

Treasury Management Strategy

Introduction

1. Treasury management is the management of the Council's cash flows, borrowing and investments, and the associated risks. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Council's prudent financial management.
2. Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) which requires the Council to approve a Treasury Management Strategy before the start of each financial year. This strategy fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.
3. Investments held for service purposes or for commercial profit are considered in the separate Appendix L - Investment Strategy.

Governance

4. The Corporate Director of Finance is responsible for the Council's treasury management operations and day to day responsibility is delegated to the Head of Finance (Policy, Planning & Strategy) / Head of Finance (Operations) and Treasury and Investments Manager. The detailed responsibilities are set out in the Council's Treasury Management Practices.
5. The Treasury Management Advisory Group (TMAG) has been established to work with Officers on treasury management. The agreed terms of reference are "The Treasury Management Advisory Group will be responsible for advising the Cabinet and Corporate Director of Finance on treasury management policy within the Council's overarching Treasury Management Strategy". TMAG meets the requirement in the CIPFA Code for a member body focussing specifically on treasury management. TMAG meets half yearly and members of the group receive detailed information on a monthly basis.
6. Council agrees the Treasury Management Strategy and receives annual and half yearly reports on treasury management activity. Governance and Audit Committee receives quarterly updates as well as annual and half-yearly reports and makes recommendations to County Council.

External Context

Economic background

7. The impact on the UK from coronavirus, lockdown measures, the rollout of vaccines, as well as the new trading arrangements with the European Union (EU), will remain major influences on the Council's Treasury Management Strategy for 2021-22.
8. The Bank of England (BoE) maintained Bank Rate at 0.10% in December 2020 and Quantitative Easing programme at £895 billion having extended it by £150 billion in the previous month. The Monetary Policy Committee (MPC) voted unanimously for both, but no mention was made of the potential future use of negative interest rates. In the November Monetary Policy Report (MPR) forecasts, the Bank expects the UK economy to shrink -2% in Q4 2020 before growing by 7.25% in 2021, lower than the previous forecast of 9%. The BoE also forecasts the economy will now take until Q1 2022 to reach its pre-pandemic level rather than the end of 2021 as previously forecast. By the time of the December MPC announcement, a COVID-19 vaccine was approved for use, which the Bank noted would reduce some of the downside risks to the economic outlook outlined in the November MPR.
9. UK Consumer Price Inflation (CPI) for November 2020 registered 0.3% year on year, down from 0.7% in the previous month. Core inflation, which excludes the more volatile components, fell to 1.1% from 1.5%. The most recent labour market data for the three months to October 2020 showed the unemployment rate rose to 4.9% while the employment rate fell to 75.2%. Both measures are expected to deteriorate further due to the ongoing impact of coronavirus on the jobs market, particularly when the various government job retention schemes start to be unwound in 2021, with the BoE forecasting unemployment will peak at 7.75% in Q2 2021. In October, the headline 3-month average annual growth rates for wages were 2.7% for total pay and 2.8% for regular pay. In real terms, after adjusting for inflation, total pay growth was up by 1.9% while regular pay was up 2.1%
10. GDP growth rebounded by 16.0% in Q3 2020 having fallen by -18.8% in the second quarter, with the annual rate rising to -8.6% from -20.8%. All sectors rose quarter-on-quarter, with dramatic gains in construction (41.2%), followed by services and production (both 14.7%). Monthly GDP estimates have shown the economic recovery slowing and remains well below its pre-pandemic peak. Looking ahead, the BoE's November MPR forecasts economic growth will rise in 2021 with GDP reaching 11% in Q4 2021, 3.1% in Q4 2022 and 1.6% in Q4 2023.

Credit outlook

11. After spiking in late March as coronavirus became a global pandemic and then rising again in October/November, credit default swap (CDS) prices for the larger UK banks have steadily fallen back to almost pre-pandemic levels. Although uncertainty around COVID-19 related loan defaults led to banks provisioning billions for potential losses in the first half of 2020, drastically reducing profits, reported impairments for Q3 were much reduced in some institutions. However, general bank profitability in 2020 and 2021 may be significantly lower than in previous years.

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12. The credit ratings for many UK institutions were downgraded on the back of downgrades to the sovereign rating. Credit conditions more generally though in banks and building societies have tended to be relatively benign, despite the impact of the pandemic.
13. Looking forward, the potential for bank losses to be greater than expected when government and central bank support starts to be removed remains a risk, suggesting a cautious approach to bank deposits in 2021/22 remains advisable.

Interest rate forecast

14. The Council's treasury management advisor Arlingclose is forecasting the BoE Bank Rate will remain at 0.1% until at least the first quarter of 2024. The risks to this forecast are judged to be to the downside as the BoE and UK government continue to react to the coronavirus pandemic and the new EU trading arrangements. The BoE extended its asset purchase programme to £895 billion in November while keeping Bank Rate on hold and maintained this position in December. However, further interest rate cuts to zero, or possibly negative, cannot yet be ruled out but this is not part of the Arlingclose central forecast.
15. Gilt yields are expected to remain very low in the medium-term while short-term yields are likely to remain below or at zero until such time as the BoE expressly rules out the chance of negative interest rates or growth/inflation prospects improve. The central case is for 10-year and 20-year gilt yields to rise to around 0.60% and 0.90% respectively over the time horizon. The risks around the gilt yield forecasts are judged to be broadly balanced between upside and downside risks, but there will almost certainly be short-term volatility due to economic and political uncertainty and events.

Local Context

16. On 31 December 2020 the Council held £877m of external borrowing and £440m of treasury investments. This is set out in further detail in Annexe A. Forecast changes in these sums are shown in the balance sheet analysis below.

	31.3.20	31.3.21	31.3.22	31.3.23	31.3.24
	Actual	Estimate	Forecast	Forecast	Forecast
	£m	£m	£m	£m	£m
Loans CFR	1,039.3	1,065.1	1,157.3	1,159.0	1,100.5
External borrowing	-883.8	-853.7	-826.0	-802.5	-776.9
Internal borrowing	155.5	211.4	331.3	356.5	323.6
Less: Usable reserves	-393.0	-413.0	-422.0	-422.0	-422.0
Less: Working capital	-144.3	-144.3	-144.3	-144.3	-144.3
Net investments	381.8	345.9	235.0	209.8	242.7

17. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the

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

18. CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years and the Council expects to comply with this recommendation.

Borrowing Strategy

19. On 31 December 2020, the Council had £877.1m external debt, including £31.6m attributable to Medway Council, as part of its strategy for funding previous years' capital programmes. This represents a decrease of £7m on 31 March 2020 and reflects the Council's strategy of maintaining borrowing below the underlying levels.
20. The balance sheet forecast in the above table shows that the Council does not expect to need to borrow in 2021-22. The Council may borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £1,016m.

Objective

21. The Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

Strategy

22. The Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability or sustainability of the debt portfolio.
23. Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.
24. By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. Using cash available on the Council's balance sheet is also known as internal borrowing and at the end of March 2020 the Council had supplemented external debt with £156m of internal borrowing. Internal borrowing is not cost free as it is at the expense of investment returns and does not remove the need for Minimum Revenue Provision (MRP) to be made.
25. The benefits of internal and short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. The Council will use the services of its treasury advisor to develop this 'cost of carry' and breakeven analysis

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and based on the results the Council will determine whether to borrow additional sums at long-term fixed rates in 2021-22 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

26. The Council has previously raised the majority of its long-term borrowing from the PWLB and is likely to continue with this practice following the publication in November of the results of the HM Treasury consultation on changes to the PWLB's lending policy. The new lending terms include a reduction of 1% in all Standard Rate and Certainty Rate PWLB loans and the PWLB will not lend to any Council that plans to buy investment assets primarily for yield anywhere in their capital plans.
27. The Council will also consider long-term loans from other sources in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA code. Alternatively, the Council may arrange forward starting loans, 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. In addition, the Council may borrow short-term loans to cover unplanned cash flow shortages.
28. **Prudential Indicators:** The Council's capital strategy prudential indicator 3 indicates that the Council does not expect to increase its external borrowing in 2021-22 but it retains the flexibility to consider borrowing either long term or short term as well as using its cash balances.
29. **Sources of borrowing:** The approved sources of long-term and short-term borrowing are:
 - HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
 - any institution approved for investments (see below)
 - any other bank or building society authorised to operate in the UK
 - any other UK public sector body
 - UK public and private sector pension funds (except the Kent County Council Superannuation Fund)
 - capital market bond investors
 - UK Municipal Bonds Agency plc and other special purpose companies created to enable local Council bond issues
 - UK Government backed funding initiatives
30. **Other sources of debt finance:** In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:
 - leasing
 - hire purchase
 - Private Finance Initiative
 - sale and leaseback
31. **LOBO (Lender's Option Borrower's Option) loans:** The Council holds £90m of LOBO loans (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. LOBOs totalling £90m have option dates during 2021-22, and although the Council understands that lenders are unlikely to exercise their options in the current

low interest rate environment, there remains an element of refinancing risk. The Council will take the option to repay LOBO loans at no cost if the opportunity arises.

32. **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 below.
33. **Debt rescheduling:** The PWLB allows councils 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 in the current interest rate environment

Treasury Investment Strategy

34. The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. Since the beginning of April 2020 the Council's cash balance has ranged between £296m and £530m. The average balance is expected to reduce in 2021-22 reflecting the Council's policy of using cash balances to repay maturing loans and internally funding capital expenditure.
35. **Objectives:** The CIPFA Code requires the Council to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults, the liquidity of investments and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.
36. **Negative interest rates:** The COVID-19 pandemic has increased the risk that the Bank of England will set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. Since investments cannot pay negative income, negative rates will 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.
37. **Strategy:** The Council's strategy for 2021-22 is essentially the same as that for 2020-21. Given the risk and very low returns from short-term unsecured bank investments the Council will continue to invest a significant proportion of the cash available for longer term investment in secure and / or higher yielding asset classes. It will continue to invest in money market funds and Government including local authority deposits to meet its liquidity requirements.
38. **Business models:** Under 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

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flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost. The IFRS 9 statutory override ends in 2024 so the Council is exploring options for mitigating the risks related to the fluctuation in the value of its investments in pooled funds.

Approved counterparties

39. The Council may invest its surplus funds with any of the counterparty types in the table below, subject to the limits shown.

	Minimum Credit rating	Individual Maximum Cash Limit	Total Maximum Cash Limit	Maximum Duration
Government				
- UK Government		unlimited		50 years
- UK Local Authorities		£25m		2 years
- Kent local authorities for cashflow purposes only			£70m	1 year
Supranational banks	AAA	£20m	£30m	25 years
Non-UK Government	AA+	£20m	£30m	25 years
UK banks and building societies (unsecured)	A-	£15m		13 months
Council's banking services provider		£20m		Overnight
Overseas banks (unsecured)	Country limit AA+,	£20m	£30m country limit	13 months
	Individual limit A-			
Short-term Money Market Funds	A+	£20m per fund or 0.5% of the fund size if lower		
Cashplus / short bond funds		£20m per fund		
Secured investments				
- Covered bonds	AAA	£20m	£100m	5 years
- Reverse repurchase agreements	collateral of AA or better	£20m each		5 years
Corporates (non-financials)	A	£2m per issuer	£20m	2 years
Registered Providers		£10m	£50m	5 years
Loans incl. to developers in the No Use Empty programme			£24m	
Strategic pooled funds and real estate investment trusts			£250m	
- Absolute Return funds		£25m per fund		

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- Multi Asset Income funds	£25m per fund		
- Property funds	£75m or 5% of total fund value if greater		
- Bond funds	£25m per fund		
- Equity Income Funds	£25m per fund		
- Real Estate Investment Trusts	£25m per fund		

40. **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 Central 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. The loans to other Kent authorities will be interest free because of the financial benefits other than earning an interest rate return.
41. Loans to all local authorities are assessed in terms of the Council's cashflow requirements and within its effective lending policies and procedures and this lending will be diversified across many local authorities. Reputational risk will be taken into account in addition to the financial risks of this investment.
42. **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.
43. **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. Unsecured investments with banks rated below the agreed minimum rating of A- are restricted to overnight deposits with the Council's current banking services provider.
44. **Money Market Funds:** Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts. 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 Council will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.
45. **Cash plus / Short Bond Funds:** Pooled investment funds whose values change with market prices and have a notice period, will be used as alternatives to unsecured bank deposits for longer investment periods.

46. **Corporates:** Bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in but are exposed to the risk of the company going insolvent.
47. **Registered providers:** 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. As providers of public services, they retain the likelihood of receiving government support if needed.
48. **Loans:** Loans to entities set up on an arms-length basis from the Council, and other suitable opportunities, on which the Council will take advice from Arlingclose with regard to the appropriate structure of the loans and applicable rate of interest. Included are interest bearing loans to developers under the No Use Empty Development Programme.
49. **Pooled investment 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 Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.
50. **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.
51. **Operational bank accounts:** The Council may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £50,000 per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.

Risk assessment and credit ratings

52. Credit ratings are obtained and monitored by the Council's treasury advisors, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:
 - no new investments will be made,
 - any existing investments that can be recalled or sold at no cost will be, and
 - full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

53. Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as “rating watch negative” or “credit watch negative”) so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that entity until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

Other information on the security of investments

54. The Council understands that credit ratings are good but not perfect predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the entities in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from Arlingclose, the Council’s treasury management advisor. No investments will be made with an entity if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.
55. When 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. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council’s cash balances, then the surplus will be deposited with the UK Government or with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

Investment limits

56. The Council may invest its surplus funds with any of the counterparty types listed above subject to the cash limits per counterparty and the durations shown in the table at paragraph 39.
57. The Council’s revenue reserves available to cover investment losses are forecast to be £272m on 31 March 2021. In order that no more than 10% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one counterparty (other than the UK Government and the Churches, Charities and Local Authorities - Local Authorities Mutual Investment Trust (CCLA LAMIT) property fund) will be £25m.

Liquidity management

58. The Council forecasts its cash flow requirements to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council’s medium-term financial plan and cash flow forecast.

59. The Council will spread its liquid cash over several bank accounts and money market funds to ensure that access to cash is maintained in the event of operational difficulties at any one provider.

Treasury Management Indicators

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

61. **Security:** The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its internally managed 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 rating	AA

62. **Liquidity:** The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period, without additional borrowing.

Liquidity risk indicator	Target
Total cash available within 3 months	£100m

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

Interest rate risk indicator	Limit
Upper limit on one-year revenue impact of a 1% <u>rise</u> in interest rates	£10m
Upper limit on one-year revenue impact of a 1% <u>fall</u> in interest rates	£10m

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

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

Refinancing rate risk indicator	Upper limit	Lower limit
Under 12 months	100%	0%
12 months and within 5 years	50%	0%
5 years and within 10 years	50%	0%
10 years and within 20 years	50%	0%
20 years and within 40 years	50%	0%
40 years and longer	50%	0%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

65. **Principal sums invested for periods longer than a year:** The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

Price risk indicator	2021-22	2021-22	2022-23
Limit on principal invested beyond year end	£300m	£300m	£300m

Related Matters

66. The CIPFA Code requires the Council to include the following in its Treasury Management Strategy.
67. **Financial Derivatives:** Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over councils' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).
68. 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.
69. Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.
70. 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.

71. **Markets in Financial Instruments Directive:** The Council has opted up to professional client status with its providers of financial services, including advisors, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the Corporate Director of Finance believes this to be the most appropriate status.

Financial Implications

72. The budget for investment income in 2021-22 is £8.2m, based on an average investment portfolio of £440m at an interest rate of 2.18%. The budget for debt interest payable in 2021-22 is £39.8m, based on an average debt portfolio of £841.2m at an average interest rate of 4.50%. If actual levels of investments and borrowing, or actual interest rates, differ from forecast, performance against budget will be correspondingly different.

Other Options Considered

73. The CIPFA Code does not prescribe any particular Treasury Management Strategy for councils to adopt. The Corporate Director of Finance, having consulted the Deputy Leader and Cabinet Member for Finance, Traded and Corporate Services, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain

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Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain
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Annexe A – Existing Investment & Debt Portfolio Position

	31-Dec-20	31-Dec-20
	Actual Portfolio	Average Rate
	£m	%
External borrowing		
Public Works Loan Board	470.9	4.99
LOBO loans from banks	90.0	4.15
Banks and other lenders (Fixed term)	291.8	4.40
Streetlighting Project	24.3	1.21
Total external borrowing	877.1	4.51
Treasury investments		
Bank Call Accounts	48.0	0.04
Covered bonds (secured)	79.7	0.65
Government (incl. local authorities)	85.4	0.10
Money Market Funds	50.7	0.02
Equity	2.1	
No Use Empty Loans	3.7	1.50
Total internally managed investments	269.6	0.25
Pooled investments funds		
- Property	56.3	3.09
- Multi Asset	59.9	2.76
- Absolute Return	5.0	1.80
- Equity UK	26.8	4.03
- Equity Global	22.2	2.77
Total pooled investments	170.2	4.14
Total treasury investments	439.8	2.18
Net debt	437.3	

GLOSSARY

Local Authority Treasury Management Terms

Bond	A certificate of long-term debt issued by a company, government, or other institution, which is tradable on financial markets
Borrowing	Usually refers to the stock of outstanding loans owed and bonds issued.
CFR	Capital Financing Requirement. A council's underlying need to hold debt for capital purposes, representing the cumulative capital expenditure that has been incurred but not yet financed. The CFR increases with capital expenditure and decreases with capital finance and MRP.
Capital gain or loss	An increase or decrease in the capital value of an investment, for example through movements in its market price.
Collective investment scheme	Scheme in which multiple investors collectively hold units or shares. The investment assets in the fund are not held directly by each investor, but as part of a pool (hence these funds are also referred to as 'pooled funds').
Cost of carry	When a loan is borrowed in advance of need, the difference between the interest payable on the loan and the income earned from investing the cash in the interim.
Counterparty	The other party to a loan, investment or other contract.
Counterparty limit	The maximum amount an investor is willing to lend to a counterparty, in order to manage credit risk.
Covered bond	Bond issued by a financial institution that is secured on that institution's assets, usually residential mortgages, and is therefore lower risk than unsecured bonds. Covered bonds are exempt from bail-in.
CPI	Consumer Price Index - the measure of inflation targeted by the Monetary Policy Committee.
Deposit	A regulated placing of cash with a financial institution. Deposits are not tradable on financial markets.
Diversified income fund	A collective investment scheme that invests in a range of bonds, equity and property in order to minimise price risk, and also focuses on investments that pay income.
Dividend	Income paid to investors in shares and collective investment schemes. Dividends are not contractual, and the amount is therefore not known in advance.
DMADF	Debt Management Account Deposit Facility – a facility offered by the DMO enabling councils to deposit cash at very low credit risk. Not available in Northern Ireland.
DMO	Debt Management Office – an executive agency of HM Treasury that deals with central government's debt and investments.
Equity	An investment which usually confers ownership and voting rights
Floating rate note (FRN)	Bond where the interest rate changes at set intervals linked to a market variable, most commonly 3-month LIBOR or SONIA

Appendix K

FTSE	Financial Times stock exchange – a series of indices on the London Stock Exchange. The FTSE 100 is the index of the largest 100 companies on the exchange, the FTSE 250 is the next largest 250 and the FTSE 350 combines the two
GDP	Gross domestic product – the value of the national aggregate production of goods and services in the economy. Increasing GDP is known as economic growth.
Income return	Return on investment from dividends, interest and rent but excluding capital gains and losses.
GILT	Bond issued by the UK Government, taking its name from the gilt-edged paper they were originally printed on.
LIBID	London interbank bid rate - the benchmark interest rate at which banks bid to borrow cash from other banks, traditionally 0.125% lower than LIBOR.
LIBOR	London interbank offer rate - the benchmark interest rate at which banks offer to lend cash to other banks. Published every London working day at 11am for various currencies and terms. Due to be phased out by 2022.
LOBO	Lender's Option Borrower's option
MMF	Money Market Funds. A collective investment scheme which invests in a range of short-term assets providing high credit quality and high liquidity. Usually refers to Constant Net Asset Value (CNAV) and Low Volatility Net Asset Value (LVNAV) funds with a Weighted Average Maturity (WAM) under 60 days which offer instant access, but the European Union definition extends to include cash plus funds
Pooled Fund	Scheme in which multiple investors hold units or shares. The investment assets in the fund are not held directly by each investor, but as part of a pool (hence these funds are also referred to as 'pooled funds').
PWLB	Public Works Loan Board – a statutory body operating within the Debt Management Office (DMO) that lends money from the National Loans Fund to councils and other prescribed bodies and collects the repayments. Not available in Northern Ireland.
Quantitative easing (QE)	Process by which central banks directly increase the quantity of money in the economy in order to promote GDP growth and prevent deflation. Normally achieved by the central bank buying government bonds in exchange for newly created money.
SONIA	Sterling overnight interest average – a benchmark interest rate for overnight deposits.
Short-dated	Usually means less than one year
Total return	The overall return on an investment, including interest, dividends, rent, fees and capital gains and losses.