AGENDA ITEM NO. 8

AUDIT COMMITTEE

21st January 2021

Subject: **Treasury Management and Investment Strategies 2021/22**

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1. Purpose of Report

The Council must comply with the Code of Practice - Treasury Management in the Public Services, published by the Chartered Institute of Public Finance and Accountancy (CIPFA). As part of this Code the Council is required to approve an annual Treasury Management and Investment Strategy for the forthcoming financial year.

2. Links to Council's priorities and objectives

The scrutiny and approval of the Council's Treasury Management and Investment Strategy is linked to the Council's priority of Efficient and Effective Customer Focused Services. Sound and strategic financial management is essential in order to ensure that resources are available to support the Council's priorities and maintain or improve services.

3. Recommendation

That following scrutiny, the Treasury Management and Investment Strategies for 2021/22 are approved for onward submission to Council on 24 February 2021 as sections 11 and 12 of the overall Policy Framework and Budget Setting Report.

Resolution required.

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4. Treasury Management and Investment Strategies 2021/22

The strategies for 2021/22 are attached as an appendix to this report.

5. Corporate Implications

(a) Legal implications

The Council's treasury management activities are regulated by a variety of professional codes, statutes and guidance, including:

- The Local Government Act 2003, and associated Statutory Instruments;
- The CIPFA Prudential Code for Capital Finance in Local Authorities;
- The CIPFA Code of Practice for Treasury Management in the Public Services.

The Council continues to comply with all the relevant statutory and regulatory requirements.

(b) Financial implications

Setting Treasury Management and Investment Strategies are cornerstones for effective treasury management and essential for sound management of the Council's finances. They are an integral part of the Budget Framework. All implications arising from this strategy have been incorporated into the budget due to be approved by Council in February 2021.

(c) Human resource and equality implications

There are no new implications.

(d) Timescale for implementation and risk factors

The Code of Practice for Treasury Management states that the Council must receive a report on annual strategy and plan in advance of the year. The Council complies with this by submitting the strategies to the annual Council budget-setting meeting in February. Failure to do this effectively or in a timely manner, could adversely affect the security of investments and increase reputational risk for the Council.

Report Author: Robert Greenfield, Accountant

11 Treasury Management Strategy

Definition of Treasury Management

1 Treasury management is:

"The management of the organisation's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

2 The Council includes the following Treasury Management clauses within its Constitution, as recommended by the Code of Practice:

The Council will create and maintain, as the cornerstones for effective treasury management:

- A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities.
- Suitable treasury management practices (TMP's) setting out how the organisation will seek to achieve those policies and objectives, prescribing how it will manage and control those activities.
- Will receive reports on its treasury management policies, practices and activities, including as a minimum an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in its TMP's.
- Delegates responsibility for the implementation and monitoring of its treasury management policies and practices to Cabinet, and for the execution and administration of treasury management decisions to the Strategic Director (Resources), who will act in accordance with the Council's policy statement and TMP's and CIPFA's Standard of Professional Practice on Treasury Management.
- Nominates Cabinet to be responsible for ensuring effective scrutiny of the Treasury Management Strategy and policies.

Treasury Management Strategy for 2021/22

3 The Strategy has been formulated after considering the advice of the Council's consultants, Link Group (Link). All activity envisaged by the Strategy will be in accordance with the Treasury Management Policy Statement.

Balanced budget requirement

4 It is a statutory requirement under the Local Government Finance Act 1992, for the Council to produce a balanced budget. This means that the Council is required to ensure the affordability of existing and new projects, both revenue and capital, within the projected income of the Council for the foreseeable future.

Brexit, economic uncertainty and interest rates

5 The United Kingdom left the EU on 31st January 2020 and the transition period ended on 31st December 2020 with a trade agreement but there is further work to be done on the services sector where temporary equivalence has been granted in both directions between the UK and EU, that now needs to be formalised on a permanent basis.

Brexit may reduce the economy's potential growth rate in the long run. However, much of that drag is now likely to be offset by an acceleration of productivity growth triggered by the digital revolution brought about by the COVID-19 crisis. The overall balance of risks to economic growth in the UK is probably now skewed to the upside but is still subject to some uncertainty due to the COVID-19 virus and the effect of any mutations, and how quick vaccines are in enabling a relaxation of restrictions. There is relatively little UK domestic risk of increases or decreases in the Bank Rate and significant changes in shorter term PWLB rates. The Bank of England has effectively ruled out the use of negative interest rates in the near term and increases in the Bank Rate are likely to be some years away given the underlying economic expectations.

6 The Bank of England base rate has been at **0.10%** throughout 2020/21**.** Growth in the UK economy is expected to remain very low and Link expects the base rate to remain at **0.10%** until at least March 2024. It is expected that the 50-year Public Works Loan Board (PWLB) long-term rate for maturity loans during 2021/22 will be around **1.40%**.

7 The Council adheres to strict investment criteria. As it remains difficult to predict longer-term rates accurately, the interest rates used to forecast investment income for the Council's budget process remain prudent. The Council may also be restricted in where it can invest funds. Officers will continue to seek the best return possible whilst always complying with the Council's policies and procedures and without compromising security and liquidity.

Current debt position and requirements for 2021/22

8 A summary of external debt that is expected to be outstanding at 31 March 2021 is as follows:

Table 12.1 External debt outstanding ***Source***	**Total at 31/03/21 £000's**
Public Works Loan Board – General Fund	13,350
Public Works Loan Board – Housing Revenue Account	36,451
Total `	**49,801**

9 The Council's General Fund borrowing consists of fixed rate loans at interest rates ranging from **1.08%** to **4.10%** per annum. The Council's HRA borrowing consists of fixed rate loans at interest rates ranging from **2.31%** to **3.49%** per annum. If loans are repaid prematurely, they attract either a premium or discount depending on the relationship between the interest rate of the loan and market rates and the unexpired period at the time of repayment. Currently as interest rates are low, premature repayment of all loans would incur a huge premium in excess of **£13m**.

10 The proposed programme of capital expenditure due to be approved by Council in February 2021 is not currently anticipated to trigger a requirement for new borrowing in 2021/22. The Policy Framework and Budget Setting Report will provide confirmation of the prudential position for future years, based on current estimates.

11 Internal borrowing is the use of the Council's own temporary investments for capital expenditure and is when the Capital Financing Requirement (CFR) exceeds the level of external borrowing. This is position is known as "under-borrowed". At the end of 2021/22 for the General Fund this is expected to be **£7.4m** due partly to capital expenditure on the Knightswick Shopping Centre and associated public realm works. As cash balances are relatively high and interest earnt on investments is lower than the rate at which the Council can take out loans, borrowing internally is an efficient use of resources that also lowers the overall cost of funding for the projects. By the end of 2021/22 the HRA will be under-borrowed by approximately **£400k**. The position fluctuates from year to year depending on various factors such as the level of capital expenditure, and a prudential indicator in the Capital Strategy ("Gross Debt and the Capital Financing Requirement") monitors and reports on this position.

Borrowing Strategy

12 The uncertainty over future interest rates increases the risk associated with treasury activity. As a result, the Council will take a fairly cautious approach to its Treasury Management Strategy.

13 If a need to borrow should arise, the Strategic Director (Resources), under delegated powers, will take the most appropriate form of borrowing depending on identified risks and the prevailing interest rates at the time. It is likely that shorter-term fixed rates may provide lower cost opportunities in the short to medium term.

14 Borrowing can only be undertaken for the purposes of capital expenditure, and not for day-to-day revenue expenditure. Any new borrowing would result in additional annual interest charges to either the General Fund or Housing Revenue Account, as well as the need to set aside sums from those funds for future repayment of the principal amount borrowed. In effect, borrowing does not finance capital expenditure, instead it merely provides the cash to enable the expenditure to take place. Therefore, the financial impact on the longer-term budget positions for both the General Fund on the Medium-Term Financial Forecast (MTFF) and the Housing Revenue Account on the HRA Business Plan, must be taken into careful consideration in all borrowing decisions. As shown within the MTFF and HRA Business Plan, the General Fund has annual funding gaps in future years to be closed, and the HRA also faces challenges, such as the impact of changes in central government policies including imposed 4-year rent reductions, as detailed within the separate HRA budget setting report.

15 On 9 October 2019 the PWLB increased their margin over gilt yields by 100 basis points to 180 basis points on loans to local authorities, making borrowing from the Government more expensive. However, on 25 November 2020 the Government reversed this. The PWLB periodically allows local authorities to register for a preferential "certainty rate" for borrowing, which is currently **0.20%** below the standard rate or **0.80%** above gilt rates. Registering for this preferential rate does not commit an authority to undertake any borrowing, it just allows it to access the preferential rate should the need arise. Although there are no current plans to borrow before 2024/25, the Council routinely registers for the preferential rate.

16 The weighted average maturity of the Council's General Fund **£13.35m** debt is quite long at 18 years. **£0.90m** matures every year for the next 9 years, currently with no requirement to refinance. **£5.25m** of the debt portfolio does not mature before 2052. Therefore, there is little refinancing risk for the General Fund.

17 The Housing Revenue Account debt of **£36.5m** taken out in March 2012 as part of the HRA self-financing changes is set to mature at different times between 2021/22 and 2041/42 with **£7m** being repaid in 2021/22. A borrowing cap of **£37.5m** was placed on the Council at the same time, which effectively left the ability to borrow a further **£1m** above the **£36.5m**. The autumn 2018 budget announced that, subject to final consultation, the borrowing cap would be removed, so that local authorities would be allowed to undertake additional borrowing to enable investment in building new homes. However, as stated above, any additional borrowing would still have to be affordable within the 30-year HRA Business Plan and be subject to a full assessment of the financial viability of any scheme.

Borrowing in advance of need

18 The Council has some flexibility to borrow funds in advance for use in future years. The Strategic Director (Resources) may do this under delegated power where, for instance, a sharp rise in interest rates is expected, and so borrowing early at fixed interest rates will be economically beneficial or meet budgetary constraints and where there is a clear business case for doing so. Furthermore, councils must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed. They must also consider carefully whether they can demonstrate value for money in borrowing in advance of need and can ensure the security of such funds.

19 MHCLG guidance has determined that the setting of constraints for any borrowing in advance of need is considered good practice. The Strategic Director (Resources) does not currently anticipate any need to borrow in advance of need, but if circumstances change then borrowing in advance will be made within the constraints that:

- It will be limited to no more than **£2m** of the expected increase in borrowing need (CFR) over the three-year planning period; and
- The Council would not look to borrow more than 18 months in advance of need.

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

funds arising from borrowing in advance of need will be invested in accordance with the Council's Investment Strategy.

Treasury management indicators

21 The Council is required to calculate several Treasury Management Indicators as part of the Treasury Management Code of Practice. The indicators are reported in the following paragraphs.

Borrowing maturity structure

22 The Prudential Code for Capital Finance in Local Authorities requires the Council to set upper and lower limits for the maturity structure of fixed rate borrowing. These limits are designed to help the Council minimise its exposure to large fixed rate sums falling due for refinancing. The proposed limits, expressed as percentages of total projected fixed rate borrowing, are as follows:

Table 12.2 Maturity structure of fixed rate borrowing

Maturity	**General Fund**		**Housing Revenue Account**	
	Upper limit %	**Lower limit %**	**Upper limit %**	**Lower limit %**
Within 1 year	50	0	50	0
Within 2 years	50	0	50	0
Within 5 years	60	0	60	0
Within 10 years	80	0	80	0
After 10 years	100	0	100	0

Borrowing – limits of fixed and variable rate exposure

23 The Prudential Code also requires the Council to set upper limits for fixed and variable interest rate exposure. These indicators identify the maximum limits for both fixed and variable interest rates based upon the Council's debt position net of investments. The proposed limits are as follows: -

Table 12.3 Upper limits of fixed and variable exposures

	2020/21 £m	**2021/22 £m**	**2022/23 £m**	**2023/24 £m**	**2024/25 £m**	**2025/26 £m**
Upper limit – fixed rates	56	55	47	47	46	45
Upper limit – variable rates	(21)	(19)	(17)	(15)	(13)	(11)

Borrowing - interest rate sensitivity

24 Any borrowing decisions will need to take account of any changes in interest rates. There are two possible scenarios: -

- a sharp rise in rates – if this is considered possible, any fixed interest borrowing will be taken while interest rates are relatively low;
- a sharp fall in rates – if this is expected, any borrowing will be postponed (waiting for borrowings to become cheaper) and rescheduling from fixed to variable rate funding will be considered.

Debt management objectives

25 A summary of the Council's debt management objectives for 2021/22 is therefore as follows: -

- to borrow, if necessary, in order to finance cash flows arising from capital expenditure in accordance with the Prudential Code;
- to reduce, if possible, the amount of long-term borrowing without incurring net losses for early redemption;

- to manage the debt maturity profile in order to avoid a high level of repayments in any one year;
- to borrow at the best interest rates achievable in relation to estimated future rates;
- to monitor and review the level of any variable interest rate loans, in order to take advantage of interest rate movements;
- if possible, to reschedule debt in order to take advantage of potential savings as interest rates change;
- to avoid as far as possible, excessive overdrawn bank balances by achieving a balanced daily cash position, unless market borrowing proves favourable by comparison;
- to ensure that overall borrowing is within the authorised limit for external debt and that this is monitored on a regular basis.

12 Investment Strategy

Investment guidance

1 This Council has regard to the MHCLG's Guidance on Local Government Investments ("Guidance") and CIPFA's Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes ("CIPFA TM Code").

Investment principles

2 The primary policy objective of the Council's treasury management and investment activities is the security of funds, and to avoid exposing public funds to inappropriate and unquantified risk. The Council's investment priorities are:

- Firstly – the **security** of capital (protecting the capital sum invested from loss) and
- Secondly – the **liquidity** of its investments (keeping the money readily available for expenditure when needed).

Provided that proper levels of security and liquidity are achieved, it may then (but only then) be reasonable to seek the highest **yield** consistent with those priorities. All investments will be in sterling.

3 Under the guidance investments made by local authorities are classified into two main categories:

- Investments held for treasury management purposes
- Other investments

All of the Council's temporary investments are held for treasury management purposes and the interest received contributes to the General Fund budget, as shown in the table below. Investments are not split between General Fund and Housing Revenue Account (HRA) but held as one portfolio with a proportion of the overall interest received applied to the HRA, calculated on the levels of HRA reserves and balances. For 2021/22 this amount is forecast to be **£7k**.

Table 13.1 General Fund investment income	**2020/21 £000's**	**2021/22 £000's**	**2022/23 £000's**	**2023/24 £000's**	**2024/25 £000's**	**2025/26 £000's**
Forecast investment income	140	107	53	53	52	51

4 The guidance maintains that the borrowing of monies purely to invest or lend on and make a return is unlawful and this Council will not engage in such activity.

Financial investments

5 Under the guidance financial investments fall in to three categories:

- Specified investments - high security, high liquidity investments in sterling with high credit quality, and with a maturity of no more than a year.
- Loans – for example to local enterprises, charities etc. The Council has none.
- Non-specified investments – all others, may be less secure.

Specified investment instruments identified for use in the financial year are listed in table 13.2. Non-specified Investments are any other type of investment, i.e. not defined as specified above, are listed in tables 13.3 and 13.4.

Non-financial investments

6 Non-financial investments are assets an organisation holds primarily or partially to generate a profit, essentially for commercial activities. The Council does not currently hold non-financial investments, but may consider doing so, if they support the priorities of the Council as detailed in the Corporate Plan, after taking expert external advice and a thorough appraisal by officers, scrutiny by the appropriate committee and approval by Council. The Council would have to carefully assess

whether such assets retain sufficient value to provide security of investment, and if they do not, the Strategy must provide details of the mitigating actions taken to protect the capital.

Liquidity

7 Based on its cash flow forecasts, the Council anticipates its fund balances in the financial year 2021/22 to range between **£24m** and **£35m**.

Risk assessment and risk appetite

8 As the Council's primary policy objective of treasury management is to avoid exposing public funds to inappropriate and unquantified risk, the Council has a very cautious approach to investing, reflected in the internal guidance which ensures the following:

1. a very high average credit weighting for the portfolio, typically AA
2. a diversified portfolio
3. weighted average maturity approximately 250 days
4. strict stepped limits on lower-rated, but still high grade (A-rated) investments of up to **£6m**.
5. Officers monitor market information including financial updates from the Council's treasury adviser on a daily and weekly basis, to keep as well-informed as possible to make the best decisions. The internal guidance can be amended by the S151 Officer, with advice from treasury officers, at very short notice. This is for flexibility and to adapt to changing circumstances in the current time of economic uncertainty, firstly to protect the security of the Council's temporary investments and secondly to achieve liquidity and yield.

Credit ratings

9 Credit quality of counterparties (issuers and issues) and investment schemes will be determined mainly by reference to credit ratings published by Fitch, Moody's and Standard & Poors. In compliance with CIPFA recommendations and the CIPFA Treasury Management Code, the rating criteria use the lowest common denominator method of selecting counterparties and applying limits. Tables 13.2 to 13.4 also set out the Council's minimum credit ratings that it considers appropriate for each category of investment.

10 The Brexit agreement hopefully reduced the possibility that credit rating agencies will downgrade the sovereign rating for the UK from the current level of AA. Two agencies have the UK on stable outlook and one on negative outlook. Investments are placed with institutions with high long-term credit ratings (minimum A-) or in money market funds with the highest possible rating (AAA or equivalent). The Council has a policy of diversification to prevent over-reliance on a small number of counterparties and Money Market Funds are used to provide a broad spread of underlying holdings.

Monitoring of credit ratings

11 All credit ratings will be monitored on a regular basis, including when investments are made. The Council's treasury adviser, Link Group, also alert the Council to changes in ratings as they occur.

- 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.
- If a counterparty/investment scheme is upgraded so that it fulfils the Council's criteria, the s151 Officer will have the discretion to include it on the lending list.

Amendment to the 2021/22 Investment Strategy to add one new investment type to the approved list of investment counterparties

12 The portfolio of investments maintained by the Council is very cautious and the yield is below that earned by some other councils. During 2019/20 the Treasury Management Strategy was amended to allow investing for longer periods than the original 364-day limit with banks and other local authorities, to increase the return on investments without significantly compromising security. In 2020/21 three further types of non-specified investment were added to the approved list of counterparties: property funds, bond funds and multi-asset funds. Due to the uncertainties created by COVID-19 and the subsequent significant fluctuations the markets have seen, Officers opted to take a cautious approach and not invest in these new areas. It is anticipated that in 2021/22 once markets have settled the Council may invest in these new approved investments to further enhance returns. Some research into these funds has already been undertaken in 2020/21, with selection criteria established.

13 For 2021/22, the Strategic Director (Resources) also now recommends adding equity funds. This will give more diversification and yield with new investments, which are used regularly by other councils, whilst maintaining reasonable levels of security. It is anticipated the new investments could provide additional investment income. Some non-specified investments are more complex instruments, requiring greater consideration and due diligence by Officers and Members. Therefore, Officers will consult with Link before investing in this new asset class to ensure a full appraisal is made of all products and any associated risks.

14 **Equity funds**

A traditional way to invest is to buy shares in companies. Shareholders have an equity stake in a business, which is why shares are also known as equities. An equity fund is an open or closed-end fund that invests primarily in stocks, allowing investors to buy into the fund and thus buy a basket of stocks more easily than they could purchase the individual securities. Equity funds tend to focus their investment on various countries, regions, industries and investment styles as a way of diversifying or spreading risk. They can be sold on daily with settlement typically after 3 days.

15 Returns can be variable but in the current low interest rate environment it may be lower. Historically equities have outperformed safer investments, such as bank accounts and bonds, however prices can be volatile, past performance is not an indication of future performance and the value of investments can fall as well as rise. Unrated credit, derivatives and other complex instruments may be used. Any fund exposes the Council to market price volatility and so Officers will carefully consider any investment opportunity.

Table 13.2 Specified Investments for the Financial Year 2021/22			
Investment	**Counterparty limit**	**Security / Minimum Credit Rating**	**Maximum period of investment**
Debt Management Agency Deposit Facility (DMADF) (this facility is at present available for investments up to 6 months)	No limit	The Debt Management Office is an agency of the UK Government	6 months (DMO imposed time limit)
Treasury Bills issued by the UK Government (currently maximum 6-month duration)	No limit	The Debt Management Office is an agency of the UK Government	364 days
Term Deposits with the UK Government or with UK local authorities (i.e. local authorities as defined under section 23 of the 2003 Act)	The lesser of £5m or 33% of total investments	High quality as either directly invested or via agencies of UK Government. (Although local authorities are not specifically credit rated)	364 days
Term Deposits with institutions, part nationalised by the UK Government	The lesser of £5m or 33% of total investments	long-term A-, short-term F1 (lowest common denominator Fitch, Moody's & S&P)	364 days
Money Market Funds (i.e. a collective investment scheme as defined in SI 2004 No 534) CNAV, LVNAV and VNAV These funds do not have a maturity date	The lesser of £5m or 33% of total investments	Fitch, Moody's or Standard and Poors AAA (Minimum of two ratings)	n/a (repayable on demand)
Current accounts, notice accounts or term deposits with credit-rated deposit takers (UK banks and building societies)	The lesser of £4m or 25% of total investments	long-term A-, short-term F1 (lowest common denominator Fitch, Moody's & S&P)	364 days (Call deposits repayable on demand)
Forward deals with credit rated banks and building societies < 1 year (i.e. negotiated deal period plus period of deposit)	The lesser of £4m or 25% of total investments	long-term A-, short-term F1 (lowest common denominator Fitch, Moody's & S&P)	364 days
Certificates of Deposit issued by UK institutions	The lesser of £4m or 25% of total investments	long-term A-, short-term F1 (lowest common denominator Fitch, Moody's & S&P)	364 days
Covered bonds (maximum 364-day period includes borrower extension option)	The lesser of £4m or 25% of total investments	long-term AA-, short-term F1 (lowest common denominator Fitch, Moody's & S&P)	364 days
Reverse repurchase agreements "repos" (a form of secured lending with enhanced security)	The lesser of £4m or 25% of total investments	long-term AA-, short-term F1 (lowest common denominator Fitch, Moody's & S&P)	364 days

Table 13.3 - Non-specified Investments for the financial year 2021/22			
Investment	**Counterparty limit**	**Security / Minimum Credit Rating**	**Maximum period of investment**
Term deposits with the UK Government or with UK local authorities (i.e. local authorities as defined under section 23 of the 2003 Act)	The lesser of £4m or 25% of total investments	High quality as either directly invested or via agencies of UK Government. (Although local authorities are not specifically credit rated)	2 years
Current accounts, notice accounts or term deposits with credit-rated deposit takers (UK banks and building societies)	The lesser of £4m or 25% of total investments	long-term A-, short-term F1 (lowest common denominator Fitch, Moody's & S&P)	2 years
Property Funds	The lesser of £4m or 25% of total investments	Unrated	n/a
Bond funds	The lesser of £4m or 25% of total investments	Unrated	n/a
Multi-Asset funds	The lesser of £4m or 25% of total investments	Unrated	n/a

Table 13.4 - Non-specified Investments for the financial year 2021/22 (Note – new addition from 2021/22)			
Investment	**Counterparty limit**	**Security / Minimum Credit Rating**	**Maximum period of investment**
Equity Funds	The lesser of £4m or 25% of total investments	Unrated	n/a

- All Specified Investments listed above must be sterling denominated.
- All investments are managed in-house.
- No shares or loan capital is held by the Council
- None of the investments are classified as capital expenditure

Country, group and sector limits

17 The Council selects counterparties according to credit quality as well as the additional information in paragraph 19 below. Group and sector limits do not form part of the formal Investment Strategy, but are used within the temporary, stricter investment guidance described in paragraph 21.

Money Market Funds

18 As has been the practice for several years, the Council continues to place a high proportion of its investments in Money Market Funds. By March 2019 the valuation method for the Council's Money Market Funds changed from constant net asset value to low volatility net asset value. Constant net asset value funds aim to preserve a stable value (such as £1) per share at which investors either subscribe or redeem, but under money market fund regulations they are being replaced with low volatility net assets funds where the underlying investments may have to be priced at market value, so potentially investors could get back slightly more or less than the £1 invested, although this is very unlikely with AAA-rated funds. The Council has assessed the implications, but it is not expected that there will be any significant impact on the value of investments.

19 **Markets in Financial Instruments Directive (MiFID)**

From 3rd January 2018 changes in legislation required the Council to opt up to professional status (rather than the default status of a retail client) with several of its counterparties to continue using a range of secure and diversified investments and not be limited solely to simple bank deposits. Organisations classified as professional have a good understanding of financial products but do not have the same protection as retail clients or ordinary consumers.

Use of additional information other than credit ratings

20 Additional requirements under the Code of Practice now require the Council to supplement credit rating information. Whilst the above criteria rely primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example equity prices, Credit Default Swaps, negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

Bail-in legislation

21 To avoid a Government bailout (i.e. where Governments inject monetary support into institutions to keep them solvent) that occurred during the financial crisis, bail-in legislation is now fully implemented in the UK. In future large investors or creditors may contribute to the rescue of failing banks rather than taxpayers, as some or all their deposits are converted into equity which could be worth less than the original investment. Consequently, the potential risk of depositing with banks may have increased, however this is reflected in the credit ratings.

Internal stricter guidance

22 The Council continues to use temporary stricter internal investment guidance than that laid out in the Investment Strategy, such as lower counterparty limits. These will remain in place for as long as they are required and are reviewed regularly, considering information and advice supplied by Link. Changes to the internal guidance are approved by the Strategic Director (Resources).

Use of derivative instruments

23 Local authorities can use any hedging tools such as derivatives, but only for the management of risk and the prudent management of financial affairs. When an authority intends to use derivative instruments the policy for their use must be clearly detailed in the annual Treasury Management Strategy. The Council does not currently use derivatives, but should this change then the Treasury Management Strategy will be amended prior to their use. The Council will seek proper advice when entering into arrangements to use such products to ensure that it fully understands those products.

Investments defined as capital expenditure

24 The acquisition of share capital or loan capital in any corporate body is defined as capital expenditure under Regulation 25(1) (d) of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003. Such investments will have to be funded out of capital or revenue resources and will be classified as Non-specified Investments. As already stated, the Council does not currently intend to invest in Non-specified Investments.

25 Investments in Money Market Funds are not treated as capital expenditure.

26 A loan, grant or financial assistance by this Council to another body for capital expenditure by that body will be treated as capital expenditure, should it occur.

Provisions for credit-related losses

27 If any of the Council's investments appeared at risk of loss due to default (i.e. a credit-related loss and not one resulting from a fall in price due to movements in interest rates) the Council will make revenue provision of an appropriate amount.

Investment strategy to be followed in-house

28 The Council's in-house managed funds are mainly cash-flow derived. At least approximately **80%** of the Council's funds will be invested for periods of less than 365 days. There are core funds of approximately **£5m** that it is very unlikely will be required for cash flow purposes for another 2 to 5 years. The recent changes to the treasury strategy will allow some or all of these funds to be invested longer-term, at higher rates, to provide additional investment income for the Council.

The Council's banking arrangements

29 The Council's banking operations are all with Lloyds Bank PLC. The current contract expires on 31st March 2025.

Risk benchmarking

30 The most recent version of the CIPFA Treasury Management Code recommended the use of security and liquidity benchmarks alongside existing yield benchmarks used to assess investment performance.

31 These benchmarks are simple targets (not limits) and so may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy depending on any changes. Any breach of the benchmarks will be reported with supporting reasons in the Mid-Year or Annual Report. Use of these benchmarks will be reviewed and they may be amended or added to if necessary.

32 **Security** – The Council's maximum-security risk benchmark for the current portfolio is:

- A credit-rating score of **4.0** for the overall investment portfolio. Each investment is given a score according to long-term credit rating (e.g. 7 for AAA, 4 for AA-, 1 for A-) and then weighted according to amount.

33 **Liquidity** – In respect of this area the Council seeks to maintain:

- The bank overdraft facility was reviewed for the new banking contract that started in April 2020 and it was decided it was not cost effective for the Council to have one permanently in place
- Liquid short-term deposits of at least **£1m** available with a day's notice
- Weighted Average Life benchmark is expected anything up to 270 days, with a max of 1 year

34 **Yield** – Local measures of yield benchmarks are:

- Investments – returns above the 7-day LIBID rate.

Treasury management adviser

35 Link Group, the largest provider of capital financing and treasury advisory services to public sector organisations, is the Council's current treasury adviser. The company provides a range of services through a formal contract, which includes technical support on treasury matters and capital finance issues; economic and interest rate analysis; debt rescheduling advice surrounding the existing portfolio; investment advice on interest rates, timing and investment instruments; credit ratings/market information service provided by the three main credit rating agencies; and data from international money markets. Officers hold meetings with the advisers at least twice a year, as well as ad-hoc when required for specific purposes, and receive various briefing documents on a continual basis. The four-year contract expires in 2022 and is regularly monitored to ensure the quality of advice and service is consistent with the schedule of services agreed with Link.

36 Whilst Link Group provide support to the internal treasury function, under current market rules and the CIPFA Treasury Management Code, the final decision on all treasury matters remains with the Council.

Member and officer training and experience

37 Members receive training on Treasury Management matters on a periodic basis. Treasury staff attend appropriate courses and seminars held by CIPFA and Link Group both to maintain and improve their knowledge and expertise. All treasury staff have accountancy or treasury qualifications and many years' experience in local authority treasury across the team.

Investment activity reporting and publication

38 Officers prepare a mid-year monitoring report on investment activity each autumn and an end of year report as part of its Annual Treasury Report after the close of each financial year. This does not preclude more frequent reporting should changes or circumstances dictate, including changes to the Treasury Management and Investment Strategy if required. The Investment Strategy is published annually on the Council's website.

Code Update

39 The 2017 edition of the Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes reaffirmed CIPFA's previous view that "throughout the public services the priority for treasury management is to protect capital rather than to maximise return." The Council complies with this view, as shown in the principles stated in paragraph 2 above.

40 The 2017 edition also included:

- Three key principles of Treasury Management, which are unchanged from the previous publication.
- Four clauses that CIPFA recommends all public services formally adopt. These are as stated in paragraph 2 of section 12 of this report.
- Twelve main practices, which cover matters such as risk management, performance measurement, decision making, approved instruments, cash flow management, and others. The requirements of these twelve practices feature throughout sections 12 and 13 of this report. Elements of these practices have been updated or expanded upon in the 2017 edition but have no fundamental impact on current procedures undertaken by the Council's officers in performing their treasury management and investment duties.

Changes in accounting standards

41 Implemented in 2018/19 IFRS9 on Financial Instruments, specified how an entity should classify and measure financial assets and financial liabilities and the CIPFA 2018/19 Code of Practice on Local Authority Accounting set out how it applies to Councils. Officers consulted with auditors and treasury advisers and made a thorough assessment of the changes required and they were not material to the Financial Statements, and only affected presentation and disclosure of the financial instruments and liabilities.