

Treasury Management Strategy for 2021/22

The strategy for 2021/22 covers two main areas:

Capital Issues

- the capital expenditure plans and the associated prudential indicators; the Minimum Revenue Policy (MRP) in Appendix 4.

Treasury Management Issues

- the current treasury position;
- treasury indicators which will limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on the use of external service providers.

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, Ministry of Housing, Communities and Local Government (MHCLG) MRP Guidance, the CIPFA Treasury Management Code and MHCLG Investment Guidance.

Capital issues

The Capital Prudential Indicators 2021/22 – 2023/24 (See Table 1 in Appendix 2)

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

Capital Expenditure. This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle.

The table below summarises the capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding need (borrowing).

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| Table 1 Capital Expenditure | 2019/20 Actual £000 | 2020/21 Revised Estimate £000 | 2021/22 Estimate £000 | 2022/23 Estimate £000 | 2023/24 Estimate £000 |
|--|------------------------------------|--|--------------------------------------|--------------------------------------|--------------------------------------|
| Programmed Spend | 14,026 | 15,906 | 17,759 | 20,168 | 12,492 |
| Financed by: | | | | | |
| Capital receipts | 2,138 | 2,222 | 2,111 | 2,464 | 2,227 |
| 3rd Party Contributions | 533 | 98 | 377 | 482 | 572 |
| Capital grants | 3,078 | 5,540 | 7,448 | 11,277 | 3,797 |
| Revenue | 223 | 1,416 | 399 | 194 | 135 |
| Net borrowing need for the year | 8,054 | 6,630 | 7,424 | 5,751 | 5,761 |

Ratio of Financing Costs to Net Revenue Streams

This indicator shows the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) expressed as a percentage against the net revenue stream. Table 1 in Appendix 2 shows there is a general trend that financing costs are taking up a higher percentage of the revenue budget. This is due to forecast reductions in future aggregate external funding based on 'revenue spending power' for the Council through reduced Government grant.

The Council's Borrowing Need (the Capital Financing Requirement)

This prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR and is represented by the net financing need for the year line. The Council's CFR is shown in Table 1 of Appendix 2 and below.

The CFR does not increase indefinitely, as the MRP is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life, and so charges the economic consumption of capital assets as they are used.

| Table 2 | 2019/20 Actual £000 | 2020/21 Revised Estimate £000 | 2021/22 Estimate £000 | 2022/23 Estimate £000 | 2023/24 Estimate £000 |
|--|------------------------------------|--|--------------------------------------|--------------------------------------|--------------------------------------|
| Capital Financing Requirement | | | | | |
| Total CFR at 31 st March | 38,597 | 44,293 | 50,498 | 54,978 | 59,423 |
| Net financing need for the year | 7,202 | 5,696 | 6,205 | 4,480 | 4,445 |

| £m | 2019/20 Actual £000 | 2020/21 Revised Estimate £000 | 2021/22 Estimate £000 | 2022/23 Estimate £000 | 2023/24 Estimate £000 |
|---|------------------------------------|--|--------------------------------------|--------------------------------------|--------------------------------------|
| Movement in CFR represented by | | | | | |
| Net borrowing need for the year (Table 1 above) | 8,054 | 6,630 | 7,424 | 5,751 | 5,761 |
| Less MRP and other financing movements | (852) | (934) | (1,219) | (1,271) | (1,316) |

Appendix 1

| | | | | | |
|--------------------------------|--------------|--------------|--------------|--------------|--------------|
| Movement in CFR in Year | 7,202 | 5,696 | 6,205 | 4,480 | 4,445 |
|--------------------------------|--------------|--------------|--------------|--------------|--------------|

Treasury Management Issues

The capital expenditure plans set out above, provide details of the activity of the Council. The treasury management function ensures that the Council's cash is organised within the relevant professional codes, so that sufficient cash is available to meet these activities. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury/prudential indicators, the current and projected debt positions and the annual investment strategy.

The Council's Current Portfolio Position

Within the prudential indicators in Appendix 2 there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2021/22 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes. In the Council's case, the estimated external debt at 31st March 2021 of £40.1m is less than the CFR which ranges from £44.3m to £59.4m which means that the Council 'borrows internally' (using reserves and balances) to finance past capital spending as this tends to be cheaper than external debt.

Treasury Limits for 2021/22 to 2023/24

It is a statutory duty under Section 3 of the Act and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Authorised Borrowing Limit".

The Council must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax levels is 'acceptable'.

Whilst termed an "Affordable Borrowing Limit", the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years, details of the Authorised Limit can be found in Table 2 in Appendix 2 of this report outlining the prudential and treasury indicators for 2021/22 – 2023/24.

The Operational Boundary is the limit beyond which external debt is not normally expected to exceed and is normally similar to the CFR. It is proposed to set this at 10% above the CFR.

The Authorised Limit is a further key indicator representing a control on the maximum level of borrowing, beyond which external debt is prohibited, and this limit needs to be set or revised by the Full Council. It reflects the level of external debt which, whilst not desired,

could be afforded in the short term, but is not sustainable in the longer term. It is proposed to set this at 10% above the operational boundary and includes provision for 'unusual cash movements'.

IFRS16 – Leased Assets

A requirement for closing of the council's accounts for 2021/22 is to bring operational leased assets onto the balance sheet. This will have the effect of increasing the council's CFR, External Debt, Authorised Limit and Operational Boundary. The Authorised Limit and Operational Boundary may therefore need to be amended mid-year, once the detailed impact is known.

The Borrowing Strategy

The Council is currently maintaining an under-borrowed position which means that the capital borrowing need (the CFR), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.

The Head of Finance & Property will monitor interest rates and adopt a pragmatic approach to changing circumstances:

- if it was felt that there was a significant risk of a sharp fall in long and short term rates, then long term borrowings will be postponed,
- if it was felt that there was a significant risk of a much sharper rise than that currently forecast, then the portfolio will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.
- will take a view on prevailing and perceived future interest rates and take decisions on whether to borrow longer-term or short-term accordingly whenever a borrowing requirement arises. As well as taking a view on the appropriate mix of fixed and variable interest rate exposure in the light of prevailing and perceived future market conditions.
- undertake a constant review of the Council's total external debt portfolio to determine the scope for any restructuring possibilities and make recommendations to Full Council accordingly.

Treasury Management - Limits on Activity

There are three debt related treasury activity limits, the purpose of which is to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. The indicators are:

- Upper limits on variable rate exposure;
- Upper limits on fixed rate exposure;
- Maturity structure on borrowing limits which are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

The Borrowing Policy and Borrowing Requirement

The Council will not borrow more than or in advance of its need purely in order to profit from the investment of the extra sums borrowed.

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The Council's maximum borrowing requirement (Authorised Limit for external debt) is £61.103m next year. This is limited to 10% above the operational boundary of £55.548m, which has been set at 10% above the CFR.

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

Debt Rescheduling

Rescheduling of current borrowing in our debt portfolio is unlikely to occur as the 1% increase in PWLB rates only applied to new borrowing rates and not to premature debt repayment portfolios

The reasons for any rescheduling to take place will include: -

- the generation of cash savings and / or discounted cash flow savings
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Consideration will also be given to identify if there is any residual potential left for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

All rescheduling will be reported to the Council at the earliest meeting following its action.

New Financial Institutions as a source of borrowing

Currently the PWLB Certainty Rate is set at gilts plus 80 basis points. However, consideration may still need to be given to sourcing funding from the following sources:

- Local Authorities (primarily shorter date maturities)
- Financial Institutions (primarily insurance companies and pension funds but also some banks, out of forward dates where the objective is to avoid a cost of carry or to achieve refinancing certainty over the next few years)
- Municipal Bonds Agency (possibly still a viable alternative depending on market circumstances prevailing at the time)

Our advisors, Link Asset Serves, will keep us informed as to the relative merits of each of these alternative funding sources.

Annual Investment Strategy

Investment Policy – management of risk

The Council's investment policy has regard to the following;

- MHCLG's Guidance on Local Government Investments ("The Guidance")
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("The Code")
- CIPFA Treasury Management Guidance Notes 2018

The Council's deposit priorities focus on;

- Security of Capital
- Liquidity, and

- Yield

The Council will aim to achieve optimum return [yield] on deposits commensurate with proper levels of security and liquidity.

Monitoring Performance:

The council has retained HSBC UK Bank plc as the provider for administering the Council's banking facilities [contract renewed in December 2018 for a three-year term]. The Council continues to have a 'sweep' facility for our current account. This means that if we do not deposit monies with other counterparties but leave the balance with HSBC, they will automatically transfer the money into an interest earning deposit account. This account is effectively a call account whereby we can get the money back instantly if required. The current rate the Council is achieving on these deposits is in line with that achieved with other counterparties.

Approved list of Counterparties for Deposits

There are strict limits in terms of the type of institution with which funds may be deposited and the length of time funds can be invested for.

As part of the Treasury Policy Statement, as a minimum, the approved list of counterparties is reviewed annually and reported to Council. The current list was revised in the 2020/21 Treasury Management Mid-Year report and approved on 16 December 2020.

It is proposed that the maximum amount that can be deposited with other counterparties for a period exceeding 364 days and up to 2 years remains limited to £4m which is shown in Appendix 3.

Creditworthiness Policy

This Council uses the creditworthiness service provided by Link Asset Services. This service uses a sophisticated modelling approach with credit ratings from all three rating agencies – Fitch, Moodys and Standard and Poors, forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following as overlays: -

- credit watches and credit outlooks from credit rating agencies
- Credit Default Swaps (CDS) spreads to give early warning of likely changes in credit ratings
- sovereign ratings to select counterparties from only the most creditworthy countries

This modelling approach combines credit ratings, credit watches, credit outlooks and CDS spreads in a weighted scoring system for which the end product is a series of colour code bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council to determine the duration for investments and are therefore referred to as durational bands. The Council is satisfied that this service gives a much

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improved level of security for its investments. It is also a service which the Council would not be able to replicate using in house resources.

The Council is alerted to changes to ratings of all three agencies through its use of the Link Asset Services' creditworthiness service.

- If a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.

In addition to the use of Credit Ratings the Council will be advised of information on:

- movements in CDS against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Councils lending list.

Sole reliance will not be placed on the use of this external service. In addition, this Council will also use market data and market information, and information on any external support for banks to help support its decision making process.

Creditworthiness

Although the credit rating agencies changed their outlook on many UK banks from Stable to Negative during the quarter ended 30.6.2020 due to upcoming risks to banks' earnings and asset quality during the economic downturn caused by the pandemic, the majority of ratings were affirmed due to the continuing strong credit profiles of major financial institutions, including UK banks. However, during quarter 1 and quarter 2 of 2020, banks made provisions for expected credit losses and the rating changes reflected these provisions. As we move into future quarters, more information will emerge on actual levels of credit losses. This has the potential to cause rating agencies to revisit their initial rating adjustments earlier in the current year. These adjustments could be negative or positive, although it should also be borne in mind that banks went into this pandemic with strong balance sheets.

Policy on the use of treasury management consultants

The Council uses Link Asset Services, Treasury Solutions as its external treasury management advisors.

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Head of Finance & Property through recommendations to Full Council, will ensure that the terms of their appointment and the methods by which their value will be assessed, are properly agreed and documented, and will be subject to regular review.