NOT CONFIDENTIAL – For public release **Item No. 13**

COUNCIL
5 MARCH 2020

Report of the Head of Resources

TREASURY MANAGEMENT STRATEGY STATEMENT 2020/21

PURPOSE OF REPORT

This report determines the Treasury Management Strategy and Annual Treasury Management Investment Strategy for 2020/21.

RECOMMENDATIONS

1. That the Treasury Management Strategy Statement for 2020/21 be approved;
2. That the Annual Treasury Management Investment Strategy for 2020/21 be approved.

WARDS AFFECTED

All

STRATEGIC LINK

The above recommendations contribute to all of the Council's Corporate Plan Priorities

1. REPORT

1.1 TREASURY MANAGEMENT ANNUAL REPORT

The Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition* (the CIPFA Code) requires the Council to approve a treasury management strategy before the start of each financial year.

In addition, the ministry for Housing, Communities and Local Government (MHCLG) issued revised *Guidance on Local Authority Investments* in March 2010 that requires the Council to approve an investment strategy before the start of each financial year.

This report fulfils the Council's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the CLG Guidance.

The Council invests 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 Council's treasury management strategy.

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

1.2 REPORTING REQUIREMENTS

The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

1. **The Treasury Management Strategy** (this report) – The first, and most important, report covers:
   - The treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
   - A treasury management investment strategy (the parameters on how investments are to be managed).

2. **A mid-year treasury management report –** This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision.

3. **An annual treasury report –** This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Scrutiny
The above reports are adequately scrutinised by the Corporate Leadership Team before being recommended to the Council.

1.3 EXTERNAL CONTEXT

1.3.1. Economic background

The UK's progress negotiating its exit for the European Union, together with its future trading arrangements, will continue to be a major influence on the Authority's treasury management strategy for 2020/21. The General Election has removed some uncertainty and the Withdrawal Agreement Bill passed through Parliament in January. However, uncertainties around the UK's future trading relationship with the EU remain as these have to be concluded in an ambitious transition period timeframe by December 2020.

GDP growth rose by 0.4% in the third quarter of 2019 from -0.2% in the previous three months with the annual rate falling further below its trend rate to 1.1% from 1.2%. Services, construction and production added positively to growth, by 0.5%, 1.2% and 0.1% respectively, while agriculture recorded a fall of 0.1%. Looking ahead, the Bank of England's Monetary Policy Report (formerly the Quarterly Inflation Report) forecasts economic growth to pick up during 2020 as Brexit-related uncertainties dissipate and provide a boost to business investment helping GDP reach 1.6% in Q4 2020, 1.8% in Q4 2021 and 2.1% in Q4 2022.

Credit Outlook

The recent Bank of England stress tests assessed all seven UK banking groups. The tests scenarios include deep simultaneous recessions in the UK and global economies that are more severe overall than the global financial crisis, combined with large falls in asset prices and a separate stress of misconduct costs. All seven banks passed the test on both a CET1 ratio and a leverage ratio basis. Major Banks have steadily increased their capital for many years now. However, there are a number of shortcomings in the

Bank's approach; timeliness as the results are over 11 months out of date when they are published, being based on end-2018 balance sheets; ring-fencing, as the test ignore the restrictions on transferring capital between ringfenced "retail" banks and non-ringfenced "investment" banks within the larger groups and; coverage – the tests should be expanded to cover a wider range of UK banks and building societies.

The Bank of England will seek to address some of these issues in 2020, when Virgin Money/Clydesdale will be added to the testing group and separate tests will be included of ringfenced banks.

Challenger banks hit the news headlines in 2019 with Metro Bank and TSB Bank both suffering adverse publicity and falling customer numbers.

Looking forward, the potential for a no UK-EU trade deal being agreed and ratified and/or a global recession remain the major risks facing banks and building societies in 2020/21 and a cautious approach to bank deposits remains advisable.

Outlook

The coronavirus could cost the global economy more than $1.1trillion in lost output, if it turns into a pandemic. The head of the International Monetary Fund Krisalina Georgieva, said that the global lender of last resort was ready to provide additional support, particularly to poorer countries by way of grants and debt relief.

Speaking at a G20 meeting of finance leaders and central bank chiefs, she said the IMF assumed the impact would be relatively minor and short-lived, although she warned that the continued spread of the virus could have dire consequences. She added "Global cooperation is essential to the containment of the Covid-19 and its economic impact particularly if the outbreak turns out to be more persistent and widespread".

The UK economy continues to slow due to both post-Brexit uncertainty and the downturn in global activity. In response, global and UK interest rate expectations have eased. Central bank actions and geopolitical risks will continue to produce significant volatility in financial markets over the period, including bond markets.

Parliament passed Prime Minister Boris Johnson's Withdrawal Agreement Bill and the UK will now exit the EU on 31st January 2020. The bill also rules out an extension to the transition period for agreeing a trade deal which means a no-deal Brexit cannot be entirely ruled out for 2020.

Our treasury advisor Arlingclose expects Bank Rate to remain at 0.75% for the foreseeable future but there remain substantial risks to this forecast, dependant on Brexit/trade deal outcomes as well as the evolution of the global economy. Arlingclose also expects gilt yields to remain at low levels for the foreseeable future and judges the risks to be weighted to the downside.

	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Official Bank Rate													
Upside risk	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Case	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Downside risk	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75

Local Context

On 31st December 2019, the Council held £5.5m of borrowing and £27m of investments. This is set out in further detail at ***Appendix B***. Forecast changes in the balance sheet analysis are shown in table 1 below:

Table 1: Balance Sheet Summary and Forecast

	31.3.19 Estimate £m	**31.3.20 Forecast £m**	**31.3.21 Forecast £m**	**31.3.22 Forecast £m**	**31.3.23 Forecast £m**
General Fund CFR	5.9	5.7	5.5	5.5	5.3
Less: Other debt liabilities *	0.2	0	0	0	0
Less: External borrowing **	5.5	5.5	5.5	5.5	5.5
Internal (over) borrowing	**0.2**	**0.2**	**0.0**	**0.0**	**-0.2**

* finance leases that form part of the Council's total debt

** shows only loans to which the Council is committed and excludes optional refinancing.

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. The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

The Council's capital expenditure plans do not currently imply any need to borrow over the forecast period. Investments are forecast to fall to £16m as capital receipts are used to finance capital expenditure and reserves are used to finance the revenue budget.

CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Council expects to comply with this recommendation during 2020/21.

1.3.2. Borrowing Strategy

The Council currently holds £5.5 million of loans, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 1 shows that the Council does not expect to need to borrow in 2020/21. The Council may however borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £12 million.

Objectives: The Council'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 Council's long-term plans change is a secondary objective.

Strategy: Given the significant cuts to public expenditure and in particular to local government funding, the Council'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.

By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal / 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 Council with this 'cost of carry' and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2020/21 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

The Authority has previously raised all of its long-term borrowing form the PWLB but the government increased PWLB by 1% in October 2019 making it now a relatively expensive option. The Authority will now look to borrow any long-term loans from other sources including banks, pensions and local authorities in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA code.

Alternatively, the authority may arrange forward starting loans during 2020/21, where the interest rate is fixed in advance, but the cash is received in later years.

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

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

- Public Works Loan Board (PWLB) and any successor body
- 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 our own Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

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

The Council has previously raised all of its long-term borrowing from the PWLB but it continues to investigate other sources of finance, such as local authority loans and bank loans, which may be available at more favourable rates.

1.3.3. **Municipal Bond Agency:** UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a joint and several guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to Council.

1.3.4. **Short-term and Variable Rate loans**: These loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators below.

1.3.5. **Debt Rescheduling:** 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 Council 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.

1.4 ANNUAL TREASURY MANAGEMENT INVESTMENT STRATEGY

1.4.1 The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council's investment balance has ranged between £11 million and £29 million, and similar levels are expected to be maintained in the forthcoming year.

1.4.2 **Objectives:** The CIPFA code requires the Council 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 Council'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 Council 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.

1.4.3 **Negative Interest Rates:** If the UK enters into a recession in 2020/21, there is a small chance that the Bank of England could 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. This situation already exists in many other European countries. 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.

1.4.4 **Strategy:** Given the increasing risk and very low returns from short-term unsecured bank investments, the Council aims to further diversify into more secure and/or higher yielding asset classes during 2020/21. This is especially the case for the estimated £2.0m that is available for longer-term investment. The majority of the Authority's surplus cash remains invested in short-term unsecured bank deposit, certificates of deposits and money market firms. This diversification will represent a continuation of the new strategy adopted in 2017.

1.4.5 **Business models:** 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.

1.4.6 **Approved Counterparties:** The Authority may invest its surplus funds with any of the counterparty types in table 2 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 2: Approved Investment Counterparties and Limits for 2020/21

Credit Rating	**Banks Unsecured**	**Banks Secured**	**Government**	**Corporates**	**Registered Providers**
UK Gov't	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£2m 5 years	£3m 20 years	£3m 50 years	£1m 20 years	£1m 20 years
AA+	£2m 5 years	£3m 10 years	£3m 25 years	£1m 10 years	£1m 10 years
AA	£2m 4 years	£3m 5 years	£3m 15 years	£1m 5 years	£1m 10 years
AA-	£2m 3 years	£3m 4 years	£3m 10 years	£1m 4 years	£1m 10 years
A+	£2m 2 years	£2m 3 years	£2m 5 years	£1m 3 years	£1m 5 years
A	£2m 13 months	£2m 2 years	£2m 5 years	£1m 2 years	£1m 5 years
A-	£2m 6 months	£2m 13 months	£2m 5 years	£1m 13 months	£1m 5 years
None	£0.25m 6 months	n/a	£4m 25 years	£50,000 5 years	£1m 5 years
Pooled funds	£4m per fund				

This table must be read in conjunction with the notes below:

1.4.7 **Credit Rating:** Investment limits are set by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. 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.

1.4.8 **Banks 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.

1.4.9 **Banks Secured:** Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they 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 to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

1.4.10 **Government:** Loans, 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 an insignificant risk of insolvency, although they are not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

1.4.11 **Corporates:** Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made either following an external credit assessment or to a maximum of £500,000 per company as part of a diversified pool in order to spread the risk widely.

1.4.12 **Registered Providers:** Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing, formerly known as Housing Associations. These bodies are tightly 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.

1.4.13 **Pooled Funds:** Shares in diversified investment vehicles consisting of any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Council 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 Council's investment objectives will be monitored regularly.

1.4.14 **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 on the shares as well as changes in the underlying properties. Investments in REIT shares cannot be withdrawn but can be sold on the stock market to another investor.

1.4.15 **Operational Bank Accounts:** The Authority may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £6 million per bank (the practicalities of making large payments, such as precept payments, on any one day mean that funds of that magnitude will be required in the Council's current account). 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.

1.4.16 **Risk Assessment and Credit Ratings**: Credit ratings are obtained and monitored by the Council's treasury advisers, 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.

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.

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

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, 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 a reduction in the level of investment income earned but will protect the principal sum invested.

1.4.18 **Investment Limits**: The Council's revenue reserves available to cover investment losses are forecast to be £2 million on 31st March 2020. A group of banks under the same ownership will be treated as a single organisation for limit purposes. 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 4: Investment Limits

	Cash limit
Any single organisation, except the UK Central Government	£4m each
UK Government	unlimited
Any group of organisations under the same ownership	£4m per group
Any group of pooled funds under the same management	£5m per manager
Negotiable instruments held in a broker's nominee account	£5m per broker
Foreign countries	£2m per country
Registered Providers	£5m in total
Unsecured investments with Building Societies	£3m in total
Loans to unrated corporates	£2m in total

Money Market Funds	£16m in total
Real estate investment trusts	5m in total
Lloyds bank – (Councils own bank)	6m in total

1.4.19 **Liquidity Management**: The Council uses cash flow forecasting spreadsheets to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium term financial plan and cash flow forecast.

1.5 TREASURY MANAGEMENT INDICATORS

The Council measures and manages its exposures to treasury management risks using the following indicators.

1.5.1 **Security:** The Council 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.

	Target
Portfolio average credit	*AA-*

1.5.2 **Liquidity:** The Council 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.

	Target
Total cash available within 3 months	£6m

1.5.3 **Interest Rate Exposures**: This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates will be:

Interest rate risk indicator	**Limit**
Upper limit on one-year revenue impact of a 1% rise in interest rates	85,000
Upper limit on one-year revenue impact of a 1%fall in interest rates	105,000

The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.

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

	Upper	Lower
Under 12 months	35%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	65%	0%
5 years and within 10 years	80%	0%
10 years and above	100%	0%

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.

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

	2020/21	2021/22	2022/23
Limit on principal invested beyond year end	£3m	£3m	£3m

1.6 OTHER ITEMS

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

1.6.1 **Policy on Use of Financial Derivatives:** 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).

The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

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

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

1.6.2 **Markets in Financial Instruments Directive:** The Authority has opted up to professional client status with its providers of financial services, allowing it access to a greater range of service but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the Head of Resources believes this to be the most appropriate status.

1.6.3 **Investment Training:** The needs of the Council's treasury management staff for training in investment management are assessed annually as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.

Council employees involved in Treasury Management regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA. Relevant employees are also encouraged to study for professional qualifications from CIPFA and other appropriate organisations.

1.6.4 **Investment Advisers:** The Council has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues.

1.6.5 **Investment of Money Borrowed in Advance of Need**: The Council may, from time to time, borrow in advance of need, where this is expected to provide the best long term value for money. Since amounts borrowed will be invested until spent, the Council is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Council's overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit of £12 million. The maximum period between borrowing and expenditure is expected to be two years, although the Council is not required to link particular loans with particular items of expenditure.

1.7 OTHER OPTIONS CONSIDERED

The CLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Head of Resources 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

2 RISK ASSESSMENT

2.1 Legal

The report complies with best practice and government guidance on the preparation of the treasury management strategy statement. The legal risk is therefore low.

2.2 Financial

The budget for investment income in 2020/21 is £134,472, which is based on an average interest rate of 0.67%. The budget for debt interest paid in 2020/21 is £225,000 based on an average debt portfolio of £5.5 million at an average interest rate of 4.1%. If actual levels of investments and borrowing, or actual interest rates, differ from those forecast, performance against budget will be correspondingly different. The financial risk is assessed as medium.

2.3 Corporate

This strategy sets in place a proposed structure and systems that place security of investments above yield. The risk is therefore assessed as low.

3 OTHER CONSIDERATIONS

In preparing this report the relevance of the following factors has also been considered prevention of crime and disorder, equalities, environmental, climate change, health, human rights, personnel and property.

4 CONTACT INFORMATION

For further information contact:

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5 BACKGROUND PAPERS

None

6 ATTACHMENTS

Appendix A – Arlingclose Economic & Interest Rate Forecast

Appendix B – Existing Investment & Debt Portfolio Position

Appendix A – Arlingclose Economic & Interest Rate Forecast as at December 2019

Underlying assumptions:

- The global economy is entering a period of slower growth in response to political issues, primarily the trade policy stance of the US. The UK economy has displayed a marked slowdown in growth due to both Brexit uncertainty and the downturn in global activity. In response, global and UK interest rate expectations have eased.

- The coronavirus could cost the global economy more than $1.1trillion in lost output if it turns into a pandemic. The head of the International Monetary Fund Krisalina Georgieva, said that the global lender of last resort was ready to provide additional support, particularly to poorer countries by way of grants and debt relief.

  Speaking at a G20 meeting of finance leaders and central bank chiefs, she said the IMF assumed the impact would be relatively minor and short-lived, although she warned that the continued spread of the virus could have dire consequences. She added “Global cooperation is essential to the containment of the Covid-19 and its economic impact particularly if the outbreak turns out to be more persistent and widespread”.

- The fallout from the US-China trade war continues which, risks contributing to a slowdown in global economic activity in 2020. Recent suggestions have been an initial compromise and potential unwinding of tariffs; however, this can change quickly. Slow growth in Europe, combined with changes in leadership at the ECB and IMF has led to a change of stance from monetary tightening to monetary loosening. Quantitative easing has continued and been extended.

- Brexit - A key concern is the limited transitionary period following a January 2020 exit date, which will maintain and create additional uncertainty over the next few years.

- UK economic growth has stalled despite Q3 2019 GDP of 0.3%. Monthly figures indicate growth waned as the quarter progressed and survey data suggest falling household and business confidence. Both main political parties have promised substantial fiscal easing, which should help support growth.

- Inflation is running below target at 1.7%. While the tight labour market risks medium-term domestically-driven inflationary pressure, slower global growth should reduce the prospect of externally driven pressure, although political turmoil could push up oil prices.

- Central bank actions and geopolitical risks will continue to produce significant volatility in financial markets, including bond markets.

Forecast:

- Although we have maintained our Bank Rate forecast at 0.75% for the foreseeable future, there are substantial risks to this forecast, dependant on General Election outcomes and the evolution of the global economy.

- Arlingclose judges that the risks are weighted to the downside.

- Gilt yields have risen but remain low due to the soft UK and global economic outlooks. US monetary policy and UK government spending will be key influences alongside UK monetary policy.

- We expect gilt yields to remain at relatively low levels for the foreseeable future and judge the risks to be broadly balanced.

	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Official Bank Rate													
Upside risk	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Case	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**
Downside risk	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 1.80%
PWLB Local Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

Appendix B – Existing Investment & Debt Portfolio Position

	December 2019 **Actual Portfolio** **£m**	December 2019 **Average Rate** **%**
External borrowing: Public Works Loan Board Other loans **Total external borrowing**	**5.5**	**4.1**
Finance Leases	0.2	
Total gross external debt	5.7	
Investments Banks & Building Societies Local Government Money Market Funds CCLA Property fund	 4.1 19 3.0 1.0	
Total treasury investments	27.1	0.79
Net debt	-21.4	