This Report will be made public on 18 January 2022

Report Number **C/21/61**

To: **Cabinet**
Date: **26 January 2022**
Status: **Key Decision**
Head of Service: **Charlotte Spendley - Director of Corporate Services**
Cabinet Member: **Councillor David Monk – Leader and Portfolio Holder for Finance**

Subject: **TREASURY MANAGEMENT STRATEGY STATEMENT 2022/23 AND TREASURY MANAGEMENT MONITORING REPORT 2021/22**

SUMMARY: This report sets out the proposed strategy for treasury management for 2022/23 including Treasury Management Prudential Indicators. The report also provides an update on the council's treasury management activities that have taken place during 2021/22 against the agreed strategy for the year.

REASONS FOR RECOMMENDATION:
Cabinet is asked to agree the recommendations set out below because:-

a) The Council must have regard to CIPFA's Code of Practice for Treasury Management in the Public Services when carrying out its duties under Part 1 of the Local Government Act 2003, including approving an annual Treasury Management Strategy Statement in advance of the financial year.
b) The Council's Financial Procedure Rules require an annual plan and strategy for treasury management to be approved in advance of the financial year.
c) Both the CIPFA Code of Practice on Treasury Management and the Council's Financial Procedure Rules require Members to receive a report on the Council's treasury management activities during the year.

RECOMMENDATIONS:

1. **To receive and note Report C/21/61.**
2. **To approve the strategy for treasury management in 2022/23 set out in the report is adopted.**
3. **To approve the Treasury Management Prudential Indicators for 2022/23 set out in the report.**

1. INTRODUCTION

1.1 Treasury management is the management of the authority's cash flows, borrowing and investments, and the associated risks. The authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the authority's treasury management strategy and its prudent financial management.

1.2 This report is in two main sections.

i) Section A – Treasury Management Monitoring Report 2021/22

This provides an update on the council's treasury management activities that have taken place during 2021/22 against the agreed strategy for the year up to 30 November 2021. It also considers any significant issues which may impact upon the treasury management function for the remainder of the current financial year.

ii) Section B – Treasury Management Strategy Statement 2022/23

This sets out the proposed strategy for treasury management for 2022/23, including Treasury Management Prudential Indicators.

1.3 Treasury risk management at the authority is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition* (the CIPFA Code). The Code requires the authority to approve both a treasury management strategy before the start of each financial year and a treasury management monitoring report during the year. This report fulfils the authority's legal obligation under the *Local Government Act 2003* to have regard to the CIPFA Code. The authority's own Financial Procedure Rules also require an annual plan and strategy for treasury management to be approved in advance of the each financial year.

1.4 Investments held for service purposes or for commercial profit are considered in a different report, the Investment Strategy which Cabinet is due to consider on 23 February 2022 ahead of it being submitted to full Council for approval on the same day.

2 REVISIONS TO THE CIPFA CODES

2.1 In February 2021 CIPFA launched two consultations on changes to its Prudential Code and Treasury Management Code of Practice. These followed the Public Accounts Committee's recommendation that the prudential framework should be further tightened following continued borrowing by some authorities for investment purposes. In June, CIPFA provided feedback from this consultation.

2.2 In September 2021 CIPFA issued the revised Codes and Guidance Notes in draft form and opened a consultation process on their proposed changes. In December 2021 CIPFA issued the revised Codes and Guidance Notes. The key changes to the Codes are:

a) **CIPFA Prudential Code**

i) Local authorities must not borrow (for capital expenditure) to invest for the primary purchase of commercial return

ii) It is not prudent for local authorities to make any investment or spending decision that will increase its Capital Financing Requirement (CFR) unless directly and primarily related to the functions of the authority

iii) Sale of commercial investments to be considered as an alternative to new borrowing for service purposes

iv) Risks associated with commercial investment should be proportionate to financial capacity to bear losses

v) Prudential Indicators to be monitored and reported at least quarterly as part of the regular budget monitoring

vi) New prudential indicator – income from commercial and service investments to net revenue stream

b) **Treasury Management (TM) Code**

i) Liability benchmark for a minimum of 10 years in chart format mandatory, with material differences between the liability benchmark and actual loans explained

ii) Long-term investments (including pooled funds) classed as commercial investments unless linked to cash flow

iii) Environmental, Social and Governance (ESG) issues to be recognised in the authority's treasury management policies and practices

iv) Pooled funds to be included in the indicator on principal sums maturing beyond the year

v) Enhanced information requirements to feature in the authority's Treasury Management Policies regarding the knowledge and skills of officers and members with responsibility for the treasury management function

vi) Quarterly reporting of Treasury Management to Members

2.3 The revised Codes support the recent legislative changes made by the government to prevent local authorities from borrowing for capital expenditure primarily to generate a financial return. As with the legislative changes, the revised Codes are not retrospective, meaning the Council is not directly impacted for its previous capital expenditure decisions.

2.4 Given that local authorities are at advanced stages with their 2022/23 budget setting process, including the preparation of Treasury Management Strategy Statements, CIPFA has acknowledged the timing of the issuing of the revised Codes may cause some problems for local authorities and they have indicated they will view 2022/23 as a transitional year to embed their new requirements.

2.5 **Environmental, Social and Governance (ESG)** – The revised TM Code now includes the following specific reference to ESG considerations relating to credit and counterparty risk management: *'The organisation's credit and counterparty policies should set out its policy and practices relating to ESG investment considerations. This is a developing area, and it is not implied that the organisation's ESG policy will include ESG scoring or other real-time ESG criteria at individual investment level'.*

2.6 CIPFA recently indicated that they will be working with the local authority sector during 2022/23 to develop an ESG scoring methodology for treasury management investments to be used in the future. In the meantime CIPFA expect local authorities to have a general regard to their own existing policies for ESG issues, such as Climate Change, for investment decisions.

2.7 The Council's existing Treasury Management Policies and Practices will need to be reviewed and updated to incorporate the revised Treasury Management Code requirements and this is planned to take place during the coming year.

3. ECONOMIC BACKGROUND AND PROSPECT FOR INTEREST RATES

3.1 Economic Background

3.1.1 The UK economic background is dominated by the unprecedented impact of the Covid-19 pandemic, rising inflation, the prospect of higher interest rates and the country's trade position post-Brexit. The key issues affecting the UK economy in particular are:

i) In December 2021 the Bank of England's (BoE) Monetary Policy Committee (MPC) responded to rising domestic inflation by increasing the Bank Rate to 0.25% from its record low level of 0.1% and to keep its Quantitative Easing programme at £895 billion. There is now a market expectation the Bank Rate will continue to rise in small steps during 2022 to between 0.5% and 1% during the year to help curb inflation.

ii) The headline rate of UK Consumer Price Inflation (CPI) rose to a ten-year high of 5.1% in November 2021, up from 4.2% in October 2021. CPI Inflation is expected to peak around 6% in the early part of 2022 before gradually falling back as the impact of higher energy prices fades and demand slows. However, the transitory factors currently affecting inflation may take longer than expected to unwind and the BoE's MPC has indicated this may require a further tightening of monetary policy (a rise in interest rates).

iii) The latest labour market data for the three months to October 2021 showed the unemployment rate fell to 4.2% while the employment rate rose by 75.5%. The BoE MPC expectations are for unemployment and employment to remain close to their current levels.

iv) Total annual pay growth to October 2021, adjusted for inflation, was 4.9% for the year while regular pay was up 4.3%. In real terms, adjusting for inflation, total pay growth was up 1.7% while regular pay was up 1%. However, these figures should be treated with some caution as they are measured against reduced earnings from 12 months ago during the original lockdown. Uncertainty remains whether or not broad-based increases in wages will continue given the pressures facing businesses.

v) Gross Domestic Product (GDP) grew by 1.3% in quarter 3 (Q3) of 2021, compared to a gain of 5.5% quarter on quarter in Q2, with the annual rate slowing to 6.6% from 23.6% as the domestic economy adjusted from the worst of the impact of the lockdown in 2020. The UK economy is now estimated to be just 0.8% below its pre-pandemic level. Forecasts from the BoE’s December 2021 Monetary Policy Report show growth has been revised down for Q4 to 0.6% from 1% due to the uncertainty to the UK’s economy from the new Omicron coronavirus variant. Household spending faces pressures from a combination of higher prices, tax and interest rate rises. These pressures coupled with the impact of the Omicron variant are likely to cause growth to be weak at best over the next year.

vi) Like the UK, the US and Eurozone economies have both seen GDP growth rapidly improving as they recover from the pandemic and are now experiencing rising inflation. Both economies are now also seeing their growth slowing down. There is some pressure for the European Central Bank to consider raising the base rate from its current level of 0% and the US Fed has indicated they are in favour of increasing their current base rates of between 0% and 0.25% up to 0.75% during 2022.

3.2 Credit Outlook

3.2.1 2021 has seen relatively benign credit conditions reflected in the credit default swap (CDS) prices for the larger UK banks remaining low and edging downwards to the pre-pandemic levels. The improved economic outlook in 2021 has helped improve bank profitability and reduce the level of impairments many have made for bad loans. However, the recent ending of government’s coronavirus-related support measures for businesses means the full impact on banks may not be known for some time.

3.2.2 The improved economic picture during 2021 led the credit rating agencies to reflect this in their assessment of the outlook for the UK sovereign as well as several financial institutions, revising them from negative to stable.

3.2.3 Looking forward, the financial institutions on the authority’s counterparty list are well capitalised and general credit conditions remain benign. Duration limits for counterparties on the authority’s lending list are under regular review and will continue to reflect economic conditions and the credit outlook.

3.3 Interest Rate Forecast

3.3.1 The authority’s treasury management adviser, Arlingclose, is forecasting the Bank Rate will rise in Q1 of 2022 to 0.50% to subdue inflationary pressures and the perceived desire by the BoE to move away from emergency levels of interest rates. The scale of Arlingclose’s rise is slightly more subdued than the current market expectations.

3.3.2 Gilt yields, which the Public Works Loans Board (PWLB) use to set its interest rates for loans to local authorities, increased sharply during the early autumn of 2021 in anticipation of a Bank Rate rise in November 2021. However, yields fell back during November 2021 due to the Base Rate being on hold at that point. Yields are expected to remain broadly at current levels over the medium-term with the 5, 10 and 20 years gilts expected to average around 0.65%, 0.9% and 1.15% respectively. The risks around the short and medium term yields are judged to be initially to the upside but shifts lower later, while for long-term yields the risk is marginally to the upside. As ever, there will almost certainly be short-term volatility due to economic and political uncertainty and events. A more detailed interest rate forecast provided by Arlingclose is attached at Appendix 1.

3.3.3 For the purpose of setting the budget, it has been assumed that new short-term treasury investments will be made at an average rate of 0.1%, and that new long-term loans will be borrowed, where possible from other local authorities, at an average rate of 1.25%.

SECTION A – TREASURY MANAGEMENT MONITORING REPORT 2021/22

4 BACKGROUND AND SUMMARY POSITION

4.1 Cabinet approved the Treasury Management Strategy Statement for 2021/22, including treasury management indicators, on 20 January 2021 (minute 66 refers). As a requirement of CIPFA’s 2017 Prudential Code, Full Council approved the Capital Strategy for 2021/22 covering capital expenditure and financing, treasury management and non-treasury investments on 24 February 2021 (minute 26 refers).

4.2 On 31 March 2021, the authority had net borrowing of £60.2m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in table 1 below.

Table 1: Balance Sheet Summary

	31.3.21 Actual £m
General Fund CFR	79.5
HRA CFR	47.4
Total CFR	**126.9**
Less: Usable reserves	(56.3)
Less: Working capital	(10.4)

Net borrowing	**60.2**

4.3 The authority’s current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low. The treasury management position as at 30 November 2021 and the change since the 31 March 2021 is show in table 2 below.

Table 2: Treasury Management Summary

	31.3.21 Balance £m	Net Movement £m	30.11.21 Balance £m	30.11.21 Rate %
Long-term borrowing	72.2	(5.0)	67.2	2.86
Short-term borrowing	6.8	5.0	11.8	1.18
Total borrowing	**79.0**	**(0.0)**	**79.0**	**2.60**
Long-term investments	(15.2)	(0.4)	(15.6)	4.18
Cash and cash equivalents	(3.6)	(15.2)	(18.8)	0.01
Total investments	**(18.8)**	**(15.6)**	**(34.4)**	**1.96**
Net borrowing	**60.2**	**(15.6)**	**44.6**	

4.4 The council’s underlying borrowing requirement is expected to increase over the current financial year. However, as table 2 above shows, there has been a temporary reduction in the council’s net borrowing to the 30 November 2021 of £15.6m. The following three main factors have contributed to this net reduction in borrowing:

i) Higher than anticipated usable reserves at 31 March 2021

ii) Delays to the council’s General Fund capital expenditure programme for 2021/22 to be met from prudential borrowing

iii) Short-term net positive cash flow from Council Tax receipts and government grants

5. BORROWING STRATEGY AND ACTIVITY 2020/21

5.1 At 30 November 2021, the authority held £79m of loans, unchanged from the position to 31 March 2021, as part of its strategy for funding previous and current years’ capital programmes. Following the introduction of the Housing Revenue Account (HRA) Self-Financing regime in 2012 the authority operates a two pool debt approach allocating its loans between the General Fund and HRA. The borrowing position at 30 November 2021 compared to 31 March 2021 is shown in table 3 below. A list of the individual loans borrowed at 30 November 2021 is shown in appendix 2 to this report.

Table 3: Borrowing Position – Two Pool Debt Approach

	31.3.21 Balance £m	2021/22 Movement £m	30.11.21 Balance £m	30.11.21 Rate %
<u>General Fund</u>				
Public Works Loan Board	7.2	-	7.2	4.69%
Local Authorities (long-term)	20.0	(5.0)	15.0	0.62%
Local Authorities (short-term	5.5	5.0	10.5	1.02%
Total General Fund borrowing	**32.7**	**0.0**	**32.7**	**1.65%**
<u>Housing Revenue Account</u> Public Works Loan Board	46.3	-	46.3	3.28%
Total HRA borrowing	**46.3**	**-**	**46.3**	**3.28%**
Total borrowing	**79.0**	**0.0**	**79.0**	**2.60%**

5.2 The weighted average maturity of the overall loans portfolio at 30 November 2021 was 7.8 years.

5.3 Public Works Loan Board (PWLB) Lending Arrangements

5.3.1 The current PWLB lending arrangements effective from 26 November 2020 prohibit local authorities from borrowing to purchase ‘investment assets primarily for yield’. HM Treasury published further guidance on PWLB borrowing in August 2021 providing additional detail and clarifications predominantly around the definition of an ‘investment asset primarily for yield’. One of the key aspects of the new guidance is capital expenditure incurred or committed to before 26 November 2020 is allowable for borrowing even for an ‘investment asset primarily for yield. The guidance also covers the requirement for authorities to regularly submit details of their capital plans to the Department for Levelling Up, Housing and Communities (DLUHC) and sanctions that can be imposed for non-compliance with it.

5.3.2 The Council is not planning to purchase any new investment assets primarily for yield within the next three years so is able to fully access the PWLB for borrowing.

5.3.3 The PWLB has also recently increased the settlement period for taking up new loans from 3 to 5 working days to provide more time to check borrowing applications made by local authorities for compliance with their arrangements. Additionally, in a move to protect the PWLB from negative interest rates, the minimum interest rate for PWLB loans has been set at

0.01%. These changes are not expected to have any material impact to the Council.

5.4 Borrowing Activity in 2021/22

5.4.1 The authority's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the authority's long-term plans change being a secondary objective.

5.4.2 With short-term interest rates remaining much lower than long-term rates and with a surplus of liquidity continuing in the local authority to local authority market, the authority has considered it to be more cost effective in the near term to use its internal resources to meet the underlying borrowing need in the current financial year. This strategy has enabled the authority to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

5.4.3 In anticipation of a £5m loan maturity due on 31 January 2022 a new loan has been agreed in advance for the same date (forward deal). This forward deal is with another local authority for two years at an interest rate of 0.4%, significantly below the equivalent PWLB interest rate of 1.11% when the deal was agreed.

5.4.4 The need for further borrowing over the remainder of the current financial year will continue to be closely monitored in conjunction with Arlingclose.

6 INVESTMENTS

6.1 The council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the period to 30 November 2021, the authority's investment balance has ranged between £18.8m and £41m due to timing differences between income and expenditure. The average investment balance held to 30 November 2021 was £32.8m. The investment position during the period to 30 November 2021 is shown in table 4 below. A list of the individual investments held at 30 November 2021 is shown in appendix 3 to this report.

Table 4: Investment Position

	31.3.21 Balance £m	Net Movement £m	30.11.21 Balance £m	Average Return
Banks & building societies (unsecured)	-	2.9	2.9	0.01%
Money Market Funds	3.6	12.3	15.9	0.01%
Property Pooled Fund	5.3	0.3	5.6	4.32%
Multi-Asset Income Funds	9.9	0.1	10.0	4.19%
Total investments	**18.8**	**15.6**	**34.4**	**1.96%**

6.2 The weighted average maturity of the investment portfolio at 30 November 2021 was 16 days.

6.3 Both the CIPFA Code and government guidance require the authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

6.4 Ultra low short-dated cash rates which have been a feature since March 2020 when Bank Rate was cut to 0.1% have resulted in the return on sterling low volatility net asset value money market funds (LVNAV MMFs) being close to zero even after some managers have temporarily waived or lowered their fees. At this stage net negative returns are not the central case of most MMF managers over the short-term, and fee cuts or waivers should result in MMF net yields having a floor of zero, but the possibility cannot be ruled out. Deposit rates with H.M. Treasury's Debt Management Account Deposit Facility (DMADF) have also been at almost zero over the period to 30 November 2021.

6.5 The council is meeting its investment objectives and strategy for 2021/22. As previously outlined in sections 3 and 4 of this report, the council has been able to use short term liquid cash to meet its underlying borrowing need through internal borrowing, reducing its exposure to credit risk. Secondly, the return from the strategic investments in pooled funds have continued to provide cash returns in excess of inflation. The performance of these pooled funds is considered in more detail below.

6.6 The level of cash available for short term investments has, on average, been about £8m higher than originally anticipated for 2021/22, as outlined in section 3 above. It is expected the level of surplus cash for short-term investments will reduce quite significantly over the remainder of the current financial year as Council Tax and Business Rates income collected by instalments tails off from January 2022.

6.7 Externally Managed Pooled Funds

6.7.1 The council has £15m invested in externally managed multi-asset and commercial property pooled funds, representing the authority's forecast minimum level of cash reserves and balances over the medium term. These pooled funds aim to provide returns in excess of inflation and, over time, provide the opportunity for some limited capital growth.

6.7.2 Table 5 below provides a summary of the pooled funds showing the changes in the unrealised capital values and the dividend yield for the current year with the comparative information for the previous year.

Table 5 – Pooled Funds Summary

Fund	Value at 31/03/21	Value 30/11/21	Valuation change	*Dividend Yield 2020/21*	Dividend Yield 2021/22	Dividend 2021/22
	£m	£m	£m	*%*	£'000	%
CCLA Local Authority Property Fund	5.28	5.65	0.37	*4.35%*	157	4.20%
CCLA Diversified Income Fund	1.94	2.07	0.13	*3.30%*	35	3.82%
Aegon Diversified Monthly Income Fund	3.52	3.52	0.00	*4.62%*	115	4.71%
Ninety-One Diversified Income Fund	3.51	3.39	(0.12)	*3.95%*	95	4.38%
UBS Multi-Asset Income Fund	0.95	0.98	0.03	*5.14%*	33	5.46%
Total	**15.20**	**15.61**	**0.41**	***4.23%***	**435**	**4.38%**

6.7.3 These funds generated an average income return of 4.38% or £435k for the period to 30 November 2021, used to support service expenditure, and unrealised capital growth of about £410k. The continued economic recovery from the pandemic and the prospects for growth has contributed to the overall increase in the capital value of the authority's investments in these funds.

6.7.4 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 medium to long-term investment objectives are regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three- to five-year period total returns will exceed cash interest rates. The authority is expected to continue to hold its strategic investments in pooled funds for the remainder of the current financial year.

7. FINANCIAL SUMMARY

7.1 The projected outturn for the net cost of treasury management to the General Fund in 2021/22 is summarised in table 6 below:

Table 6: Financial Summary

	2021/22 Original Estimate	2021/22 Projection	Variance
	£'000	£'000	£'000
Interest on all Borrowing	2,705	2,108	(597)
Less Capitalised Interest	(581)	(192)	389
Related HRA Charge	(1,573)	(1,521)	52
General Fund Borrowing Cost	**551**	**395**	**(156)**
Investment Interest	(535)	(610)	(75)
HRA Element	50	5	(45)
General Fund Investment Income	**(485)**	**(605)**	**(120)**
Net General Fund Borrowing Cost	**66**	**(210)**	**(276)**

7.2 The main reasons for the reduction of £276k in the projected net borrowing cost are;-

		£'000
i)	delays to and reprofiling of capital expenditure plans being met from prudential borrowing and greater use of short-term internal borrowing met from cash balances held, and	(208)
ii)	returns from pooled fund investments being better than originally anticipated	(75)

7.3 **Compliance with Borrowing and Investment Limits** – The Director of Corporate Services reports that the treasury management activities undertaken in the current financial year to 30 November 2021 complied with the CIPFA Code of Practice for Treasury Management, the council's approved Treasury Management Strategy and its approved borrowing limits. Further information regarding compliance with the specific investment and Treasury indicators is covered in Section B of this report.

8 NON-TREASURY INVESTMENTS

8.1 Although not classed as treasury management activities, the 2017 CIPFA Code and the MHCLG Investment Guidance requires the authority to report on investments for policy reasons outside of normal treasury management. This includes service investments for operational and/or regeneration as well as commercial investments which are made mainly for financial reasons. This includes the authority's investments in its wholly owned subsidiary companies, Oportunitas Limited and Otterpool Park LLP. These are summarised in table 7 below:

Table 7: Non-Treasury Investments

Investment Type	Value 31/03/21 £m	Value 30/11/21 £m	Net Income (Expenditure) 2021/22 £'000	Rate of Return %
Investment Property				
Otterpool Property	64.9	65.3	(524)	(0.8)
Offices	17.4	17.4	357	2.1
Commercial Land	0.7	0.7	-	-
Commercial Units	1.8	1.8	126	6.9
Retail	2.2	2.2	(84)	(3.8)
Assets Under Construction	0.2	0.2	-	-
Total Investment Property	**87.2**	**87.6**	**(125)**	**(0.1)**
Subsidiaries				
Oportunitas loan	4.3	4.3	210	4.9
Oportunitas equity	3.5	4.5	0	0
Total Oportunitas	**7.8**	**8.8**	**210**	**2.4**
Otterpool Park LLP	1.3	1.8	71	5.0
Total Subsidiaries	**9.1**	**10.6**	**281**	**2.75**
Total Non-Treasury	**96.3**	**98.2**	**156**	**0.16**

8.2 The net income and rate of return excludes the impact of any unrealised property valuation gains or losses. Ordinarily the rate of return on non-treasury investment assets would be expected to be higher than that earned on treasury investments reflecting the additional risks to the council of holding such investments. This is demonstrated with the return on the commercial units and subsidiary companies. However the return on the investment property portfolio for 2021/22 is significantly distorted because of the land acquisitions taking place for the Otterpool Park project in particular. The council is receiving rental streams from some of the Otterpool property in the short to medium term.

SECTION B – TREASURY MANAGEMENT STRATEGY STATEMENT 2022/23

9. THE COUNCIL'S FORECAST BORROWING AND INVESTMENT POSITION

9.1 The forecast borrowing and treasury investment positions are shown in the balance sheet analysis in table 8 below.

Table 8: Balance Sheet Summary and Forecast

	31.3.21 Actual £m	**31.3.22 Estimate £m**	**31.3.23 Forecast £m**	**31.3.24 Forecast £m**	**31.3.25 Forecast £m**
General Fund CFR	13.4	14.8	19.2	18.3	13.2
HRA CFR	47.4	47.4	47.4	50.7	57.7
Investments CFR	66.1	71.3	93.7	120.0	141.5
Total CFR	**126.9**	**133.5**	**160.3**	**189.0**	**212.4**
Less: External borrowing	(79.0)	(77.2)	(81.4)	(125.6)	(158.0)
Internal borrowing	**47.9**	**56.3**	**78.9**	**63.4**	**54.4**
Less: Balance Sheet resources	(66.7)	(52.1)	(34.7)	(31.0)	(30.5)
Treasury Investments (-) or / New Borrowing (+)	**(18.8)**	**4.2**	**44.2**	**32.4**	**23.9**

9.2 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying Balance Sheet resources available for investment. The authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

9.3 The movement in table 8 is based on the projected outturn for the current financial year, the draft revenue and capital budgets being proposed for 2022/23, the proposed Medium Term Capital Progamme, the HRA Business Plan and information taken from the latest approved Medium Term Financial Strategy for 2023/24 and 2024/25. The authority has an increasing CFR arising from its planned capital investment and will therefore be required to borrow up to a further £104.7m over the forecast period.

9.4 CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. Table 8 shows that the authority expects to comply with this recommendation during 2022/23.

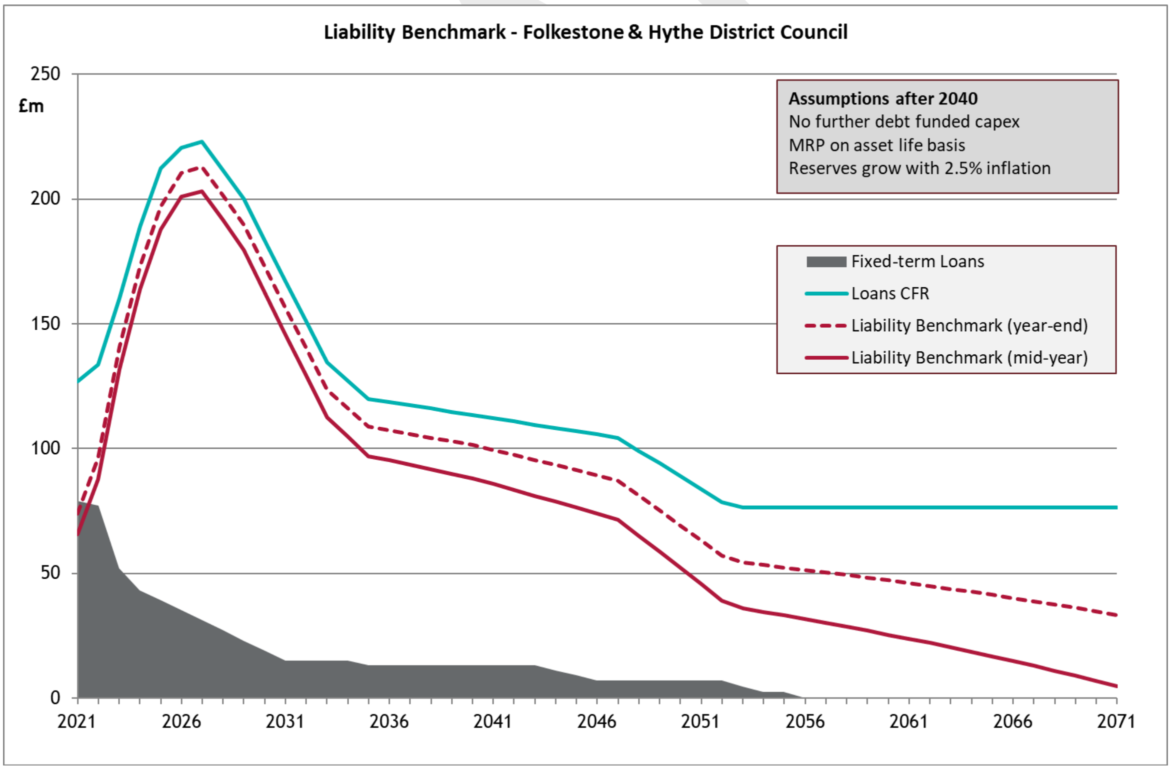
9.5 Liability Benchmark

9.5.1 To compare the authority's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as table 8 above, but that cash and investment balances are kept to a minimum level of £15m at each year-end, in line with strategic investment objectives.

Table 9: Liability benchmark

	31.3.21 Actual £m	31.3.22 Estimate £m	31.3.23 Forecast £m	31.3.24 Forecast £m	31.3.25 Forecast £m
CFR	126.9	133.5	160.3	189.0	212.4
Less: Balance Sheet resources	(66.7)	(52.1)	(34.7)	(31.0)	(30.5)
Net loans requirement	60.2	81.4	125.6	158.0	181.9
Plus: Liquidity allowance	18.8	15.0	15.0	15.0	15.0
Liability Benchmark	**79.0**	**96.4**	**140.6**	**173.0**	**196.9**

9.5.2 Following on from the medium-term forecasts in table 9 above, the long-term liability benchmark assumes further capital expenditure funded by borrowing after 31 March 2025 for Otterpool Park and the HRA new build programme, minimum revenue provision on new capital expenditure based on asset life (except for Otterpool Park which assumes the majority of the borrowing for the scheme to be repaid by 2035), and income, expenditure and reserves all increasing by inflation of 2.5% a year. This is shown in the chart below:



10 BORROWING STRATEGY

10.1 The authority currently holds £79 million of loans as part of its strategy for funding previous years' capital programmes. The current loans are shown in appendix 2 to this report. The balance sheet forecast in table 8 shows that the authority expects to borrow up to a further £44.2m in 2022/23. The authority may however borrow to pre-fund future years' requirements, providing this does not exceed the forecast authorised limit for borrowing of £196 million for 2022/23. The authorised borrowing limit will be considered in more detail as one of the prudential indicators for capital expenditure which will be included in the Capital Strategy for 2022/23 report to Cabinet at its meeting on 23 February 2022 before going to full Council for approval on the same day.

10.2 Objectives

10.2.1 The authority's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the authority's long-term plans change is a secondary objective.

10.3 Strategy

10.3.1 Given the significant reductions to public expenditure and in particular to local government funding, the authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

10.3.2 By doing so, the authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of both internal and short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the authority with this 'cost of carry' and breakeven analysis. Its output may determine whether the authority borrows additional sums at long-term fixed rates in 2022/23 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

10.3.3 The authority has previously used the PWLB as its main source of long-term borrowing. However over recent years the authority has borrowed from other local authorities for periods typically up to two years at rates significantly cheaper than the PWLB. The authority will consider borrowing long-term loans from the PWLB as well as other sources including banks, pensions and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. 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 access to PWLB loans.

10.3.4 Alternatively, the authority may arrange forward starting loans where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

10.3.5 In addition, the authority may borrow further short-term loans to cover unplanned cash flow shortages.

10.4 Sources of Borrowing

10.4.1 The approved sources of long-term and short-term borrowing are:

- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- any other UK public sector body
- UK public and private sector pension funds (except the Kent County Council Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

10.4.2 In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- leasing
- hire purchase
- Private Finance Initiative
- sale and leaseback

10.5 Short-term and Variable Rate Loans

10.5.1 These loans leave the authority exposed to the risk of short-term interest rate rises and are therefore subject to interest rate exposure limits in the treasury management indicators below. Financial derivatives may be used to manage this interest rate risk (see section below).

10.6 Debt Rescheduling

10.6.1 The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The authority may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

11 TREASURY INVESTMENT STRATEGY

11.1 The authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During 2021/22 until 30 November, the authority's investment balance has ranged between £18.8 million and £41 million with the average being £32.8 million. The average investment balance held is expected to reduce to around £25 million in the coming year as the council uses its reserves to meet its approved capital expenditure plans and also continues to use some of its cash balances in lieu of external borrowing (i.e. internal borrowing). The authority's current investment portfolio is shown in appendix 3 to this report.

11.2 Objectives

11.2.1 The CIPFA Code requires the authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the authority will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

11.2.2 **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.

11.3 Strategy

11.3.1 Given the increasing risk and very low returns from short-term unsecured bank investments, the authority aims to continue with its current strategy to diversify into more secure and/or higher yielding asset classes during 2022/23. This is especially the case for the estimated £25m that is available for longer-term investment, represented by forecast usable reserves held to 31 March 2025. A significant but reducing proportion of the authority's surplus cash is currently invested in money market funds in particular, although this is likely to reduce further in 2022/23 as a result of the capital and revenue expenditure plans. Given the council's increasing borrowing need for 2022/23 and beyond the maximum duration for new investments is proposed to remain at 5 years.

11.3.2 The authority has about £15m of its cash reserves invested in a range of professionally managed pooled property and diversified income funds. These are seen as longer term strategic investments which aim to provide returns in excess of inflation and have the potential for some limited capital growth, thereby helping to protect the value of these reserves. Maintaining these pooled funds is seen as an important part of the authority's proposed investment strategy for 2022/23.

11.4 Business Models

11.4.1 Under the new IFRS 9 standard, the accounting for certain investments depends on the authority's "business model" for managing them. The authority 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.

11.5 Approved Counterparties

11.5.1 The authority may invest its surplus funds with any of the counterparty types in table 10 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 10: Approved Investment Counterparties and Limits for New Investments effective from 1 April 2021

Sector	Time limit	Counterparty limit	Sector limit
The UK Government	5 years	Unlimited	n/a
Local authorities & other government entities	5 years	£5m	Unlimited
Secured investments *	5 years	£5m	Unlimited
Banks (unsecured) *	13 months	£3m	Unlimited
Building societies (unsecured) *	13 months	£3m	£6m
Registered providers (unsecured) *	5 years	£3m	£15m
Money market funds *	n/a	£5m	Unlimited
Strategic pooled funds	n/a	£5m	£25m
Real estate investment trusts	n/a	£5m	£15m
Other investments *	5 years	£3m	£9m

This table must be read in conjunction with the notes below

11.5.2 ***Minimum credit rating:** Treasury investments in the sectors marked with an asterisk 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.

11.5.3 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 £5m per counterparty as part of a diversified pool e.g. via a peer-to-peer platform.

11.5.4 **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 5 years.

11.5.5 **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.

11.5.6 **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.

11.5.7 **Registered providers (unsecured):** Loans to, and bonds issued or guaranteed by, registered providers of social housing or registered social landlords, formerly known as housing associations. These bodies are regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

11.5.8 **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.

11.5.9 **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.

11.5.10 **Real estate investment trusts:** Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.

11.5.11 **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.

11.5.12 **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 the authority will endeavour to keep its end of day balances below £0.5m per bank. However, unexpected cash flow transactions may mean this level could be breached and would need rectifying on the next working day. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the authority maintaining operational continuity.

11.6 Risk Assessment and Credit Ratings

11.6.1 Credit ratings are obtained and monitored by the authority's treasury adviser, who will notify changes in 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.

11.6.2 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 on the next working day 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.

11.7 Other Information on the Security of Investments

11.7.1 The authority 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 and analysis and advice from the authority's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the credit rating criteria.

11.7.2 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the authority 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. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the authority's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

11.8 Investment Limits

11.8.1 The authority's revenue reserves available to cover investment losses are forecast to be £18 million 31 March 2022. In order that no more than 25% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £5 million. A group of entities under the same ownership will be treated as a single organisation for limit purposes.

11.8.2 Credit risk exposures arising from non-treasury investments, financial derivatives and balances greater than £0.5m in operational bank accounts count against the relevant investment limits.

11.8.3 Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled 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 11: Additional Investment Limits

	Cash limit
Any group of pooled funds under the same management	£10m per manager
Negotiable instruments held in a broker's nominee account	£10m per broker
Foreign countries	£5m per country

11.9 Liquidity Management

11.9.1 The authority uses spreadsheet forecasts 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 authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the authority's medium term financial plan and cash flow forecast.

11.9.2 The authority will spread its liquid cash over at least four providers (e.g. bank accounts and money market funds) to ensure that access to cash is maintained in the event of operational difficulties at any one provider.

12 TREASURY MANAGEMENT PRUDENTIAL INDICATORS

12.1 The authority measures and manages its exposures to treasury management risks using indicators and those proposed for 2022/23 are outlined below for approval. The latest position for the indicators in 2020/21 against the existing approved target is also shown below.

12.2 **Security -** The authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	2021/22 Target	**30/11/2021 Actual**	**2022/23 Target**
Portfolio average credit rating	A	AA-	A

12.3 **Liquidity -** The authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period, without additional borrowing.

	2021/22 Target	**30/11/2021 Actual**	**2022/23 Target**
Total cash available within 3 months	£5m	£18.8m	£5m

12.4 **Interest Rate Exposures** - This indicator is set to control the authority's exposure to interest rate risk. The upper limits of a 1% rise or fall in interest rates will be:

	2021/22 Limit	**30/11/2021 Actual**	**2022/23 Limit**
Upper limit on one year revenue impact of a 1% **rise** in interest rates	£164,000	£41,000	£187,000
Upper limit on one year revenue impact of a 1% **fall** in interest rates	(£185,000)	(£133,000)	(£245,000)

12.5 The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at new market rates. The increase in the limits for 2022/23 are consistent with the Council's projected borrowing required for the year.

12.6 **Maturity Structure of Borrowing -** This indicator is set to control the authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	30/11/21 Actual	2022/23 Upper	2022/23 Lower
Under 12 months	15.0%	30%	0%
12 months and within 24 months	25.3%	40%	0%
24 months and within 5 years	15.2%	50%	0%
5 years and within 10 years	25.3%	80%	0%
10 years and above	19.2%	100%	0%

12.7 Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment. The borrowing is measured against the authority's authorised borrowing limit

12.8 **Principal Sums Invested for Periods Longer than 364 days -** The purpose of this indicator is to control the authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

Long-term Treasury Management Investments	2022/23	2023/24	2024/25
Limit on principal invested beyond year end	£15m	£5m	£5m
Limit on amounts invested in longer term investments with no fixed maturity date	£25m	£25m	£25m

12.9 The proposed limit for the amounts invested in longer term investments with no fixed maturity date is an increase of £5m over the approved value for 2021/22 and reflects the projected increase in the level of cash reserves to be held over the same period.

13. OTHER ITEMS

13.1 The CIPFA Code requires the authority to include the following in its Treasury Management Strategy.

13.2 Policy on Use of Financial Derivatives

13.2.1 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).

13.2.2 The authority 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 authority is exposed to.

Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

13.2.3 Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria, assessed using the appropriate credit rating for derivative exposures. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

13.2.4 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.

13.3 Policy on Apportioning Interest to the HRA

13.3.1 On 1st April 2012, the authority notionally split each of its existing long-term loans into General Fund and HRA pools. Since then, new long-term loans borrowed are assigned in their entirety to one pool or the other (General Fund or HRA). Interest payable and other costs/income arising from long-term loans (e.g. premiums and discounts on early redemption) are charged/ credited to the respective revenue account. Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) result in a notional cash balance which may be positive or negative. This balance is measured over the financial year and interest transferred between the General Fund and HRA at the Authority's average interest rate on investments, adjusted for credit risk. This policy will continue for 2022/23.

13.4 Markets in Financial Instruments Directive

13.4.1 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.

14. FINANCIAL IMPLICATIONS

14.1 The net revenue cost of the council's treasury management borrowing and investment activity based on information at budget setting time is estimated to be:

£'000	2021/22 Estimate	2022/23 Estimate	Variance 2020/21 to 2021/22
Revenue Budgets	£'000	£'000	£'000
Interest on Borrowing	2,705	**2,772**	67
Less Capitalised Interest	(581)	**(529)**	52
HRA Element	(1,573)	**(1,580)**	(7)
GF Borrowing Cost	551	**663**	112
Investment income	(535)	**(610)**	(75)
HRA Element	50	**5**	(45)
GF Investment income	(485)	**(605)**	(120)
Net Cost (GF)	66	**58**	(8)

14.2 The main reasons for the projected net reduction in the General Fund borrowing cost of £8k in 2022/23 compared to 2021/22 are:

		£'000
i)	Increase in borrowing costs for existing and planned capital expenditure being met from prudential borrowing	119
ii)	Increase in investment income on pooled funds	(75)
iii)	Net reduction in interest adjustments to the HRA	(52)
	Total reduction	**(8)**

15. OTHER OPTIONS CONSIDERED

15.1 The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Director for Corporate Services, having consulted the Cabinet Member for Finance, 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.

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
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

16. RISK MANAGEMENT ISSUES

16.1 Inherently treasury management is concerned with the management of risk, e.g. interest rate risk, market risk, credit risk and liquidity risk. The strategies in this Report are developed to minimise the impact of risk changes whilst at the same time providing a framework for the council to reduce its net interest costs.

16.2 Specific risks to be addressed are as follows:

PERCEIVED RISK	SERIOUSNESS	LIKELIHOOD	PREVENTATIVE ACTION
Interest Rate Risk (rates moving significantly different to expectations)	High	Medium	With an increasing borrowing requirement rising interest rates would be detrimental. The council would need to consider taking out fixed borrowing to help mitigate this risk and/or use further internal borrowing if resources are available. Falling

			interest rates would be broadly beneficial to the council given the increasing borrowing requirement.
Market Risk (adverse market fluctuations affect value of investment capital)	Medium	Low	A limit is placed on the value of principal exposed to changes in market value.
Credit Risk (risk to repayment of Capital)	High	Medium	The council's investment criteria restricts counterparties to those of the highest quality and security.
Liquidity Risk (risk that cash will not be available when needed)	Medium	Medium	Council's investment portfolio structured to reflect future liquidity needs. Temporary borrowing is also available to meet short term liquidity issues.
Changes to the Capital Programme and/or revenue streams	High	Medium	Cash flows are calculated monthly and regular projections are made to identify changes to the council's funding requirements. Prudential borrowing to support capital expenditure can be used for schemes expected to provide a financial benefit to the council. There may be some slippage in capital expenditure between years and the impact will be monitored.

17 LEGAL/FINANCIAL AND OTHER CONTROLS/POLICY MATTERS

17.1 Legal Officer's Comments (NM)

There are no legal implications arising directly out of this report. Part 1 of the Local Government Act 2003 gives the Council the power to borrow and to invest for any purpose relevant to its functions or for the purposes of the prudent management of its financial affairs. It also requires the Council to act prudently when carrying out these activities, including an obligation to determine and keep under review how much money it can borrow. In addition, the Council is required by the Local Government Finance Act 1992 to produce a balanced budget. Generally the Council must take into account its fiduciary duties to local tax payers and its continuing obligation to ensure it has the funding required to perform its statutory undertakings.

17.2 Finance Officer's Comments (LW)

The report has been prepared by Finance and the relevant financial implications are contained within it.

17.3 Diversities and Equalities Implications (DA)

The report does not cover a new service/policy or a revision of an existing service or policy therefore does not require an EIA

17.4 Climate Change Implications *[Pilot Reporting Period]*

(Due to Christmas leave arrangements this is a draft comment)

There are no direct climate change implications arising from this report. However, the report outlines Environment, Social and Governance (ESG) investment considerations required as part of the revised CIPFA Treasury Management Code.

17.5 Communications Officer's Comments (JW)

There are no particular communications implications arising from this report

18. CONTACT OFFICER AND BACKGROUND DOCUMENTS

Councillors with any questions arising out of this report should contact the following officers prior to the meeting:

Lee Walker – Capital and Treasury Senior Specialist
Tel: 01303 853593 Email: lee.walker@folkestone-hythe.gov.uk

The following background documents have been relied upon in the preparation of this report:

Arlingclose's Half Year Treasury Management Monitoring Report Template 2021/22
Arlingclose's Treasury Management Strategy Statement Template 2022/23

Appendicies

Appendix 1 – Arlingclose Interest Rate Forecast at November 2021
Appendix 2 – Borrowing portfolio at 30 November 2021
Appendix 3 – Investment portfolio at 30 November 2021

Appendix 1 – Arlingclose Interest Rate Forecast December 2021

	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	0.00	0.00	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk	0.00	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
3-month money market ra													
Upside risk	0.05	0.05	0.25	0.35	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.25	0.55	0.55	0.60	0.60	0.60	0.60	0.65	0.65	0.65	0.65	0.65	0.65
Downside risk	0.00	-0.25	-0.25	-0.30	-0.30	-0.30	-0.30	-0.35	-0.35	-0.35	-0.35	-0.35	-0.35
5yr gilt yield													
Upside risk	0.00	0.35	0.45	0.55	0.55	0.55	0.55	0.55	0.55	0.50	0.50	0.45	0.45
Arlingclose Central Case	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.65	0.70	0.75	0.75
Downside risk	-0.10	-0.20	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.30	-0.35	-0.40	-0.40
10yr gilt yield													
Upside risk	0.10	0.25	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.55	0.55	0.55
Arlingclose Central Case	0.80	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.90	0.90	0.95	0.95
Downside risk	-0.10	-0.25	-0.30	-0.35	-0.35	-0.35	-0.35	-0.35	-0.35	-0.40	-0.40	-0.40	-0.40
20yr gilt yield													
Upside risk	0.30	0.40	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	1.00	1.05	1.10	1.10	1.10	1.10	1.15	1.15	1.15	1.20	1.20	1.20	1.20
Downside risk	-0.15	-0.30	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45
50yr gilt yield													
Upside risk	0.25	0.30	0.40	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.70	0.75	0.80	0.85	0.90	0.95	1.00	1.05	1.05	1.10	1.10	1.15	1.15
Downside risk	-0.15	-0.30	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45

PWLB Standard Rate (Maturity Loans) = Gilt yield + 1.00%
PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%
PWLB Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

Appendix 2 – Borrowing Portfolio at 30 November 2021

Lender	Loan No	Loan Type	Start Date	Maturity Date	Principal Outstanding 30/11/2021	Interest Rate
					£	%
Public Works Loan Board	430141	Annuity	09/11/1973	01/11/2033	3,709.27	11.38
Public Works Loan Board	480111	Fixed	14/10/1997	31/03/2023	1,000,000.00	6.63
Public Works Loan Board	488942	Fixed	12/08/2004	07/08/2034	2,000,000.00	4.80
Public Works Loan Board	492233	Fixed	28/09/2006	15/03/2054	2,000,000.00	4.05
Public Works Loan Board	493698	Fixed	10/08/2007	07/08/2055	2,500,000.00	4.55
Public Works Loan Board	493914	Fixed	10/09/2007	07/02/2053	2,500,000.00	4.55
Public Works Loan Board	494027	Fixed	31/10/2007	15/03/2044	2,000,000.00	4.65
Public Works Loan Board	494028	Fixed	31/10/2007	15/03/2045	2,000,000.00	4.65
Public Works Loan Board	494029	Fixed	31/10/2007	15/03/2046	2,141,190.00	4.65
Public Works Loan Board	500536	Fixed	28/03/2012	28/03/2023	4,000,000.00	2.56
Public Works Loan Board	500537	Fixed	28/03/2012	28/03/2031	4,010,000.00	3.26
Public Works Loan Board	500538	Fixed	28/03/2012	28/03/2028	4,000,000.00	3.08
Public Works Loan Board	500540	Fixed	28/03/2012	28/03/2025	4,000,000.00	2.82
Public Works Loan Board	500541	Fixed	28/03/2012	28/03/2029	4,000,000.00	3.15
Public Works Loan Board	500542	Fixed	28/03/2012	28/03/2030	4,000,000.00	3.21
Public Works Loan Board	500543	Fixed	28/03/2012	28/03/2027	4,000,000.00	3.01
Public Works Loan Board	500545	Fixed	28/03/2012	28/03/2022	1,300,000.00	2.40
Public Works Loan Board	500546	Fixed	28/03/2012	28/03/2024	4,000,000.00	2.70
Public Works Loan Board	500548	Fixed	28/03/2012	28/03/2026	4,000,000.00	2.92
Total - Public Works Loan Board					**53,454,899.27**	
London Borough of Barking and Dagenham		Fixed	31/01/2020	31/01/2022	5,000,000.00	1.60
London Borough of Wandsworth		Fixed	29/01/2021	31/01/2023	10,000,000.00	0.60
Durham County Council		Fixed	01/02/2021	03/10/2022	5,000,000.00	0.55
Leicester City Council		Fixed	01/03/2021	01/03/2023	5,000,000.00	0.65
Folkestone Town Council	n/a	Variable - 2 day call notice	Various May 2018	n/a	500,000.00	0.00
Total - Other Loans						
Total - Borrowing at 30/11/2021					**78,954,899.27**	

Appendix 3 – Investment Portfolio at 30 November 2021

Category and Counterparty	Amount or Value £	Terms	Indicative Interest Rate or Yield %
Banks & Building Societies (unsecured)			
NatWest - Business Reserve	0	No notice instant access	0.01
Money Market Funds			
Aberdeen Standard MMF	3,620,000	No notice instant access	0.01
Other Pooled Funds			
Commercial Property Funds			
CCLA Property Fund	5,282,587	No specified maturity date	4.91
Multi-Asset Income Funds			
CCLA Diversified Income Fund	1,946,036	No specified maturity date	2.35
UBS Multi-Asset Income Fund	949,602	No specified maturity date	3.61
Aegon Asset Management Diversified Monthly Income Fund	3,519,652	No specified maturity date	4.67
Ninety-One Diversified Income Fund	3,506,271	No specified maturity date	2.86
Total Investments	**18,824,148**		3.21