CT/21/14
Corporate Infrastructure & Regulatory Services Scrutiny Committee
28 January 2021

TREASURY MANAGEMENT AND INVESTMENT STRATEGY 2021-22

Report of the County Treasurer

Please note that the following recommendations are subject to consideration and determination by the Committee before taking effect.

Recommendation: that the Committee consider whether it wishes to draw to the attention of the Cabinet any observations on the proposals contained within the Treasury Management and Investment Strategy.

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1. Introduction

1.1 In February 2018, following the publication of a revised Code of Practice for Treasury Management by the Chartered Institute of Public Finance and Accountancy (CIPFA), the Council adopted a revised Treasury Management Policy Statement together with a statement of its ‘Treasury Management Practices’ (TMPs). No changes are proposed to these policies for 2021/22.

1.2 The policy requires the Council to consider a treasury strategy report, setting out the strategy and plans to be followed in the coming year, as part of the budget process.

2. Treasury Management and Investment Strategy – Key Points

2.1 The Treasury Management and Investment Strategy is shown in draft at Appendix 1. It sets out the minimum revenue provision (MRP) policy, capital expenditure funding, prudential indicators, the current treasury position, debt and investments; prospects for interest rates; the borrowing strategy; and the investment strategy.

2.2 The key issues for 2021/22 are set out in the Treasury Management and Investment Strategy Overview section. These include:

a) Consideration of the need for prudent management of the Council’s cash resources in order to support the capital strategy and repay external debt maturing in 2027.
b) The continued inclusion of higher yielding investments, which would only be used subject to further consultation with the Cabinet Member for Resources Management.
c) The target rates for 2021/22.
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2.3 In general, the strategy remains broadly similar to that for 2020/21, with no changes, for example, to the MRP policy, or approved counterparty criteria.

3. Conclusion

3.1 The Treasury Management and Investment Strategy will be considered by Cabinet along with the draft budget for 2021/22 on 12 February, and will become part of the budget book to be approved by Council at its budget meeting on 18 February.

3.2 The Committee is invited to make observations on these proposals prior to their consideration by the Cabinet on 12 February.

Mary Davis
County Treasurer

Electoral Divisions: All

Local Government Act 1972:
List of Background Papers: Nil
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Treasury Management Strategy 2021/22 – 2024/25 and Prudential Indicators 2021/22 - 2025/26

Introduction

In February 2018, following the publication of a revised Code of Practice for Treasury Management by the Chartered Institute of Public Finance and Accountancy (CIPFA), the Council adopted a revised Treasury Management Policy Statement together with a statement of its ‘Treasury Management Practices’ (TMPs). No changes are proposed to these policies for 2021/22.

The policy requires the Council to consider a treasury strategy report, setting out the strategy and plans to be followed in the coming year, as part of the budget process. The strategy for 2021/22 is broadly consistent with that adopted for 2020/21.

The Treasury Management Strategy sets out the County Council’s policies in relation to:

- the management of the Council’s cashflows, its banking, money market and capital market transactions;
- borrowing and investment strategies;
- monitoring of the level of debt and funding of the capital programme.

The Treasury Management Strategy should be read in conjunction with the Capital Strategy.

The County Council is required to monitor its overall level of debt in line with the national code of practice drawn up by CIPFA. Part of this code requires consideration of a set of “prudential indicators” in order to form a judgement about the affordable, prudent and sustainable level of debt.

The prudential indicators, treasury management strategy and the annual investment strategy have been reviewed in line with the Capital Programme 2021/22 – 2025/26, and the Capital Strategy.

This Treasury Management Strategy document sets out:

- Minimum revenue provision;
- Capital expenditure funding;
- Prudential indicators on the impact of capital financing and monitoring of the level and make-up of debt;
- The current treasury position, debt and investments;
- Prospects for interest rates;
- The borrowing strategy; and
- The investment strategy.

Treasury Management and Investment Strategy Overview

The Treasury Management and Investment Strategy sets out the MRP policy, capital expenditure funding, prudential indicators, the current treasury position, debt and investments; prospects for interest rates; the borrowing strategy; and the investment strategy.

External Borrowing

Since 2009 the Council has followed a policy of containing the capital programme, taking out no new external borrowing and repaying debt whenever this can be done without incurring a financial penalty. Capital expenditure new starts are limited to those that are financed from sources other than external borrowing. To meet the need for capital expenditure, the highest priority schemes across the Authority are funded from corporate capital receipts and internal borrowing over the capital programme timescale.

The capital programme for 2021/22 requires borrowing of £17 million, which will be internal borrowing. This is offset by the MRP figure of £12 million which will leave the Council with total internal borrowing of £84 million, i.e. the Council has borrowed £84 million from its cash balances, in addition to the external debt of £507.85 million, to fund the capital programme. However, this is forecast to reduce in future years. The ability to internally borrow from the Council's cash has enabled the Council to fund its capital programme in recent years without taking out further external debt and incurring additional interest costs and other capital financing costs.

The potential impact of COVID 19 makes it very difficult to predict what the financial requirements of the Council will be over the next few years and the resources that will be available to it to meet those requirements. Funding will need to be flexible. It is difficult to know if the Council's own cash resources and the capital receipts that it can generate will be sufficient to provide the required level of flexibility.

Given the current economic climate and low interest rates, there may be an opportunity in the next few years to externally borrow or to restructure existing debt to ensure that cash resources are sufficient to support the future objectives of the Capital Programme. The Medium Term Financial Strategy (MTFS) continues to assume that, over the three year period, no new long-term borrowing will be required, but this will be kept under review. If key priorities cannot be delivered due to a reduced availability of external funding, the Authority's cash resources, or capital receipts, then external borrowing may be required. This will need to be balanced against the ability to support additional capital financing costs from within the revenue budget.

Target Rates for Investment

For the 2021/22 financial year it has been assumed that the average interest rate earned on lending to banks and building societies will be 0.30% p.a. The target rate has been set based on the forecast that the Bank of England's base rate is likely to remain at 0.10% for the foreseeable future. It also takes into account the higher rates on some current deposits that extend into 2021/22.

The yield from investment in the CCLA Property Fund is assumed to be 3.80%. This assumes potential reductions in yield as a result of the pandemic. Further analysis will be required to identify short-dated bond funds and multi-asset income funds that would meet the Council's requirements, should this option be taken up. The targeted yield from those funds would be 2.00% for short dated bond funds and 3.50% for multi-asset income funds. Currently these are not factored into the budget for investment income. Any decision to invest in such funds would be subject to agreement by the Cabinet Member for Resource Management and a competitive process to identify suitable funds.

Minimum Revenue Provision

Minimum Revenue Provision (MRP) is a charge to the authority's revenue account to make provision for the repayment of the authority's external debt and internal borrowing. The authority has a statutory obligation to charge to the revenue account an annual amount of MRP.

The authority's MRP strategy is to charge all elements based on the period of benefit of the capital investment i.e. over the life of the asset.

All supported capital expenditure and unsupported borrowing up to 1st April 2008 will be charged over the life of the assets, calculated using the 'asset life: annuity' method. This approach was adopted by the authority in 2018/19 and delivered significant revenue savings. MRP is calculated by dividing the existing debt over the estimated life of the asset, but reflects the fact that an asset's deterioration is slower in the early years of its life and accelerates towards the latter years. In order to calculate MRP under the annuity method, an appropriate annuity rate needs to be selected. The percentage chosen corresponds with the Bank of England Monetary Policy Committee's inflation target rate of 2.1%. MRP will increase by this percentage each year

Any unsupported (internal) borrowing post 1 April 2008 (including Vehicle and Equipment Loans Pool, Capitalisation Direction and charges to other public sector bodies) will be charged over the life of the asset, on a straight line basis. The annuity method will not be applied to projects financed from internal borrowing, as this source of financing is applied to a wider range of projects with differing lives. Therefore, the 'asset life: equal instalment' method is a more appropriate method of calculating MRP.

We will not provide for MRP in circumstances where the relevant expenditure is intended to be financed from external contingent income, where it has not yet been received but where we conclude that it is more probable than not that the income will be collected, for example when forward funding S106 contributions.

Capital financing costs are also affected by PFI/PPP contracts and finance leases coming 'on Balance Sheet'. The MRP policy for PFI/PPP contracts will remain unchanged, with MRP being charged over the period of benefit of the capital investment i.e. over the life of the asset.

The main Prudential Indicator to measure the acceptable level of borrowing remains the ratio of financing costs to total revenue stream. The figures for MRP shown in table 6 reflect the adoption of this strategy.

Capital Expenditure

Table 1 shown below, summarises the Capital Programme and liabilities from capital projects that will appear on the balance sheet in future years. The Capital Programme has been tested for value for money via option appraisal and for prudence, affordability and sustainability by looking at the impact that the proposed Capital Programme has on the revenue budget and through the Prudential Indicators.

Table 1 – Capital Expenditure

	2021/22 Estimate £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000
Total Capital programme	**147,355**	**129,962**	**91,704**	**65,417**	**64,361**
Funded by:					
Gross borrowing	12,354	10,030	3,309	1,604	1,548
Other capital resources	135,001	119,932	88,395	63,813	62,813
Total capital programme funding	**147,355**	**129,962**	**91,704**	**65,417**	**64,361**
Total capital expenditure	**147,355**	**129,962**	**91,704**	**65,417**	**64,361**

Prudential Indicators

Capital Financing Requirement

The Capital Financing Requirement represents the Council's underlying debt position. It shows the previous and future spend for capital purposes that has been or will be financed by borrowing or entering into other long term liabilities. The Capital Financing Requirement and debt limits will be higher than the Council's external debt, as they will be partly met by internal borrowing from the Council's internal cash resources. This reduces the cost of the required borrowing, but the Council also needs to ensure that a prudent level of cash is retained.

The forecast Capital Finance Requirement for 2021/22 and the following four years are shown in table 2 below.

Table 2 – Capital Financing Requirement

	2021/22 Estimate £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000
Underlying borrowing requirement	602,208	598,769	587,984	575,162	562,046
Other long-term liabilities	118,485	112,918	106,854	100,569	94,950
Capital financing requirement	**720,693**	**711,687**	**694,838**	**675,731**	**656,996**

Limits to Debt

The Authorised Limit represents the level at which the Council is able to borrow and enter into other long term liabilities. Additional borrowing beyond this level is prohibited unless the limit is revised by the Council. Table 3 details the recommended Authorised Limits for 2021/22 – 2025/26.

Table 3 – Authorised Limits

	2021/22 Estimate £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000
Authorised limits for borrowing	647,708	644,269	633,484	620,662	607,546
Authorised limit for other long-term liabilities	118,485	112,918	106,854	100,569	94,950
Authorised limit for external debt	**766,193**	**757,187**	**740,338**	**721,231**	**702,496**

The Operational Boundary is based on the anticipated level of external debt needed during the year. Variations in cash flow may lead to occasional, short term breaches of the Operational Boundary that are acceptable. Sustained breaches would be an indication that there may be a danger of exceeding the Authorised Limits. Table 4 details the recommended Operational Boundaries for 2021/22 and following years.

Table 4 - Operational Limits

	2021/22 Estimate £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000
Operational limits for borrowing	622,708	619,269	608,484	595,662	582,546
Operational limit for other long-term liabilities	118,485	112,918	106,854	100,569	94,950
Operational limit for external debt	**741,193**	**732,187**	**715,339**	**696,231**	**677,496**

The forecast opening balance for External Borrowing at 1 April 2021 is £507.85 million and remains unchanged at 31 March 2022.

The Council also needs to ensure that its gross debt does not, except in the short term, exceed the total of the Capital Financing Requirement. Table 5 details the Capital Financing Requirement against the total gross debt plus other long term liabilities. The level of under borrowing reflects the use of internal borrowing from the Council's internal cash resources.

Table 5 – Underlying Borrowing Requirement to Gross Debt

	2021/22 Estimate £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000
Capital financing requirement	720,693	711,687	694,839	675,731	656,996
Gross borrowing and other long-term liabilities	636,487	631,738	626,335	620,768	614,704
Under/ (over) borrowing	**84,206**	**79,949**	**68,504**	**54,963**	**42,292**

The debt management strategy and borrowing limits for the period 2021/22 to 2025/26 have been set to ensure that over the medium term net borrowing will only be for capital purposes.

Ratio of Financing Cost to Net Revenue Stream

Table 6 below shows the relationship between Capital Financing Costs and the Net Revenue Stream for 2021/22 and future years. Financing cost is affected by Minimum Revenue Provision (MRP), interest receivable and payable and reductions in other long term liabilities.

Table 6 – Ratio of Financing Costs to Net Revenue Stream

	2021/22 Estimate £'000	**2022/23 Estimate £'000**	**2023/24 Estimate £'000**	**2024/25 Estimate £'000**	**2025/26 Estimate £'000**
Minimum revenue provision	12,996	13,469	14,094	14,427	14,664
Interest payable	26,017	26,017	26,017	26,017	26,017
Recharges and other adjustments	(520)	(740)	(1,037)	(1,214)	(1,322)
Interest receivable	(800)	(800)	(800)	(800)	(800)
Capital financing cost (excluding other long-term liabilities)	37,693	37,946	38,274	38,430	38,559
Capital financing costs of other long-term liabilities	14,901	14,636	14,689	14,428	13,262
Capital financing costs including other long-term liabilities	52,594	52,582	52,963	52,858	51,821
Estimated net revenue stream	**501,949**	**524,271**	**530,725**	**543,552**	**543,552**
Ratio of financing costs (excluding other long term liabilities) to net revenue stream	**7.51%**	**7.24%**	**7.21%**	**7.07%**	**7.09%**
Ratio of financing costs (including other long-term liabilities) to net revenue stream	10.48%	10.03%	9.98%	9.72%	9.53%

Treasury Management Prudential Indicators

Where external borrowing is required it can either be at fixed or variable rates of interest, and can be taken out for periods from a year to 50 years. The use of prudential indicators seeks to reduce the risks associated with fixed and variable interest rate loans and with borrowing for different loan periods.

Borrowing at fixed rates of interest for long periods can give the opportunity to lock into low rates and provide stability, but means that there is a risk of missing possible opportunities to borrow at even lower rates in the medium term. Variable rate borrowing can be advantageous when rates are falling, but also means that there is a risk of volatility and a vulnerability to unexpected rate rises.

Borrowing for short periods or having large amounts of debt maturing (and having to be re-borrowed) in one year increases the risk of being forced to borrow when rates are high.

The Council's policy has been to borrow at fixed rates of interest when rates are considered attractive.

The proposed Prudential Indicators for 2021/22 and beyond are set out in Table 7.

Table 7 – Treasury Management Prudential Indicators

Prudential Indicators	Upper Limit %	Lower Limit %
Limits on borrowing at fixed interest rates	100	70
Limits on borrowing at variable interest rates	30	0
Percentage of Fixed Rate Debt maturing in:		
Under 12 months	20	0
12 Months to within 24 months	25	0
24 Months to within 5 Years	30	0
5 years and within 10 Years	35	0
10 years and within 20 years	45	0
20 years and within 35 years	60	0
35 years and within 50 years	75	20

The limits have been set taking into account the CIPFA Code of Practice which requires that the maturity date for LOBO (Lender Option Borrower Option) loans is assumed to be the next call date, rather than the total term of the loan. This will apply to the Council's Money Market loans.

Monitoring the Indicators

It is important to monitor performance against forward looking indicators and the requirement that borrowing should only be for capital purposes. The total level of borrowing will be monitored daily against both the operational boundary and the authorised limit. If monitoring indicates that the authorised limit will be breached, a report will be brought to the Cabinet outlining what action would be necessary to prevent borrowing exceeding the limit and the impact on the revenue budget of breaching the limit. It will be for the Cabinet to make recommendations to the County Council to raise the limit if it is felt appropriate to do so.

The indicators for capital expenditure, capital financing requirement, capital financing costs and the treasury management indicators will be monitored monthly. Any significant variations against these indicators will be reported to the Cabinet.

Analysis of Long Term Debt

The following Table 8 shows the County Council's fixed and variable rate debt as at 31 March 2020 and 31 December 2020 (current).

The interest rates shown do not include debt management costs or premiums/discounts on past debt rescheduling.

There has been no movement in the Council's external debt over the last financial year, as no new borrowing has been required and no further opportunities have arisen to repay debt.

Table 8 – Analysis of Long Term Debt

	Actual 31.03.20 £'m	Interest Rate %	Current 31.12.20 £'m	Interest Rate %
Fixed Rate Debt				
PWLB	436.35	4.99	436.35	4.99
Money Market	71.50	5.83	71.50	5.83
Variable Debt				
PWLB	0.00		0.00	
Money Market	0.00		0.00	
Total External Borrowing	**507.85**	**5.11**	**507.85**	**5.11**

Schedule of Investments

The following schedule shows the County Council's fixed and variable rate investments as at 31 March 2020 and as at 31 December 2020 (current).

Table 9 – Schedule of Investments

	Maturing in:	Actual 31.03.20 £'m	Interest Rate %	Current 31.12.20 £'m	Interest Rate %
Bank, Building Society and MMF Deposits					
Fixed Rates					
Term Deposits	< 365 days	72.50	1.00	60.00	1.09
	365 days & >	20.00	1.40	18.00	1.13
Callable Deposits					
Variable Rate					
Call Accounts		45.00	0.65	7.71	0.06
Notice Accounts		45.00	0.90	85.00	0.24
Money Market Funds (MMFs)		23.01	0.48	0.00	
Property Fund		10.00	4.28	10.00	4.04
All Investments		**215.51**	**1.04**	**180.71**	**0.82**

The Council's cash balance available for investment varies during the year, with peaks when Government grants and Council Tax precepts are received, which then taper down as expenditure is incurred. The cash balance as at 31st December 2020 is lower than at the start of the year. This is consistent with current expectations that the cash balance will be lower at year end, as a result of the pressure on revenue budgets from the COVID pandemic, the impact of the growing deficit on the provision for Special Educational Needs (SEND) and the decision to pay three years' pension deficit contributions in advance. The cash balance may fall further by 31st March 2021.

The recent investment performance of the County Council's cash has been affected by the coronavirus pandemic which led the Bank of England to reduce its base rate firstly to 0.25% and then to 0.1% during March 2020.

Term deposits carried forward into 2020/21 that were made at the rates prevailing before the pandemic hit the economy have provided some mitigation against the rate cuts, as have forward deals totalling £20 million at rates above 1% that were made with local authorities that were seeking to bolster their cash balances in March 2020. However, as these deposits mature, the rates achievable on new deposits will be significantly lower.

The returns on the County Council's cash investments are therefore forecast to remain at low levels for the foreseeable future; however, the Treasury Management Strategy will continue to ensure a prudent and secure approach.

Prospects for Interest Rates

Forecasting future interest rate movements even one year ahead is always difficult. The factors affecting interest rate movements are clearly outside the Council's control. Whilst short term rates are influenced by the Bank of England's Base Rate, long term rates are determined by other factors, e.g. the market in Gilts. Rates from overseas banks will be influenced by their national economic circumstances. The County Council retains an external advisor, Link Asset Services, who forecast future rates several years forward. Similar information is received from a number of other sources.

The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its subsequent meetings to 5th November, although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the following forecast table, no increase in Bank Rate is expected in the foreseeable future as economic recovery is expected to be only gradual and, therefore, prolonged.

Gilt yields had already been on a generally falling trend up until the coronavirus crisis hit western economies during March 2020. After gilt yields spiked up during the financial crisis in March, we have seen these yields fall sharply to unprecedented lows as investors panicked during March in selling shares in anticipation of impending recessions in western economies, and moved cash into safe haven assets i.e. government bonds. However, major western central banks took rapid action to deal with excessive stress in Gilt yields and, therefore, PWLB rates have been at remarkably low rates during 2020/21, and as shown in the following table there is expected to be little upward movement in PWLB rates over the next two years. It will take economies, including the UK, a prolonged period to recover all the momentum they have lost in the sharp recession caused during the coronavirus shut down period.

From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment, (as shown on 9th November when the first results of a successful COVID-19 vaccine trial were announced). Such volatility could occur at any time during the forecast period.

Table 10 – Base Rate Forecasts and PWLB Rates

Base Rate Forecasts	**Dec (act) 2020**	**March 2021**	**June 2021**	**Sep 2021**	**Dec 2021**	**March 2022**	**June 2022**	**Sep 2022**	**Dec 2022**
Link Asset Services	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%
Capital Economics	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%

PWLB Rates	**Dec (act) 2020**	**March 2021**	**June 2021**	**Sep 2021**	**Dec 2021**	**March 2022**	**June 2022**	**Sep 2022**	**Dec 2022**
Link Asset Services forecast									
10 Year	1.21%	1.10%	1.10%	1.10%	1.10%	1.20%	1.20%	1.30%	1.30%
25 Year	1.75%	1.50%	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%
50 Year	1.56%	1.30%	1.40%	1.40%	1.40%	1.40%	1.50%	1.50%	1.50%

When budgeting for interest payments and receipts a prudent approach has been adopted to ensure that, as far as is possible, both budgets will be achieved.

Borrowing Strategy 2021/22 – 2024/25

The overall aims of the Council’s borrowing strategy are to achieve:

- Borrowing at the lowest rates possible in the most appropriate periods;
- The minimum borrowing costs and expenses; and
- A reduction in the average interest rate of the debt portfolio.

Since 2009 the Council has followed a policy of containing the capital programme, taking out no new external borrowing and repaying debt whenever this can be done without incurring a financial penalty. This strategy has worked well in a period of austerity. The Council's external borrowing level has reduced by £102m since 2008/09, resulting in reduced Capital Financing Charges.

The capital programme for 2021/22 requires borrowing of £17 million, which will be internal borrowing. This is offset by the MRP figure of £12 million which will leave the Council with total internal borrowing of £84 million, i.e. the Council has borrowed £84 million from its cash balances, in addition to the external debt of £507.85 million, to fund the capital programme. However, this is forecast to reduce in future years. The ability to internally borrow from the Council's cash has enabled the Council to fund its capital programme in recent years without taking out further external debt and incurring additional interest costs and other capital financing costs.

While cash balances remain relatively high, the Council can continue to internally borrow to meet capital commitments and maintain a measured level of future capital investment. However, this may become more challenging if there continues to be growing pressure on both the Council's capital programme and revenue budget, and other calls on cash balances such as the deficit on Special Educational Needs.

No opportunities have arisen during this financial year to repay external debt without incurring substantial premium penalties, which would negate any benefit of repaying the debt. The PWLB sets premature repayment rates and, where the interest rate payable on a current loan is higher than the repayment rate, the PWLB policy imposes premium penalties for early repayment. With current low rates of interest these penalties would be of a significant cost. Therefore, it will only make financial sense to repay debt early if the PWLB changes its current policy, or if interest rates rise significantly and cancel out the repayment premiums. This is unlikely to happen in the short to medium term.

The earliest date on which any of the Council's external debt matures is 31 March 2027, when the Council is due to repay a PWLB loan of £33.8 million, with a further £5.8 million to be repaid later in 2027. While this may still seem a long time away, the Council has begun to consider plans for the repayment of these loans. Given that the Council's capital programme has borrowed from its internal cash resources, there will need to be careful management of future capital requirements to ensure that cash resources are available so that these loans can be repaid, otherwise there might be a future need to take out new external borrowing to re-finance the debt.

Given the current economic climate and low interest rates, there may be an opportunity in the next few years to externally borrow or to restructure existing debt to ensure that cash resources are sufficient to support the future objectives of the Capital Programme. The Medium Term Financial Strategy (MTFS) continues to assume that, over the three year period, no new long-term borrowing will be required, but this will be kept under review. If key priorities cannot be delivered due to a reduced availability of external funding, the Authority's cash resources, or capital receipts, then external borrowing may be required. This will need to be balanced against the ability to support additional capital financing costs from within the revenue budget.

Active treasury management and the maintenance of levels of liquidity aim to ensure that no short term borrowing is required to fund cashflow. Cash positions are monitored daily and modelled over the financial year to ensure that anticipated liquidity levels are forecast accurately. Given current low interest rates, if short-term borrowing is required to aid cashflow, this will be targeted at an average rate of **0.1%**.

Investment Strategy 2021/22 – 2024/25

The County Council continues to adopt a very prudent approach to its investments. The majority of investments will be "Specified Investments" as defined by the Ministry of Housing, Communities and Local Government (MHCLG), For such investments, only a small number of selected UK banks and building societies, money market funds and overseas banks in highly rated countries are being used, subject to strict criteria and the prudent management of deposits with them. The lending policy is kept under constant review with reference to strict criteria for inclusion in the counterparty list. In addition, non-specified investments are included in the strategy, including the potential to invest in property funds, short-dated bond funds and multi-asset income funds.

The Treasury Management Strategy will continue to be set to ensure a prudent and secure approach.

The full County Council is required under the guidance in the CIPFA Treasury Management Code of Practice to approve an Annual Investment Strategy.

The overall aims of the Council's strategy continue to be to:

- Limit the risk to the loss of capital;
- Ensure that funds are always available to meet cash flow requirements;
- Maximise investment returns, consistent with the first two aims; and
- Review new investment instruments as they come to the Local Authority market, and to assess whether they could be a useful part of our investment process.

The overriding objective will be to invest prudently, with priority being given to security and liquidity before yield.

In 2020/21 the Council made a pre-payment of deficit contributions into the Pension Fund of £32 million, which represented the total deficit contributions set for the Council for the next three years. In return for making an advance payment of three years' deficit contributions the Pension Fund provided a 4.5% discount on the payment required, resulting in a saving of £0.5 million in each of 2020/21, 2021/22 and 2022/23.

This reduced the balance available for investment via the Treasury Management Strategy in 2020/21, but this will be partly restored in 2021/22, as no payment will be required to meet the budgeted deficit contributions for the year. The saving achieved represents a slightly higher return than the Council could achieve by investing more in the CCLA Property Fund or in a multi-asset income fund for arguably less overall risk.

The outlook for cash investment remains challenging. Whereas in the past there has been a perception that Governments would not allow banks to fail, the current regulatory environment puts more emphasis on the requirement for investors to take a hit by funding a "bail-in". A bail-in is where the bank's creditors, including local authorities depositing money with them, bear some of the burden by having part of the debt they are owed written off. The balance of risk has therefore changed, and as a result the Council has considered alternative forms of investment in order to diversify its risk.

Under the Markets in Financial Instruments (MiFID II) directive, local authorities are now classed as retail clients by the Financial Conduct Authority (FCA). This has implications for the range of investments that are available to local authorities. While bank and building society deposits are unaffected by the new regulations, some banks have determined that they will only take term deposits from professional clients, and a range of alternative forms of investments are only available to professional clients. However, if the local authority meets criteria set by the FCA, then it can apply to the financial institutions with which it wishes to invest to request that the institution concerned "opts up" the local authority to elective professional client status. The Council has made applications and been opted up to elective professional client status where required.

Those counterparties who have confirmed that they will treat the Council as a professional client under the MiFID II regulations are set out in Table 11 below.

Table 11 – Counterparties that have "opted up" the Council to elective professional client status

Counterparty	Counterparty Type
Standard Chartered	UK Bank
Commomwealth Bank of Australia	Overseas Bank
CCLA	Property Fund
Aberdeen Standard	Money Market Fund
Insight	Money Market Fund

In addition, brokers Tradition, Tullett Prebon and Imperial Treasury, and our treasury advisors, Link Asset Services, have opted up the Council to professional client status. The majority of bank and building society deposits are unaffected by the MiFID II regulations.

Subject to the MiFID II regulations, a variety of investment instruments are available to the Local Authority market. In addition to the notice accounts and fixed term deposits available from UK and overseas banks, it is also possible for the Council to invest, for example, in UK Government Gilts, bond funds and property funds. These alternative instruments would either require the Council to tie up its cash for significantly longer periods, thus reducing liquidity, or would carry a risk of loss of capital if markets go down. The Council has considered these alternatives and concluded that investment in a range of different funds should be permitted within the Treasury Management Strategy.

The Investment Strategy will be split between “Specified Investments”, which meet criteria specified in guidance issued by the Ministry of Housing, Communities and Local Government (MHCLG), and a range of longer term “Non-specified Investments”.

Specified Investments

Specified Investments will be those that meet the criteria in the MHCLG Guidance, i.e. the investment:

- is sterling denominated;
- has a maximum maturity of 1 year;
- meets the “high credit quality” as determined by the Council or is made with the UK government or is made with a local authority in England, Wales, Scotland or Northern Ireland or a parish or community council; and
- the making of which is not defined as capital expenditure under section 25(1)(d) in SI 2003 No 3146 (i.e. the investment is not loan capital or share capital in a body corporate).

Specified Investments will include bank and building society deposits. Security is achieved by the creation of an ‘Approved List of Counterparties’. These are the banks, building societies, money market funds and other public bodies with whom we are prepared to deposit funds. In preparing the list, a number of criteria will be used not only to determine who is on the list, but also to set limits as to how much money can be placed with them, and how long that money can be placed for.

Banks are expected to have a high credit rating. The Council uses the ratings issued by all three of the major credit rating agencies, Fitch, Moody’s and Standard & Poor’s, made available to the Council through its external Treasury Advisors. These are monitored daily.

The lowest rating published by any of the agencies is used to decide whether an institution is eligible for inclusion. Where the counterparty is only rated by two of the major ratings agencies the lowest rating published by either of the two is used. This rating also determines the maximum amount which can be loaned to an individual counterparty. Overseas banks that meet the criteria are included from countries with an ‘AAA’ Sovereign rating.

The time length of all deposits with financial institutions will be managed prudently, taking account of the latest advice from the Council’s external advisors.

Money Market Funds have a portfolio comprised of short-term (less than one year) securities representing high-quality, liquid debt and monetary instruments. Following the financial crisis these funds were seen as higher risk and were therefore not used by the Council. However, the new regulatory environment around the concept of “bail-in” means that many money market funds are now regarded as a more secure form of investment than bank deposits, as they diversify their investments across a range of financial institutions to spread the risk, and will therefore be used where appropriate.

Money market funds must have an ‘AAA’ rating to be included on the counterparty list. They may be CNAV (Constant Net Asset Value), LVNAV (Low Volatility Net

Asset Value) or VNAV (Variable Net Asset Value). Yields and prices will be monitored on a daily basis to ensure that there is minimal risk of loss of capital.

Other public sector bodies are principally arms of Government, or other local authorities, and although not rated are deemed suitable counterparties because of their inherent low risk.

The ‘Approved List of Counterparties’ specifies individual institutions and is formally reviewed at least monthly. Notification of credit rating downgrades (or other market intelligence) is acted upon immediately, resulting in any further lending being suspended.

Table 12 below summarises the current ‘Approved List’ criteria.

Table 12 – Specified Investments Counterparty Approved List Criteria

Counterparty Type	Fitch	Moody's	Standard & Poor's	Credit Limit
UK Banks				
not below	AA- & F1+	Aa3 & P-1	AA- & A-1+	£50 million
not below	A- & F1	A3 & P-1	A- & A-1	£30 million
UK Building Societies				
not below	AA- & F1+	Aa3 & P-1	AA- & A-1+	£50 million
not below	A- & F1	A3 & P-1	A- & A-1	£30 million
Overseas Banks				
Sovereign Rating of	AAA	Aaa	AAA	
and not below	AA- & F1+	Aa3 & P-1	AA- & A-1+	£50 million
and not below	A- & F1	A3 & P-1	A- & A-1	£30 million
UK Public Bodies				
Central Government				
– Debt Management Office				Unlimited
Local Government				
– County Councils				£10 million
– Metropolitan Authorities				£10 million
– London Boroughs				£10 million
– English Unitaries				£10 million
– Scottish Authorities				£10 million
– English Districts				£5 million
– Welsh Authorities				£5 million
Fire & Police Authorities				£5 million
Money Market Funds	AAA	Aaa	AAA	£30 million

Where the short term rating of a counterparty is one notch below the stated criteria, but the counterparty meets the long term rating criteria, they may still be used subject to the advice of our external advisors (Link Asset Services) who will take into account a range of other metrics in arriving at their advice.

The counterparty limits shown in the table also apply at a banking group level. This ensures that the Council is not exposed to the risk of having maximum sums invested in multiple institutions owned by a group that encounters financial difficulties.

The credit ratings shown in the table for banks and building societies allow for greater sensitivity in recognising counterparty risk. Liquidity in investments is the second key factor in determining our strategy. Funds may be earmarked for specific purposes or may be general balances, and this will be a consideration in determining the period over which the investment will be made.

The Council has a self-imposed limit of ensuring that at least 15% of deposits will be realisable within one month.

The Council will look to invest in specified investments for a range of durations up to one year to ensure sufficient liquidity for cashflow purposes. Our treasury advisors, Link Asset Services, provide advice on the recommended maximum length of deposit for each of the counterparties that the Council uses, and their recommendations will be taken into account when determining the length of time that any deposit is placed for.

Non-Specified Investments

Non-specified investments are those that do not meet the criteria described above, but are intended to be a longer term investment, generating a higher yield, but with a slightly higher degree of risk.

The limit on non-specified investments will be set at no more than 25% of the total treasury investments at any time or £40m whichever is the lower.

The Council has previously decided that investment in a commercial property fund would be a prudent way to diversify risk and achieve a higher yield, as it would benefit from forecast growth in GDP. The CCLA Property Fund is therefore included as an approved counterparty, and an initial investment of £10 million was made in 2015.

In addition, short-dated bond funds and multi-asset income funds may be used. Short dated bond funds will invest in high quality short dated government or corporate bonds. Multi-asset income funds will invest in a wider range of investments designed to produce a higher income yield, but will have a higher level of risk. In both cases, funds will be targeted where the total return is likely to be higher than the income yield, to reduce the risk of capital loss should the investment need to be realised.

The Council will only use funds that are subject to a statutory override to IFRS9. Under the IFRS9 accounting standard unrealised gains and losses arising from funds previously measured as Available for Sale will now be classified as Fair Value through Profit and Loss and taken to the Comprehensive Income and Expenditure Account in the year they arise. As a result, any capital loss would impact on the yield gained from the investment.

However, Parliament has put in a statutory override for investments that fall under the following definitions:

- A money market fund;
- A collective investment scheme as defined in section 235 (1) of the Financial Services and Markets Act 2000;
- An investment scheme approved by the Treasury under section 11(1) of the Trustee Investments Act 1961 (local authority schemes)

The regulation (override) makes it clear that the revenue account should not be charged in respect of that fair value gain or loss and instead that amount should be charged to an account established, charged and used solely for the purpose of recognising fair value gains and losses in accordance with this regulation. The statutory override applies from 1st April 2018 to 31st March 2023. This reduces the risk to the Council of capital losses impacting on investment income, as any capital loss would only impact on the Council at the point that the investment is realised, or after the statutory override ends in March 2023. However, the risk of loss of capital at those points needs to be recognised, and these investments should be seen as longer-term investments.

Non-specified investments can also include bank and building society deposits of over a year, in line with the criteria set out in the section on Specified Investments.

Table 13 below summarises the 'Approved List' criteria for non-specified investments.

Table 13 – Non-Specified Investments Counterparty Approved List Criteria

Counterparty Type	**Credit Limit**
CCLA Property Fund	£30 million
Short-dated bond funds	£20 million
Multi-asset income funds	£20 million
Bank and Building Society Deposits over 1 year (meeting credit rating criteria as per Specified Investments)	£30 million

Where a bank or building society is considered for an investment of over one year, the credit limit will be applied to the total investments with that institution, including specified and non-specified investments, i.e. deposits above and below one year.

Interest Rate Targets

For the 2021/22 financial year it has been assumed that the average interest rate earned on lending to banks and building societies will be **0.30%** p.a. The target rate takes into account that the Bank of England's base rate is likely to remain at 0.10% for the foreseeable future. It also takes into account the higher rates on some current deposits that extend into 2021/22.

The yield from investment in the CCLA Property Fund is assumed to be **3.80%**. This takes into account potential reductions in yield as a result of the pandemic. Further analysis will be required to identify short-dated bond funds and multi-asset income funds that would meet the Council's requirements. The targeted yield from those funds would be **2.00%** for short dated bond funds and **3.50%** for multi-asset income funds. Currently these are not factored into the budget for investment income.

The targets we have set for 2021/22 are considered to be achievable.

Given the degree of uncertainty about future economic prospects and the future level of interest rates, MTFS forecasts have been based on the average rates for lending to banks and building societies continuing to be 0.30% for 2021/22 and 2022/23. However, these will be reviewed in the light of changes to the rates on offer from the Council's counterparties over the MTFS period. It may be possible to increase the target rate should the impact of the vaccination programme on the pandemic enable the economy to recover, but the uncertainty is likely to mean that it will be some time before the Bank of England is in a position to consider rate rises.

Investments that are not part of treasury management

The revised Treasury Management Code also requires the authority to report on investments in financial assets and property that are not part of treasury management activity, but where those investments are made primarily to achieve a financial return.

The Council's policy is not to make commercial investments outside of its treasury management activity for mainly financial reasons. All capital investments outside of treasury management activities are held explicitly for the purposes of operational services, including regeneration, and are monitored through existing control frameworks.

This will be important if at any stage the council decides to take out new external borrowing to fund its capital programme. The Government has been concerned for some time about the risk involved in local authorities taking out external debt to fund investments in commercial property to generate income. In November 2020, they announced a change in the PWLB's lending terms. This introduced a prohibition to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three year capital programme. Given the Council's policy, this should have no impact on our treasury management strategy.

The Council does not generally invest in equity shares but does have two £1 shares in NPS (SW) Ltd, valued at £247,000 and an equity investment in Exeter Science Park Ltd of £1.881 million. At 31 March 2020 these shares were recognised in the balance sheet at £2.128 million. However, these are not held as financial investments, but for the purposes of providing operational services, including economic regeneration.

Performance Targets

The primary targets of the Treasury Management Strategy are to minimise interest payments and maximise interest receipts over the long term whilst achieving annual budgets, without taking undue risk. Where there are comparative statistics available for individual aspects of the Strategy these will be used to monitor performance. The Council will continue to review best practice at other authorities and work with its treasury advisors (Link Asset Services) to assess performance.