

**COTSWOLD
DISTRICT
COUNCIL**

**Treasury
Management
Strategy
2022/23**

I Introduction

- I.1 This report sets out the Treasury Management Strategy and policy for 2022/23. It includes: the interest rate outlook, the Council's treasury management arrangements for the year and the overall framework and risk management controls which are used in carrying out the Council's borrowing, lending and other treasury activities.
- I.2 The Council's treasury management objectives and activities are defined as:
- “The management of the organisation’s borrowing, investments and 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.”*
- I.3 Effective treasury management will provide support towards the achievement of the Council's business and service objectives. The Council is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.
- I.4 This Treasury Strategy forms part of the overall Corporate Planning Framework which complies with the statutory requirement to have regard to the following Codes and Guidance:
- CIPFA's Code of Practice for **Treasury Management in the Public Services** (revised December 2017 and 2021 code)
 - CIPFA's **Prudential Code for Local Authority Capital Finance** (revised December 2017 and 2021 code)
 - The Government Guidance on **Local Authority Investments**
- I.5 It provides a mechanism by which treasury management decisions can be aligned with the overarching corporate priorities and objectives over the medium term.
- I.6 The ongoing impact on the UK from coronavirus, together with higher inflation, higher interest rates, and the country's trade position post-Brexit, will be major influences on the Council's treasury management strategy for 2022/23.
- I.7 A detailed assessment of the current economic background and the forecast impact on credit and interest rates has been provided by the Council's Treasury Management advisors, Arlingclose. This is included as **Appendices Ia** and **Ib** to this Strategy.

2 Purpose of the Treasury Management Strategy

2.1 The 2022/23 Treasury Management Strategy has been developed with the following key aims:

- To outline how the Council will invest its money to ensure it will have the financial resources to support the key priorities outlined in its Corporate Plan
- To set out key principles on which borrowing and investment decisions are made, including how security and risk are assessed.
- To present the arrangements for managing and monitoring treasury management decisions, including assessment of outcomes and the alignment to the Corporate Plan

3 Treasury Management Strategy and Risk Management

- 3.1 The Council's objectives in relation to debt and investment can be stated as follows:
- “To assist the achievement of the Council's service objectives by obtaining funding and managing the Council's debt and treasury investments at a net cost which is as low as possible, consistent with a high degree of interest cost stability and a very low risk to sums invested.”**
- 3.2 The successful identification, monitoring and control of risk are the prime criteria by which the effectiveness of the Council's treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.
- 3.3 The Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management and to employing suitable, comprehensive performance measurement techniques within the context of effective risk management.
- 3.4 Therefore, for the Council, the achievement of high returns from treasury activities is of secondary importance compared with the need to limit the exposure of public funds to the risk of loss.
- 3.5 It is not possible to avoid all treasury risks, and a balance has to be struck. The main treasury risks which the Council is exposed to include:
- **Interest rate risk - the risk that future borrowing costs rise**
 - **Credit risk - the risk of default in a Council investment**
 - **Liquidity and refinancing risks - the risk that the Council cannot obtain funds when needed**
- 3.6 The Council does not currently hold any borrowings, but as it expects to during 2022/23, it will be important for the Council to manage its interest rate exposure due to the risk that changes in the level of interest rates leads to an unexpected burden on the Council's finances. The stability of the Council's interest costs will be affected by the level of borrowing exposed to short term or variable interest rates. Short term interest rates are typically lower, so there can be a trade-off between achieving the lowest rates in the short term and in the long term, and between short term savings and long term budget stability.
- 3.7 As a result, the approach to risk must be implemented flexibly in the light of changing market circumstances.

4 Why and how we invest our money

- 4.1 The revised CIPFA Prudential and Treasury Codes recommend that authorities' capital strategies should include a policy and risk management framework for all investments. The Codes identify three types of local authority investment:
- **Treasury management investments**, which are taken to manage cash flows and as part of the Council's debt and financing activity
 - **Commercial investments** (including investment properties), which are taken mainly to earn a positive net financial return
 - **Service investments**, which are taken mainly to support service outcomes
- 4.2 The Council's **Investment Strategy** outlines the principles and arrangements in place for the second two categories of investment. The **Treasury Management Strategy** focuses on the first category. The following paragraphs set out the Council's policy for these 'treasury management' investments.
- 4.3 The Council holds significant 'treasury management' funds representing income received in advance of expenditure and reserves held. In the past 12 months, the Council's investment balance has averaged from £20m to £47m. The large range was due to the Council holding grants that were due to be returned to the Government. The average forecast investment balance for 2022/23 is estimated to be around £26.9m.
- 4.4 On 31 December 2021, the Council held £33.668m of treasury investments which are outlined in **Table I**.

Table I – Treasury investments as at 31 December 2021

Treasury Investments	31 st December Actual Portfolio £m	31 st December Average Rate %
Money Market Funds/Call Accounts and other pooled funds	21.168	0.05
CCLA Property Investment Management	2.500	3.37
CCLA Diversified Income	1.000	2.14
Schroders Unit Trusts Ltd	1.000	5.96
M&G Securities Ltd	2.000	3.40
Ninety One (formerly Investec)	2.000	2.77
Columbia Threadneedle Fund	2.000	2.45
Federated Cash Plus Fund	1.000	0.01
Fundamentum Housing REIT	1.000	2.25
Total treasury investments	33.668	1.40%

4.5 Forecast investments over the next three financial years are shown in **Table 2**.

Table 2 – Investments balances

	31.3.21 Actual £m	31.3.22 Estimate £m	31.3.23 Forecast £m	31.3.24 Forecast £m	31.3.25 Forecast £m
Short term holdings					
Call Accounts	10.468	1.523	2.200	4.500	4.100
MMFs	1.590	4.942	4.000	4.000	4.000
Current Account	0.630	0.100	0.100	0.100	0.100
Total Short term	12.688	7.565	6.300	8.600	8.200
Longer term holdings					
Pooled Funds	10.500	10.500	10.500	10.500	10.500
REIT	1.000	1.000	1.000	1.000	1.000
Cash + Fund	1.000	1.000	1.000	1.000	1.000
Total Longer term	12.500	12.500	12.500	12.500	12.500
TOTAL INVESTMENTS	24.620	20.065	18.800	21.100	20.700

4.6 The Council's policy on treasury investments, in line with the CIPFA code, is to prioritise security and liquidity over yield. This focuses on minimising risk rather than maximising returns. Cash that is likely to be spent in the near term is invested securely to minimise risk of loss. Money held for the longer term is invested more widely, including bonds, shares and property to balance the risk of loss against the risk of receiving returns below inflation. Both short term and longer term investments may be held in pooled funds, where an external fund manager makes decisions on which investments to buy. The Council is also able to request the return of its funding at short notice with these pooled funds. 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 inflation rate, in order to maintain the spending power of the sum invested.

4.7 Due to the coronavirus pandemic, councils experienced increased uncertainty over their cash-flows during 2021/22. Central Government provided significant grants to the Council as it looked to use local authorities to co-ordinate the support required by the local population in dealing with the financial impact of the pandemic. As a result, the Council held liquid cash balances that far exceeded the guidance of £10m throughout the year. This is likely to continue if the financial impact of coronavirus continues into 2022/23 as a result of the Omicron variant.

4.8 As the economic consequences of the pandemic and the details of the Brexit trade deal become clearer, there is the risk that the Bank of England will set the Bank Rate at or below zero, which would feed through to negative interest rates on low risk, short term investment options. Since investments cannot pay negative income, negative rates would be applied by reducing the value of investments. In this event,

security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

- 4.9 Under Financial Reporting Standards (IFRS 9), the accounting for certain investments depends on the Council's business model for managing them. The Council aims to achieve value from its 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.
- 4.10 The Council will continue to make deposits only with institutions having high credit quality as set out in the Lending Criteria table below. These limits have been set by the Council in consultation with Arlingclose, the Council's Treasury advisors in **Table 3**. Further explanation of each of the categories in Table 3 are included as **Appendix 2**.

Table 3 – Lending Criteria

Sector	Time limit	Counterparty limit	Sector limit
The UK Government	50 years	Unlimited	n/a
Local authorities & other government entities	25 years	£3m	Unlimited
Secured investments *	25 years	£3m	Unlimited
Banks (unsecured) *	13 months	£3m	Unlimited
Building societies (unsecured) *	13 months	£2m	£10m
Registered providers (unsecured) *	5 years	£5m	£10m
Money market funds *	n/a	£3m	Unlimited
Strategic pooled funds	n/a	£4m	£20m
Real estate investment trusts	n/a	£3m	£20m
Other investments *	5 years	£1m-£3m	£10m

** investments in these sectors will only be made with entities whose lowest published long-term credit rating is no lower than A-*

- 4.11 Treasury investments will only be made with entities whose lowest published long term credit rating is no lower than an A-. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely on credit ratings, and all other relevant factors including external advice will be taken into account.
- 4.12 Money may be lent to the Council's own banker (Lloyds Banking Group), in accordance with the above lending limits. However, if Lloyds Bank does not meet the above criteria, money may only be lent overnight (or over the weekend), and these balances will be minimised.
- 4.13 Credit rating methodologies and credit limit requirements may change as the circumstances demand: in this event the Chief Finance Officer may determine revised

and practicable criteria seeking similarly high credit quality, pending the next annual review of this treasury management policy.

- 4.14 Temporarily surplus cash will be invested having regard to the period of time for which the cash is expected to be surplus. The CIPFA Prudential Code envisages that authorities will not borrow more than three years in advance, so it is unlikely that the Council will plan to have surplus cash for longer than three years. However, where surplus cash for over 12 months is envisaged, it may be appropriate to include some longer term (non-specified) investments within a balanced risk portfolio.
- 4.15 In making investments in accordance with the criteria set out in this section, the Chief Finance Officer will seek to spread risk (for example, across different types of investment and to avoid concentration on lower credit quality). This may result in lower interest earnings, as safer investments will usually earn less than riskier ones.
- 4.16 The Council does not currently use investment managers (other than through the use of pooled investment vehicles such as Money Market Funds). However, if investment managers are appointed, their lending of Council funds would not be subject to the above restrictions, provided that their arrangements for assessing credit quality and exposure limits have been agreed by the Chief Finance Officer.
- 4.17 The Council seeks to be a responsible investor. In line with the requirements of the 2021 Code, the Council is currently in the process of developing a policy covering environmental, social and governance (ESG) investment considerations. This policy will be the subject of a separate report to a future meeting of the Full Council.

5 How we borrow money

Current Position in terms of borrowing

- 5.1 At 1st January 2022, the Council holds no borrowing, but it is anticipated that borrowing will be required in future years. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR). The net borrowing can be reduced from this total through the use of reserves and working capital.
- 5.2 CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Council's external borrowing should be lower than its highest forecast CFR over the following three years.
- 5.3 To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes that cash and investment balances are kept to a minimum level of £10m at each year end to maintain sufficient liquidity but minimise credit risk.
- 5.4 The total forecast net borrowing against the CFR and liability benchmark is set out in the **Table 4** and **Table 4a** below for the period of the Medium Term Financial Strategy.

Table 4 - Forecast Borrowing Requirement £m

	31.3.21 Actual	31.3.22 Estimate	31.3.23 Forecast	31.3.24 Forecast	31.3.25 Forecast
CFR	0.1	0.5	37.95	63.61	87.42
Less External Borrowing	0	-0.5	-37.9	-63.6	-87.4
Internal Borrowing	-0.1	0	-0.001	-0.004	-0.002
Usable reserves	25.9	17.368	16.175	18.473	18.935
Working capital	-0.7	2.7	2.7	2.7	2.7
Investments	25.2	20.1	18.875	21.173	21.635

Table 4a – Liability Benchmark £m

	31.3.21 Actual	31.3.22 Estimate	31.3.23 Forecast	31.3.24 Forecast	31.3.25 Forecast
CFR	0.1	0.5	37.95	63.61	87.42
Less Balance Sheet Resources	-25.188	-20.068	-18.875	-21.173	-18.935
Net Loans Requirement	-25.088	-19.568	19.075	42.437	68.485
Plus Liquidity Allowance	10.0	10.0	10.0	10.0	10.0
Liability Benchmark	-0.7	-9.568	29.075	52.437	78.485

5.5 This benchmark is currently £-0.7 million, reflecting the fact that the Council is debt free and its cash balances are invested through application of the Treasury Management Strategy. Over the next two years, the liability benchmark moves to £29 million reflecting a use of capital receipts and earmarked reserves to partially fund the Capital Programme and need to externally borrow as represented in table 4.

Borrowing Strategy

5.6 This strategy sets out how the Council plans to obtain the required new borrowing shown above, by a combination of short term and long term borrowing.

5.7 The borrowing will be required to fund significant investments into the Councils key priorities as outlined in the Corporate Plan, in particular the Recovery Investment Strategy. The key priorities are outlined below:

- Priority 1 – delivering our services to the highest standard
- Priority 2 – responding to the challenges presented by the climate crisis
- Priority 3 – providing good quality social rented homes
- Priority 4 – presenting a local plan that is green to the core
- Priority 5 – helping residents and communities access the support they need for good health and wellbeing
- Priority 6 – supporting businesses to grow in a green, sustainable manner, and to provide high value jobs.

5.8 The Council’s main objective when borrowing money is to strike a balance between securing low interest rates and certainty of costs over the period for which funds are required.

5.9 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 being 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.

- 5.10 By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of doing this will be monitored regularly against the potential for incurring additional costs by deferring borrowing into the future when long term borrowing rates are forecast to rise modestly, even if this causes additional cost in the short term.
- 5.11 Alternatively, the Council may arrange forward starting loans during 2022/23, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period. The Council may also borrow short term loans to cover unplanned cash flow shortages.
- 5.12 The strategy results in a forecast for new long term borrowing of £37.9m in 2022/23.

Sources of Borrowing

- 5.13 The main source of long term borrowing for local authorities historically has been the **Public Works Loans Board (PWLB)**. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield. The Council has not undertaken any PWLB borrowing to fund commercial investments for yield and does not plan to do this in the future in order to retain access to PWLB loans. All capital investments are linked to service developments. The PWLB rate offers a cheaper and quicker route to borrowing than alternative sources of borrowing. The Council would thus aim to use the PWLB for its long term borrowing needs. In addition it is uncertain how private sector lenders would view the risk profile for councils that were no longer eligible for PWLB loans.
- 5.14 The **UK Municipal Bonds Agency Plc** was established in 2014 by the Local Government Association as an alternative to the PWLB. It issues bonds on the capital market and lends proceeds to local authorities. This is a more complicated source of finance than the PWLB for two reasons; borrowing authorities are required to provide bond investors with a 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 Cabinet and Full Council.
- 5.15 **LOBOs:** The Council currently does not hold any LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost.
- 5.16 **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 interest rate exposure limits in the treasury management indicators.
- 5.17 **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.

- 5.18 **Community Municipal Investments** are a form of debt/loan-based crowdfunding. Community Municipal Investments (CMI) are issued by a council corporate body, with residents and general public investors providing capital on the basis of receiving a financial return. The majority of CMIs are typically linked in some form to environmental or social criteria and provide tangible benefit to the local community beyond just financial.
- 5.19 The Council is currently considering the launch of a CMI. Communities can invest money, with £5 being the minimum investment, for a fixed period (the initial bond is expected to be for a five year period) and will receive income at regular intervals. The Council is expected to benefit through this offering as a cheaper alternative to PWLB borrowing. The Council would pay a small initial and annual fee to the organisation responsible for setting up and administering the bonds. The funds raised by these bonds would be used to finance capital spend in respect of the installation of electric vehicle charging points and Council property solar panels across the district in support of the Council's 'responding to the challenges presented by the climate crisis' priority. CMIs have a higher social value than mainstream borrowing as a result of increased community engagement and directing the cost of borrowing (interest payments) back into the local area.
- 5.20 The Council will continue to monitor market developments and will seek to use and develop other funding solutions if better value may be delivered. This may include other sources of long term borrowing if the terms are suitable, including listed and private placements, bilateral loans from banks, local authorities or others and sale and leaseback arrangements.
- 5.21 The Treasury Management Prudential Limits and Indicators consistent with the above strategy are set out in **Section 7**.
- 5.22 The Treasury Management Strategy must be flexible to adapt to changing risks and circumstances. The strategy will be kept under review by the Chief Finance Officer in accordance with treasury management delegations.

6 Monitoring Treasury Management Investments

- 6.1 The CIPFA guidance for Treasury Management in the Public Services (2017 edition), requires the Council to approve a treasury management 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 the CIPFA code.
- 6.2 The guidance also requires the Council to produce reports on its treasury and investment management policies, practices and activities, as a minimum with a mid-term review and an annual report after year end closure.
- 6.3 The Council delegates responsibility for the implementation and regular monitoring of its treasury management practices to Cabinet and for the execution and administration of treasury management decisions to the Chief Finance Officer, who will act in accordance with this strategy. The Audit Committee will be responsible for ensuring effective scrutiny of the treasury management strategy and policies.
- 6.4 Credit ratings are monitored on a real-time basis as provided via Arlingclose, and the Council’s lending list is updated accordingly, when a rating changes. Other information is taken into account when deciding whether to lend. This may include the ratings of other rating agencies; commentary in the financial press; analysis of country, sector and group exposures; and the portfolio make up of Money Market Funds. The use of particular permitted counterparties may be restricted if this is considered appropriate.
- 6.5 Where deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council 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. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council’s cash balances, then the surplus will be deposited with the UK Government, via the Debt management Office or invested in government treasury bills or other local authorities, as decided by the Chief Finance Officer.
- 6.6 In order to monitor this, the Council has set the following cash limits on the credit quality of the investments in **Table 5**.

Table 5 – Approved investment counterparties and limits

Sector	Time limit	Counterparty limit	Sector limit
The UK Government	50 years	Unlimited	n/a
Local authorities & other government entities	25 years	£3m	Unlimited

Sector	Time limit	Counterparty limit	Sector limit
Secured investments *	25 years	£3m	Unlimited
Banks (unsecured) *	13 months	£3m	Unlimited
Building societies (unsecured) *	13 months	£2m	£10m
Registered providers (unsecured) *	5 years	£5m	£10m
Money market funds *	n/a	£3m	Unlimited
Strategic pooled funds	n/a	£4m	£20m
Real estate investment trusts	n/a	£3m	£20m
Other investments *	5 years	£1m-£3m	£10m

* Investments in these sectors will only be made with entities whose lowest published long-term credit rating is no lower than A-

6.7 The Council's revenue reserves available to cover investment losses are forecast to be £4m on 31 March 2022. In order to ensure that no more than a maximum of available reserves of 25% are therefore put at risk in the case of single default (other than the UK Government), the total lending limit will be £5m. A group of banks under the same ownership will be treated as a single organisation. Limits are also placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as in **Table 6** below. Investments in pooled funds and multilateral development banks do not count against the limit for a single foreign currency, as the risk is spread over many countries.

Table 6 – Cash Limit by Organisation

Table 6 – Cash Limits	Cash limit
Any single organisation, except the UK Central Government	£3m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£3m per group
Any group of pooled funds under the same management	£4m per fund manager
Foreign countries	£3m per country
Registered providers	£3m in total
Real estate investment trusts	£3m per REIT
Unsecured investments with building societies	£2m in total per BS
Money Market Funds	£20m in total

6.8 The Council uses cash flow forecasting 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 MTFS and cash flow forecast.

6.9 The Treasury Management team has suitably qualified and trained staff to actively manage treasury risks within this Policy framework. Officers regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA. However, staff resources are limited, and this may constrain the Council's ability to respond to market opportunities or take advantage of more highly structured financing arrangements. External advice and support may also be required. The following activities may for example be appropriate based on an assessment at the time, to the extent that skills and resources are available:

- the refinancing of existing debt
- forward-starting loans
- leasing and hire purchase
- use of innovative or more complex sources of funding such as green bond issues, private placements and sale and leaseback structures
- investing surplus cash in institutions or funds with a high level of creditworthiness, rather than placing all deposits with the Government

6.10 The Council appointed Arlingclose Limited to provide treasury management advice to the Council, including the provision of credit rating and other investment information. Advisors are a useful support in view of the size of the Council's transactions and the pressures on staff time. The contract with Arlingclose is due to expire in 2022/23 and work will be ongoing to appoint a new treasury management advisor going forward.

6.11 Government investment guidance expects local authorities to have a policy for borrowing in advance of need, in part because of the credit risk of investing the surplus cash. The Council's policy is to borrow to meet its forecast Net Loan Debt, including an allowance (currently of £10m) for liquidity risks. The Council will only borrow in advance of need where there is a clear business case for doing so and will only do so for the forecast capital programme or to meet other expected cash flows.

7 Treasury Management Prudential Indicators

7.1 The Council is required under the Local Government Act 2003 and the CIPFA Treasury Management Code to set Prudential Indicators for treasury management to measure and manage its exposure to treasury management risk using the following indicators:

7.2 **Security** – The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value weighted average 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.

Credit risk indicator	Target
Portfolio average credit	A-

7.3 **Interest Rate exposures** – This indicator is set to control the Council’s exposure to interest rate risk. The upper limits on the one year 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% <u>rise</u> in interest rates	-£0.15m
Upper limit on one-year revenue impact of a 1% <u>fall</u> in interest rates	£0.15m

Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate.

7.4 **Maturity structure of borrowing:** This indicator is set to control the Authority’s exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing will be:

Refinancing rate risk indicator	Upper limit	Lower limit
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and within 30years	100%	0%
30 years and above	100%	0%

7.5 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.

7.6 **Long term treasury management investments** – 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 for longer than a year will be:

Price risk indicator	2022/23	2023/24	2024/25
Limit on principal invested for longer than a year.	£20m	£20m	£20m
Amounts invested in longer term instruments with no fixed maturity date	£20m	£20m	£20m

8 Treasury Management Revenue Budget

- 8.1 The budget for investment income in 2022/23 is £0.450m, based on an average investment portfolio of £26.9m at an interest rate of 1.67%.
- 8.2 The Council aims to maintain its portfolio of long term investments in strategic funds at £12.5m. This is forecast to return £0.422m.
- 8.3 Investments in liquid assets such as bank deposits and money market funds are expected to return 0.2% and generate a yield of £0.028m.
- 8.4 This estimate reflects a prudent view of investment income. Actual interest income will be affected not only by future interest rates, but also by the Council's cash flows and the level of its revenue reserves and provisions.

9 Other

- 9.1 Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in section 1 of the *Localism Act 2011* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).
- 9.2 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.
- 9.3 In line with the CIPFA Code, the Council will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.
- 9.4 Miffid 2 is a legislative framework instituted by the European Union to regulate the financial markets and improve protections for investors. This Council has elected for Professional Client Status which means that to be able to invest in certain investments, it must hold a minimum of £10m in investments. If this falls below the minimum level then access to certain financial market instruments could be made unavailable to this Council.

Appendix Ia – Arlingclose Limited Economic & Interest Rate Forecast December 2021

Economic background:

The ongoing impact on the UK from coronavirus, together with higher inflation, higher interest rates, and the country's trade position post-Brexit, will be major influences on the Authority's treasury management strategy for 2022/23.

The Bank of England (BoE) increased Bank Rate to 0.25% in December 2021 while maintaining its Quantitative Easing programme at £895 billion. The Monetary Policy Committee (MPC) voted 8-1 in favour of raising rates, and unanimously to maintain the asset purchase programme.

Within the announcement the MPC noted that the pace of the global recovery was broadly in line with its November Monetary Policy Report. Prior to the emergence of the Omicron coronavirus variant, the Bank also considered the UK economy to be evolving in line with expectations, however the increased uncertainty and risk to activity the new variant presents, the Bank revised down its estimates for Q4 GDP growth to 0.6% from 1.0%. Inflation was projected to be higher than previously forecast, with CPI likely to remain above 5% throughout the winter and peak at 6% in April 2022. The labour market was generally performing better than previously forecast and the BoE now expects the unemployment rate to fall to 4% compared to 4.5% forecast previously, but notes that Omicron could weaken the demand for labour.

UK CPI for November 2021 registered 5.1% year on year, up from 4.2% in the previous month. Core inflation, which excludes the more volatile components, rose to 4.0% y/y from 3.4%. The most recent labour market data for the three months to October 2021 showed the unemployment rate fell to 4.2% while the employment rate rose to 75.5%.

In October 2021, the headline 3-month average annual growth rate for wages were 4.9% for total pay and 4.3% for regular pay. In real terms, after adjusting for inflation, total pay growth was up 1.7% while regular pay was up 1.0%. The change in pay growth has been affected by a change in composition of employee jobs, where there has been a fall in the number and proportion of lower paid jobs.

Gross domestic product (GDP) grew by 1.3% in the third calendar quarter of 2021 according to the initial estimate, compared to a gain of 5.5% q/q in the previous quarter, with the annual rate slowing to 6.6% from 23.6%. The Q3 gain was modestly below the consensus forecast of a 1.5% q/q rise. During the quarter activity measures were boosted by sectors that reopened following pandemic restrictions, suggesting that wider spending was flat. Looking ahead, while monthly GDP readings suggest there had been some increase in momentum in the latter part of Q3, Q4 growth is expected to be soft.

GDP growth in the euro zone increased by 2.2% in calendar Q3 2021 following a gain of 2.1% in the second quarter and a decline of -0.3% in the first. Headline inflation has been strong, with CPI registering 4.9% year-on-year in November, the fifth successive month of inflation. Core CPI

inflation was 2.6% y/y in November, the fourth month of successive increases from July's 0.7% y/y. At these levels, inflation is above the European Central Bank's target of 'below, but close to 2%', putting some pressure on its long-term stance of holding its main interest rate of 0%.

The US economy expanded at an annualised rate of 2.1% in Q3 2021, slowing sharply from gains of 6.7% and 6.3% in the previous two quarters. In its December 2021 interest rate announcement, the Federal Reserve continue to maintain the Fed Funds rate at between 0% and 0.25% but outlined its plan to reduce its asset purchase programme earlier than previously stated and signalled they are in favour of tightening interest rates at a faster pace in 2022, with three 0.25% movements now expected.

Credit outlook:

Since the start of 2021, relatively benign credit conditions have led to credit default swap (CDS) prices for the larger UK banks to remain low and had steadily edged down throughout the year up until mid-November when the emergence of Omicron has caused them to rise modestly. However, the generally improved economic outlook during 2021 helped bank profitability and reduced the level of impairments many had made as provisions for bad loans. However, the relatively recent removal of coronavirus-related business support measures by the government means the full impact on bank balance sheets may not be known for some time.

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

Looking ahead, while there is still the chance of bank losses from bad loans as government and central bank support is removed, the institutions on the Authority's counterparty list are well-capitalised and general credit conditions across the sector are expected to remain benign. Duration limits for counterparties on the Authority's lending list are under regular review and will continue to reflect economic conditions and the credit outlook.

Interest rate forecast:

The Authority's treasury management adviser Arlingclose is forecasting that Bank Rate will continue to rise in calendar Q1 2022 to subdue inflationary pressures and the perceived desire by the BoE to move away from emergency levels of interest rates.

Investors continue to price in multiple rises in Bank Rate over the next forecast horizon, and Arlingclose believes that although interest rates will rise again, the increases will not be to the extent predicted by financial markets. In the near-term, the risks around Arlingclose's central case are to the upside while over the medium-term the risks become more balanced.

Yields are expected to remain broadly at current levels over the medium-term, with the 5, 10 and 20 year gilt yields expected to average around 0.65%, 0.90%, and 1.15% respectively. The risks around for short and medium-term yields are initially to the upside but shifts lower later, while for long-term yields the risk is to the upside. However, as ever there will almost certainly be short-term volatility due to economic and political uncertainty and events.

A more detailed economic and interest rate forecast provided by Arlingclose is attached as Appendix 1b.

Appendix 1b – Arlingclose Limited underlying assumptions as at December 2021

The global recovery from the pandemic has entered a more challenging phase. The resurgence in demand has led to the expected rise in inflationary pressure, but disrupted factors of supply are amplifying the effects, increasing the likelihood of lower growth rates ahead. The advent of the Omicron variant of coronavirus is affecting activity and is also a reminder of the potential downside risks.

Despite relatively buoyant activity survey data, official GDP data indicates that growth was weakening into Q4 2021. Other data, however, suggested continued momentum, particularly for November. Retail sales volumes rose 1.4%, PMIs increased, and the labour market continued to strengthen. The end of furlough did not appear to have had a significant impact on unemployment. Wage growth is elevated.

The CPI inflation rate rose to 5.1% for November and will rise higher in the near term. While the transitory factors affecting inflation are expected to unwind over time, policymakers' concern is persistent medium term price pressure.

These factors prompted the MPC to raise Bank Rate to 0.25% at the December meeting. Short term interest rate expectations remain elevated.

The outlook, however, appears weaker. Household spending faces pressures from a combination of higher prices and tax rises. In the immediate term, the Omicron variant has already affected growth – Q4 and Q1 activity could be weak at best.

Longer-term government bond yields remain relatively low despite the more hawkish signals from the BoE and the Federal Reserve. Investors are concerned that significant policy tightening in the near term will slow growth and prompt the need for looser policy later. Geo-political and coronavirus risks are also driving safe haven buying. The result is a much flatter yield curve, as short-term yields rise even as long-term yields fall.

The rise in Bank Rate despite the Omicron variant signals that the MPC will act to bring inflation down whatever the environment. It has also made clear its intentions to tighten policy further. While the economic outlook will be challenging, the signals from policymakers suggest their preference is to tighten policy unless data indicates a more severe slowdown.

Forecast:

The MPC will want to build on the strong message it delivered this month by tightening policy despite Omicron uncertainty.

Arlingclose therefore expects Bank Rate to rise to 0.50% in Q1 2022, but then remain there. Risks to the forecast are initially weighted to the upside, but becoming more balanced over time. The Arlingclose central forecast remains below the market forward curve.

Gilt yields will remain broadly flat from current levels. Yields have fallen sharply at the longer end of the yield curve, but expectations of a rise in Bank Rate have maintained short term gilt yields at higher levels.

Easing expectations for Bank Rate over time could prompt the yield curve to steepen, as investors build in higher inflation expectations.

The risks around the gilt yield forecasts vary. The risk for short and medium term yields is initially on the upside but shifts lower later. The risk for long-term yields is weighted to the upside.

	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Official Bank Rate													
Upside risk	0.00	0.00	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk	0.00	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
3-month money market rate													
Upside risk	0.05	0.05	0.25	0.35	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.25	0.55	0.55	0.60	0.60	0.60	0.60	0.65	0.65	0.65	0.65	0.65	0.65
Downside risk	0.00	-0.25	-0.25	-0.30	-0.30	-0.30	-0.30	-0.35	-0.35	-0.35	-0.35	-0.35	-0.35
5yr gilt yield													
Upside risk	0.00	0.35	0.45	0.55	0.55	0.55	0.55	0.55	0.55	0.50	0.50	0.45	0.45
Arlingclose Central Case	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.65	0.70	0.75	0.75
Downside risk	-0.10	-0.20	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.30	-0.35	-0.40	-0.40
10yr gilt yield													
Upside risk	0.10	0.25	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.55	0.55	0.55
Arlingclose Central Case	0.80	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.90	0.90	0.95	0.95
Downside risk	-0.10	-0.25	-0.30	-0.35	-0.35	-0.35	-0.35	-0.35	-0.35	-0.40	-0.40	-0.40	-0.40
20yr gilt yield													
Upside risk	0.30	0.40	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	1.00	1.05	1.10	1.10	1.10	1.10	1.15	1.15	1.15	1.20	1.20	1.20	1.20
Downside risk	-0.15	-0.30	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45
50yr gilt yield													
Upside risk	0.25	0.30	0.40	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.70	0.75	0.80	0.85	0.90	0.95	1.00	1.05	1.05	1.10	1.10	1.15	1.15
Downside risk	-0.15	-0.30	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45

PWLB Standard Rate (Maturity Loans) = Gilt yield + 1.00%

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%

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

Appendix 2 – Investment criteria definitions

Government: Loans to, and bonds and bills issued or guaranteed by, national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Government are deemed to be zero credit risk due to its ability to create additional currency and therefore may be made in unlimited amounts for up to 50 years.

Secured investments: Investments secured on the borrower's assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments.

Banks and building societies (unsecured): Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

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

Money market funds: Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the Authority will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

Strategic pooled funds: Bond, equity and property funds that offer enhanced returns over the longer term but are more volatile in the short term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.

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

Other investments: This category covers treasury investments not listed above, for example unsecured corporate bonds and company loans. Non-bank companies cannot be bailed-in but can become insolvent placing the Authority's investment at risk.

Operational bank accounts: The Council banks with Lloyds (Lloyds Banking Group). On adoption of this Strategy, it will meet the minimum credit criteria of A- (or equivalent) long term. It is the Council's intention that even if the credit rating of Lloyds Bank falls below the minimum criteria A- the bank will continue to be used for short term liquidity requirements (overnight and weekend investments) and business continuity arrangements.

Policy Investments: The Council will provide cash flow for third party organisations linked to the Council. The following limit is set for 2022/23:

- Publica Group - £0.5m up to one year duration
- Ubico - £0.5m up to one year duration