping up to date with changes and in order to comply with the CIPFA Treasury Management Code of Practice.

The training needs of the officers involved on treasury management are identified through the annual performance and development appraisal process, and additionally when the responsibilities of individual members of staff change. Staff attend relevant training courses, seminars and conferences.

Officers regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA. Relevant officers are also encouraged to study professional qualifications from CIPFA, the Association of Corporate Treasurers and other appropriate organisations.

Staff involved in non-Treasury investments and commercial property purchases attend training, Continuing Professional Development and networking events and generally follow the market to keep abreast of current trends and values. The Team is represented at meetings of ACES (Association of Chief Estates Surveyors and Property Managers in the public Sector) which provides a forum for networking and sharing property information.

Investment Advisers

The Council currently contracts with Arlingclose Limited as its treasury management adviser and receives specific advice on investment, debt and capital finance issues. However, responsibility for final decision making remains with the Council and its officers. The contract runs until 30 June 2022.

The quality of this service is controlled and monitored against the contract by the Financial Services Divisional Manager.

Property Investments are undertaken in accordance with the Investment Opportunities Land and Property protocol. Investment advisors are appointed depending on staffing capacity or risk basis, where specialist advice may be required.

Reporting

Treasury investments

The Council/Cabinet will receive as a minimum:

- An annual report on the strategy and plan to be pursued in the coming year and on the need to review the requirements for changes to be made to the Treasury Management Strategy Statement.
- A mid-year review
- An annual report on the performance of the treasury management function, on the effects of decisions taken and the transactions executed in the past year, by 30th September in the next financial year, including any circumstances of non-compliance with the organisation's treasury management policy statement and Treasury Management Practices.

The body responsible for scrutiny of treasury management policies and practices is the Corporate Governance and Audit Committee. Monitoring reports on Treasury performance and compliance with this strategy will be prepared and presented to this Committee as a minimum for the half year to September and the full year to March.

The Leader of the Council, the Cabinet Member for Corporate Services and the members of the Corporate Governance & Audit Committee receive weekly monitoring reports of the investments held. Corporate Governance & Audit Committee will receive half yearly monitoring reports.

Non-Treasury Investments

For commercial investments, the Council's Commercial Board and Cabinet will receive reports on performance and risk each year. Approval for investments and reporting on them will be in line with the Council's protocol on investment opportunities.

For service investments, the reporting process will comply with the Council's Constitution on a case by case basis.

Other Options Considered

The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Director of Corporate Services believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Table 14: Alternatives considered

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller

Appendix 2A – Economic and interest rate forecast – January 2021

This summary has been provided by Arlingclose Ltd

Economic background

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

The Bank of England (BoE) maintained Bank Rate at 0.10% in December 2020 and Quantitative Easing programme at £895 billion having extended it by £150 billion in the previous month. The Monetary Policy Committee (MPC) voted unanimously for both, but no mention was made of the potential future use of negative interest rates. In the November Monetary Policy Report (MPR) 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. By the time of the December MPC announcement, a COVID-19 vaccine was approved for use, which the Bank noted would reduce some of the downside risks to the economic outlook outlined in the November MPR.

UK Consumer Price Inflation (CPI) for November 2020 registered 0.3% year on year, down from 0.7% in the previous month. Core inflation, which excludes the more volatile components, fell to 1.1% from 1.5%. The most recent labour market data for the three months to October 2020 showed the unemployment rate rose to 4.9% while the employment rate fell to 75.2%. Both measures are expected to deteriorate further due to the ongoing impact of coronavirus on the jobs market, particularly when the various government job retention schemes start to be unwound in 2021, with the BoE forecasting unemployment will peak at 7.75% in Q2 2021. In October, the headline 3-month average annual growth rate for wages were 2.7% for total pay and 2.8% for regular pay. In real terms, after adjusting for inflation, total pay growth was up by 1.9% while regular pay was up 2.1%.

GDP growth rebounded by 16.0% in Q3 2020 having fallen by -18.8% in the second quarter, with the annual rate rising to -8.6% from -20.8%. All sectors rose quarter-on-quarter, with dramatic gains in construction (41.2%), followed by services and production (both 14.7%). Monthly GDP estimates have shown the economic recovery slowing and remains well below its pre-pandemic peak. Looking ahead, the BoE's November MPR 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.

GDP growth in the euro zone rebounded by 12.7% in Q3 2020 after contracting by -3.7% and -11.8% in the first and second quarters, respectively. Headline inflation, however, remains extremely weak, registering -0.3% year-on-year in November, the fourth successive month of deflation. Core inflation registered 0.2% y/y, well below the European Central Bank's (ECB) target of 'below, but close to 2%'. The ECB is expected to continue holding its main interest rate of 0% and deposit facility rate of -0.5% for some time but expanded its monetary stimulus in December 2020, increasing the size of its asset purchase scheme to €1.85 trillion and extended it until March 2022.

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

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

Credit outlook: After spiking in late March as coronavirus became a global pandemic and then rising again in October/November, 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 and 2021 may be significantly lower than in previous years.

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.

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. The medium-term global economic outlook remains weak. Second waves of Covid cases have prompted more restrictive measures and further lockdowns in Europe and the UK. This ebb and flow of restrictions on normal activity will continue for the foreseeable future, at least until an effective vaccine is produced and importantly, distributed.

The global central bank and government responses have been significant and are in many cases on-going, maintaining more stable financial, economic and social conditions than otherwise. Although these measures supported a sizeable economic recovery in Q3, the imposition of a second national lockdown in England during November will set growth back and likely lead to a fall in GDP in Q4.

Signs of a slowing economic recovery were already evident in UK monthly GDP and PMI data, even before the latest restrictions. Despite some extension to fiscal support measures, unemployment is expected to rise when these eventually come to an end in mid-2021.

This situation will result in central banks maintaining low interest rates for the medium term. In the UK, Brexit is a further complication. Bank Rate is therefore likely to remain at low levels for a very long time, with a distinct possibility of being cut to zero. Money markets continue to price in a chance of negative Bank Rate.

Longer-term yields will also remain depressed, anchored by low central bank policy rates, expectations for potentially even lower rates and insipid inflation expectations. There is a chance yields may follow a slightly different path in the medium term, depending on investor perceptions of growth and inflation, the development of a vaccine or if the UK leaves the EU without a deal

Interest rate forecast

Underlying assumptions:

- The medium-term global economic outlook has improved with the distribution of vaccines, but the recent upsurge in coronavirus cases has worsened economic prospects over the short term.
- Restrictive measures and further lockdowns are likely to continue in the UK and Europe until the majority of the population is vaccinated by the second half of 2021. The recovery period will be strong thereafter, but potentially longer than previously envisaged.
- Signs of a slowing UK economic recovery were already evident in UK monthly GDP and PMI data, even before the second lockdown and Tier 4 restrictions. Employment is falling despite an extension to support packages.
- The need to support economic recoveries and use up spare capacity will result in central banks maintaining low interest rates for the medium term.
- Brexit will weigh on UK activity. The combined effect of Brexit and the after-effects of the pandemic will dampen growth relative to peers, maintain spare capacity and limit domestically generated inflation. The Bank of England will therefore maintain loose monetary conditions for the foreseeable future.
- Longer-term yields will also remain depressed, anchored by low central bank policy rates, expectations for potentially even lower rates and insipid longer-term inflation expectations. There is a chance yields may follow a slightly different path in the medium term, depending on investor perceptions of growth and inflation, or the deployment of vaccines.

Forecast:

- Arlingclose expects Bank Rate to remain at the current 0.10% level.
- Our central case for Bank Rate is no change, but further cuts to zero, or perhaps even into negative territory, cannot be completely ruled out, especially with likely emergency action in response to a no-deal Brexit.
- Gilt yields will remain low in the medium term. Shorter term gilt yields are currently negative and will remain around zero or below until either the Bank expressly rules out negative Bank Rate or growth/inflation prospects improve.
- Downside risks remain, and indeed appear heightened, in the near term, as the government reacts to the escalation in infection rates and the Brexit transition period ends.

	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
Official Bank Rate													
Upside risk	0.00	0.00	0.15	0.15	0.15	0.15	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Downside risk	0.30	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50