Appendix 2 - Treasury Management and investment Strategy

Contents

Treasury Management Policy Statement, Treasury Management Strategy Statement and Annual Investment Strategy for 2022/23

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 DLUHC 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 Authority is currently debt free and its capital expenditure plans do not currently imply any need to borrow over the forecast period. This strategy has been prepared assuming that it will not need to borrow any monies, except for short term cash flow purposes for revenue and capital commitments.

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).

Treasury Management Strategy

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 DLUHC 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 Department for Levelling Up, Housing & Communities (DLUHC) 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.

At 15 November 2021 the Council held £125.9m of investments as set out in table 1.

Table 1: Investment Portfolio Position

Investments	£m	Return %*
Short term Investments (cash, call accounts, deposits)	38.0	0.05
Money Market Funds	53.9	0.05

Total Liquid Investments	91.9	0.05
External Pooled funds	34.0	4.35
Total Treasury Financial Investments	125.9	1.31

returns are based on income only as at 30 September.

For the purposes of the limits in this strategy, the position in table 1 is not representative of the long term stable investment position of the Council. As residual balances on the various COVID-19 national support schemes are settled, officers expect cash balances to fall over the next twelve months by around £30m.

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. CIPFA suggests calculating a Liability Benchmark to demonstrate this and this is shown in Table 2 below. The Liability Benchmark is effectively the Net Borrowing Requirement of a local authority plus a liquidity allowance. In its simplest form, it is calculated by deducting the amount of investable resources available on the balance sheet (reserves, cash flow balances) from the amount of outstanding external debt and then adding the minimum level of investments required to manage day-to-day cash flow.

As the Council's net Treasury position is debt free across the entire forecast period, the Council's liability benchmark (and CFR) is also negative across the forecast period, indicating that there is no present need to borrow given the Council's current resources and capital intentions.

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Table 2: Balance sheet forecast to 31 March 2026 (£m)

	2021 Actual	2022	2023	2024	2025	2026
Capital Financing requirement	-1	0	0	0	0	0
Less: Other debt liabilities	0	0	0	0	0	0
Less: Balance sheet resources						
• Usable Reserves	-73	-64	-52	-52	-51	-52
• Capital receipts reserve	-2	-3	-6	-7	-10	-11
• Working capital	-3	-4	-4	-4	-4	-4
CIL	-11	-7	-4	-4	0	0
Treasury Investments	-90	-78	-66	-67	-65	-67
Plus: Liquidity allowance	10	10	10	10	10	10
Liability Benchmark	-80	-68	-56	-57	-55	-56

The above figures are based on resource projections and include assumptions about timing of transactions that may differ from actual delivery. Other debt liabilities may increase slightly once an assessment is made of finance lease liabilities in advance of the implementation of IFRS16 for the 2022/23 financial year.

The CIL projections are based on the Council's infrastructure business plan as at September 2021.

The Liquidity allowance is set at £10m and is the minimum level of funds invested to maintain professional investor status under the relevant financial regulations.

The Council's operational boundary and authorised debt ceilings are set out in tables 5 and 6 (page 15) 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 2023.

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.

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 £78m and £66m during the 2022/23 financial year (table 2, above). 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 3 below, subject to the cash limits (per counterparty) and time limits shown.

The Authority's lowest revenue reserves available to cover investment losses are forecast to be £59 million on 31st March 2023 (usable reserves, less capital receipts plus CIL and working capital).

The Authority's expected average investment balance in 2022/23 from Table 2 is £72m.

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

Given the forecasts above, the Council has set the general counterparty investment limit for 2022/23 at £6m. This is lower than the maximum available limit using the above methodology but is considered prudent given the forecast investment balance at 31 March 2023.

The Council's investment with the CCLA property fund has a higher, separate limit. Where this counterparty limits in tables 3 and 4 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. For external pooled funds, the limit applied will be that in force on the date of the investment. Should counterparty limits fall after this date, a balanced view will be taken by the s.151 officer as to if and when the investment above the new limit will be redeemed.

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 3 below, table 4 sets limits on any group of pooled funds under the same management.

Table 3: Approved Investment Counterparties

Sector	**Time limit**	**Counterparty limit**	**Sector limit**	**Notes**
The UK Government	50 years	Unlimited	n/a	
Local authorities & other government entities	10 years	£6m	Unlimited	
Secured investments	10 years	£6m	Unlimited	1
Banks (unsecured)	13 months	£3m	Unlimited	1,2
Building societies (unsecured)	13 months	£3m	£6m	1
Money market funds	n/a	£6m or 0.5% of fund value	Unlimited	1 3
Strategic pooled funds (excluding LAPF)	n/a	£6m	£50m	5
Strategic pooled funds (CCLA - LAPF)	n/a	£15m	£15m	5
Real estate investment trusts	n/a	£2m	£4m	5
Other investments	2 years	£3m	£6m	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 £6m, 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 3*

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 4 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 4: Additional investment limits

	Cash limit
Any group of pooled funds under the same management	£20m per manager
Negotiable instruments held in a broker's nominee account	£6m per broker (1)
Foreign countries	£6m 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 3 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 3 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 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.

Negative interest rates

In the event of negative interest rates, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

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.

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, to comply with Statutory Guidance 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.

Borrowing

The Council is currently debt-free and has no borrowing other than that which might occur as part of routine working capital management. 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 any reduction in borrowing costs available from the Public Works Loan Board (PWLB) for authorities who provide information on their plans for long-term borrowing and associated capital spending.

PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Authority intends to avoid this activity in order to retain its potential access to PWLB loans.

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 5: Operational boundary for external debt

Operational Boundary	2021/22 £m	2022/23 £m	2023/24 £m	2024/25 £m	2025/26 £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 6: Authorised limit for external debt

Authorised Limit	2021/22 £m	2022/23 £m	2023/24 £m	2024/25 £m	2025/26 £m
Borrowing	20	20	20	20	20
Other long-term liabilities	5	5	5	5	5
Total Debt	25	25	25	25	25

Treasury Management Indicators

Security and credit risk

Table 7: Security risk indicators

Measure	Target
Portfolio Average Credit Rating (time weighted)	Minimum “A” rating
Proportion Exposed to Bail-in (%)	Less than the average of other District Councils
Fair Value of external funds	• Overall Fair value of external funds Less • Nominal value of funds invested Plus • reserves set aside to reduce risk Is greater than zero.

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 8: 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

Maturity Structure of Borrowing

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

Long term treasury management investments

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 9 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 9: Limits on investment periods (£m)

	2022/23	2023/24	2024/25
Limit on principal invested beyond year end	80	80	80

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 economic risk exceeds 50% the Council's individual Counterparty limit (equivalent to £3m).

This indicator is calculated and reported annually as part of the Council's statement of accounts. Outside of this, an exception will be reported where it is clear there are significant changes to the risk, mainly as a result of changes to the composition of the investment portfolio. The position as at 31 March 2021 is set out in table 10.

Table 10: Exposure to economic risk (£m)

	1% change in Interest rates	5% change in equity prices	5% change in property prices	TOTAL
CCLA Property Fund	-	-	(0.46)	
Pooled Funds	(0.49)	(0.35)	(0.04)	
Money market Funds	(0.01)	-	-	
TOTAL	(0.50)	(0.35)	(0.50)	1.35

Other Items

There are a number of additional items that the Council is obliged by CIPFA or DLUHC 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.

Markets in Financial Instruments 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, the Director of Corporate Services believes this to be the most appropriate status.

Investment of Money Borrowed in Advance of Need

Although not envisaged at this stage, the Council may, exceptionally, borrow to pre-fund future borrowing requirements, where this is expected to provide the best long term value for money. Any borrowing in advance of need must comply with DLUHC 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 6. 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.

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 and an exercise to appoint a suitably qualified advisor for periods after this will be complete by this date.

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

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 monthly monitoring reports of the investments held.

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 11: 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

Investment Strategy 2022/23

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: Property

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 will apply the policy and processes established by its investment opportunities protocol in deciding whether to make a commercial investment or not. This protocol provides specific guidance on the enhanced scrutiny required, including:

- Acquisitions or original build 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; and,
- Where necessary, Specialist advisers are to be employed to provide advice and act for the Council.

To mitigate the impact of uncertainty the Council's investment objective is to provide a spread of investments with varying degrees of risk, given that it is recognised that the inherent risk is generally reflected either in the price or the rate of return (i.e. the higher the risk, the higher the return and vice versa).

The consideration of any investment shall include a risk assessment that measures as objectively as possible the likelihood and severity of the impact should the risks identified be realised. This can provide comparison against the potential benefits (financial and

otherwise) for which the investment is being considered in the first place, and form part of the decision making process.

Among the risk factors to be considered are:

- Acquisition Risk – the Council may incur transaction costs without guarantee of securing the investment (e.g. the Council may be one of several bidders, or required to pay a premium);
- Price & Cost Risk – Once acquired the price or cost of the investment may fluctuate over time, which may in itself reflect variations in demand and supply;
- Economic / Political Risk – the ability to retain or dispose of an investment may be inhibited by the economic and political environment at any point in time; and,
- Market Risk – the Council's ability to influence the price, financial return or other benefits pertaining to the investment may be limited by the market in which it operates

The Council's current commercial investment portfolio value is disclosed in the Council's statement of accounts and set out below using the latest valuation information available (31 March 2021). It is not possible to prepare a formal expectation of value in advance of the actual valuation exercise undertaken for to provide information for the Council's annual accounts. Where any valuations are felt to be unrealistic or may have changed materially, this is noted in the table below.

Table 12: Property held for investment purposes in £ millions

Property reference	**Actual**	**31.3.2021 actual**	
	Purchase cost	**Gains or (losses)**	**Value in accounts**
IP001	0.87	0.09	0.96
IP002	0.87	0.16	1.03
IP003	2.51	2.98	5.49
IP004	1.61	(0.37)	1.24
IP005	1.63	0.03	1.66
IP006	3.64	(0.38)	3.26
LD264	0.06	0.0	0.06
TOTAL	**11.19**	**2.51**	**13.70**

Security

The Council defines security for investment properties as maintaining the fair value of the investment property portfolio above the purchase price paid.

The Council recognises that any form of investment is not without risk since the value of any investment may rise or fall over time, especially where it is to be retained over many years.

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 £13.7m on 31 March 2021, significantly above the total initial purchase cost.

Within this, two of the properties had a fair value that was below the initial 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 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. Should the 2021/22 year end accounts preparation and audit process value these any properties materially below their purchase cost, then the Director of Corporate Governance will assess if the risk is such that a report together with an updated investment strategy is necessary detailing the impact of the loss on the security of investments and any possible revenue consequences arising therefrom.

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: Loans

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 risk of liabilities crystallising and requiring payment is monitored by the service department and financial services.

The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to limit this risk, and ensure that total exposure to service loans remains proportionate to the size of the Authority and this will be determined by the Director of Corporate Services as necessary on a case by case basis.

The Council only includes debt taken on formal loan terms in the figures below. It excludes monies owed as part of its normal operational activities, for example trade debtors, monies owed for other operational purposes, such as Council Tax and Business rates arrears, and monies owned under leasing agreements.

Table 13: Loans for service purposes in £ millions

Category of borrower	**31.3.2021 actual**		
	Balance owing	**Loss allowance**	**Net figure in accounts**
Service suppliers and contracts	0.00	0.00	0.00
Local Businesses	0.00	0.00	0.00
Housing (Rent deposits)	0.05	(0.05)	0.00
Local residents (Housing Renewal Loans)	0.22	0.00	0.22
Employees (Car loans)	0.21	0.00	0.21
Other organisations	0.00	0.00	0.00
TOTAL	**0.48**	**(0.05)**	**0.43**

Accounting standards require the Authority to set aside loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Authority's statement of

accounts are shown net of this loss allowance. However, the Authority makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments.

Loan Commitments and Guarantees

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.

Proportionality

Income from non-Treasury investments is expected to remain below 10% of the Council's net cost of services.

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 14: Proportionality of Investments (£m)

	2020/21 Actual	**2021/22 Forecast**	**2022/23 Budget**
Investment income (£m)	0.85	0.90	0.90
Net Cost of Services (£m)	20.49	31.18	21.00
Proportion	4.3%	2.8%	4.3%

Investment income is net of direct costs but before changes in fair value (ie; net operating surplus). Net Cost of Services is as presented in the Council's annual financial statements.

The budget net cost of services and forecast commercial income levels are not available at the date of writing this strategy. The net cost of services for 2021/22 included significant capital financing charges within the planning policy budget so an estimate of £21m has been used as a proxy for 2022/23. This is felt to be a reasonable estimate given the present budgetary intentions of the Council.

The Council does not project the net cost of services beyond the upcoming budget year and further work will be undertaken in 2022/23 on the methodology for this indicator to allow longer term projections should they be required by the CIPFA Code.

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 DLUHC guidance, the Council may be asked to approve a revised strategy should the assumptions on which this report is based change significantly.

Non-Specified Investments

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 does not currently hold any non-specified investments.

If the need arises to make a non-specified investment, the investment will comply with limits both individually and cumulatively in table 15, below.

Table 15: 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-	20
Total non-specified investments	30

For clarity, in accordance with paragraph 21 of the DLUHC Guidance these limits do NOT apply to Treasury Investments (which include external investments in pooled funds)

Investment Indicators

The Authority has set the following quantitative indicators to allow elected members and the public to assess the Authority's total risk exposure as a result of its investment decisions.

Investment Risk

The first indicator shows the Authority's total exposure to potential investment losses. This includes amounts the Authority is contractually committed to lend but have yet to be drawn down and guarantees the Authority has issued over third party loans.

Table 16: Total investment exposure in £millions

Total investment exposure	31.03.2021 Actual (£m)	31.03.2022 Forecast (£m)	31.03.2023 Forecast (£m)
Treasury management investments	90.0	78.0	66.0
Service investments: Loans	0.48	-	-
Commercial investments: Property	13.70	-	-

It is not possible to forecast the market value of the Council's Treasury Management investments at a future date. The value will vary according to external factors including interest rates, economic activity levels and the value of equities, bonds and property.

The Council does not prepare a forecast for the fair values of service of commercial investments. Commercial Property values are prepared to inform the council's statement of accounts and are not available at the time of preparing this strategy.

Further work will be undertaken in 2022/23 on the methodology for the above indicators to allow longer term projections should they be required by the CIPFA Code.

Government guidance is that these indicators should include how investments are funded. Since the Authority is debt free, all the above investments have been funded from internally generated cash resources and reserves.

Rate of return received

This indicator shows the investment income received less the associated costs, including the cost of borrowing where appropriate, as a proportion of the sum initially invested. Note that due to the complex local government accounting framework, not all recorded gains and losses affect the revenue account in the year they are incurred.

Table 17: Investment rate of return

	31.03.2021 Actual %	31.03.2022 Forecast	31.03.2023 Forecast
Treasury management: • Internal Investments • External pooled Funds	 0.10 4.1	 0.30 4.1	 1.00 4.1
Service investments: Loans	n/a	n/a	n/a
Commercial investments: Property	6.2	6.5	6.5

Income estimates from table 14 have been used to project the rate of return for commercial investments based on a stable market value as at 31 March 2021 (table 16). No rate of return indicator is shown for service investments as they are not made to achieve a return on the investment but rather to support corporate aims and objectives.

Voluntary Indicators

In addition to the indicators prescribed above, the Council will use the voluntary measures set out below to measure its exposure to risk associated with non-treasury investments

Table 18: Non-Treasury investment risk indicators

Measure	Risk/ Measure	2020/21 Actual	2021/22 Forecast	2022/23 Forecast
Vacancy levels and tenant exposure	Monitoring vacancy levels (voids) to ensure the property portfolio is being managed productively.	16.33%	10%	10%
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.	Nil	Nil	Nil

Capacity, Skills and Culture

Both the Divisional Manager for Property & Growth and service manager are chartered surveyor and registered valuers. The Council's Investment protocol sets out the necessary acquisition procedure, including due diligence and requires the use of external advisors where necessary. This is supported by the Council's Constitution which also sets out process for considering/agreeing to any acquisitions

Reporting

For commercial investments, the Council's Corporate Governance and Audit Committee will receive reports on performance and risk each year in line with the requirement of DLUHC and CIPFA Guidance. For service investments, the reporting process will comply with the Council's Constitution on a case by case basis as determined by the relevant Service Director.

This summary has been provided by Arlingclose Ltd

Economic background

Underlying assumptions:

- The global economy continues to recover from the pandemic but has entered a more challenging phase. The resurgence of demand has led to the expected rise in inflationary pressure, but disrupted factors of supply are amplifying the effects, increasing the likelihood of lower growth rates ahead. This is particularly apparent in the UK due to the impact of Brexit
- While Q2 UK GDP expanded more quickly than initially thought, the 'pingdemic' and more latterly supply disruption will leave Q3 GDP broadly stagnant. The outlook also appears weaker. Household spending, the driver of the recovery to date, is under pressure from a combination of retail energy price rises, the end of government support programmes and soon, tax rises. Government spending, the other driver of recovery, will slow considerably as the economy is taken off life support
- Inflation rose to 3.2% in August. A combination of factors will drive this to over 4% in the near term. While the transitory factors affecting inflation, including the low base effect of 2020, are expected to unwind over time, the MPC has recently communicated fears that these transitory factors will feed longer-term inflation expectations that require tighter monetary policy to control. This has driven interest rate expectations substantially higher
- The supply imbalances are apparent in the labour market. While wage growth is currently elevated due to compositional and base factors, stories abound of higher wages for certain sectors, driving inflation expectations. It is uncertain whether a broad-based increased in wages is possible given the pressures on businesses.
- Government bond yields increased sharply following the September FOMC and MPC minutes, in which both central banks communicated a lower tolerance for higher inflation than previously thought. The MPC in particular has doubled-down on these signals in spite of softer economic data. Bond investors expect higher near-term interest rates but are also clearly uncertain about central bank policy.
- The MPC appears to be playing both sides, but has made clear its intentions to tighten policy, possibly driven by a desire to move away from emergency levels. While the economic outlook will be challenging, the signals from policymakers suggest Bank Rate will rise unless data indicates a more severe slowdown.

Forecast:

- Arlingclose expects Bank Rate to rise in Q2 2022. We believe this is driven as much by the Bank's desire to move from emergency levels as by fears of inflationary pressure.
- Investors have priced in multiple rises in Bank Rate to 1% by 2024. While we believe Bank Rate will rise, it is by a lesser extent than expected by markets
- Gilt yields have risen sharply as investors factor in higher interest rate and inflation expectations. From here, we believe that gilt yields will be broadly steady, before falling as inflation decreases and market expectations fall into line with our forecast
- The risk around our forecasts for Bank Rate is to the upside over the next few months, shifting to the downside in the medium term. The risks around the gilt yield forecasts are initially broadly balanced, shifting to the downside later

	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Official Bank Rate													
Upside risk	0.15	0.15	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Case	0.10	0.10	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk	0.00	0.00	-0.15	-0.15	-0.15	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40
3-month money market ra													
Upside risk	0.10	0.15	0.20	0.20	0.30	0.30	0.30	0.30	0.35	0.35	0.35	0.35	0.35
Arlingclose Central Case	0.10	0.15	0.35	0.40	0.45	0.60	0.65	0.65	0.60	0.60	0.60	0.60	0.60
Downside risk	0.00	-0.05	-0.25	-0.25	-0.30	-0.45	-0.50	-0.50	-0.45	-0.45	-0.45	-0.45	-0.45
5yr gilt yield													
Upside risk	0.25	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.65	0.65	0.65	0.65	0.65	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60
Downside risk	-0.25	-0.25	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40
10yr gilt yield													
Upside risk	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35
Arlingclose Central Case	1.05	1.05	1.05	1.05	1.05	1.05	1.00	0.95	0.95	0.95	0.90	0.90	0.90
Downside risk	-0.25	-0.35	-0.40	-0.40	-0.40	-0.40	-0.45	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50
20yr gilt yield													
Upside risk	0.30	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	1.40	1.40	1.40	1.40	1.35	1.35	1.30	1.30	1.30	1.30	1.30	1.30	1.30
Downside risk	-0.35	-0.40	-0.45	-0.45	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
50yr gilt yield													
Upside risk	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	1.30	1.30	1.30	1.30	1.25	1.25	1.20	1.20	1.20	1.20	1.20	1.20	1.20
Downside risk	-0.35	-0.35	-0.35	-0.40	-0.40	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50

PWLB certainty rate = relevant gilt yield + 0.80%

Update: Impact of COVID-19 Omicron variant

The uncertainty surrounding the new coronavirus variant and its effect on the UK economy and rates/yields is significant. Volatility is likely to remain heightened as investors assess the developments around Omicron.

Arlingclose already expected UK growth to wane over the next six months due to the effect of higher inflation and other pressures on households, and our forecast for Bank Rate was already lower than market expectations. The Omicron variant increases the risks to the downside and raises the spectre of other variants arising in the future.