Treasury Management Strategy Statement, Minimum Revenue Provision Policy Statement and Annual Investment Strategy for 2021-22

Governance and Audit Committee – 25 November 2020

Report Author	Tim Willis, Deputy Chief Executive & Section 151 Officer
Portfolio Holder	Councillor Rob Yates, Cabinet Member for Finance, Administration and Community Wealth Building
Status	For Decision
Classification	Unrestricted
Previously Considered by	Not applicable
Ward	Thanet Wide

Executive Summary:

This report and annexes includes the proposed Treasury Management Strategy Statement, Minimum Revenue Provision Policy Statement, Annual Investment Strategy, Capital Strategy and Non-Treasury Investments Report (TMSS) for 2021-22.

The Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as:

"The management of the local authority'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."

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides:

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

Key reporting items to consider include:

- capital expenditure of £35.7m forecast over the next three years (2021-22 to 2023-24 inclusive), requiring borrowing of £4.8m.

- No change to the Minimum Revenue Provision policy (policy for paying off the accumulated borrowing requirement).

- This report is in line with the amendment as per the Treasury Management and Annual Investment Strategy Mid Year 2020-21 Review; that the council may use investment counterparties with a minimum long term credit rating from at least one of Fitch, Moody’s and Standard and Poors (where rated) of A- (or equivalent), where this was previously given as A in the TMSS, and that any such investments be included as specified investments.

Recommendation(s):

That the Governance and Audit Committee:

- Makes comments on this report and annexes as appropriate.
- Recommends this report and annexes, including each of the key elements listed below, to council for approval.

    - The Capital Plans, Prudential Indicators and Limits for 2021-22 to 2023-24, including the Authorised Limit Prudential Indicator.
    - The Minimum Revenue Provision (MRP) Policy.
    - The Treasury Management Strategy for 2021-22 to 2023-24 and the Treasury Indicators.
    - The Investment Strategy for 2021-22 contained in the Treasury Management Strategy, including the detailed criteria.
    - The Capital Strategy for 2021-22.
    - The Non-Treasury Investments Report for 2021-22.

Corporate Implications

Financial and Value for Money

The financial implications are highlighted in this report.

Legal

Section 151 of the 1972 Local Government Act requires a suitably qualified named officer to keep control of the council’s finances. For this council, this is the Deputy Chief Executive, and this report is helping to carry out that function.

Corporate

Failure to undertake this process will impact on the council’s compliance with the Treasury Management Code of Practice.

Equalities Act 2010 & Public Sector Equality Duty

There are no equity and equalities implications arising directly from this report, but the council needs to retain a strong focus and understanding on issues of diversity amongst the local community and ensure service delivery matches these.

It is important to be aware of the council's responsibility under the Public Sector Equality Duty (PSED) and show evidence that due consideration had been given to the equalities impact that may be brought upon communities by the decisions made by council.

CORPORATE PRIORITIES

This report relates to the following corporate priorities: -

- Growth
- Environment
- Communities.

1 INTRODUCTION

1.1 Background

The council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the council's low risk appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of the council's capital plans. These capital plans provide a guide to the borrowing need of the council, essentially the longer-term cash flow planning, to ensure that the council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans, or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet council risk or cost objectives.

The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities (arising usually from capital expenditure) and are separate from the day to day treasury management activities.

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"The management of the local authority'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."

1.2 Reporting requirements

1.2.1 Capital Strategy

The CIPFA 2017 Prudential and Treasury Management Codes require all local authorities to prepare reports which will provide the following:

- a high-level long term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services.
- an overview of how the associated risk is managed.
- the implications for future financial sustainability.

The aim of this is to ensure:

- that all elected members on the full council fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.
- the separation of the core treasury function under security, liquidity and yield principles, and the policy and commercialism investments usually driven by expenditure on an asset.

For this council, these additional reports are the Capital Strategy and the Non-Treasury Investments Report.

1.2.2 Treasury Management reporting

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

a. **Prudential and treasury indicators and treasury strategy** (this report) - The first, and most important report is forward looking and covers:
   - the capital plans (including prudential indicators);
   - a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
   - the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
   - an investment strategy (the parameters on how investments are to be managed).

b. **A mid-year treasury management report** – This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision.

c. **An annual treasury report** – This is a backward looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Scrutiny

The above reports are required to be adequately scrutinised before being recommended to the council. This role is undertaken by the Governance and Audit Committee.

1.3 Treasury Management Strategy for 2021-22

The strategy for 2021-22 covers two main areas:

Capital issues

- the capital expenditure plans and the associated prudential indicators;
- the minimum revenue provision (MRP) policy.

Treasury management issues

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

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

1.4 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. Training was last undertaken by members on 31 October 2019 and further training will be arranged as required.

The training needs of treasury management officers are periodically reviewed.

1.5 External service providers

The council uses Link Group, Treasury Solutions as its external treasury management advisors.

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

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

The council uses the Institutional Cash Distributors (ICD) Portal to invest or redeem trades in its Money Market Funds (MMFs). The portal provides advanced reporting tools so that the authority can assess its exposure to certain banks or countries.

Most investments via the ICD portal are made via JP Morgan, who act as a clearing house for eight of the ten MMFs the council currently uses. The clearing house allows the authority to make several investments in different MMFs but only requires one payment to the clearing house, therefore saving the authority costs in CHAPS fees.

2 THE CAPITAL PRUDENTIAL INDICATORS 2021-22 – 2023-24

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

2.1 Capital expenditure

This prudential indicator is a summary of the council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts:

Capital expenditure £m	2019-20 Actual	2020-21 Budget	2021-22 Budget	2022-23 Budget	2023-24 Budget
General Fund	6.887	21.389	5.461	5.308	3.894
HRA	10.586	22.418	16.451	2.324	2.305
Total	**17.473**	**43.807**	**21.912**	**7.632**	**6.199**

The above capital expenditure forecast excludes any potential capital project(s) that may be required in connection with the council's Covid-19 Plan for Recovery. Likewise, this has not been reflected elsewhere in this report, pending the formulation and approval of any such scheme(s).

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

Capital expenditure £m	2019-20 Actual	2020-21 Budget	2021-22 Budget	2022-23 Budget	2023-24 Budget
General Fund	6.887	21.389	5.461	5.308	3.894
HRA	10.586	22.418	16.451	2.324	2.305
Total	**17.473**	**43.807**	**21.912**	**7.632**	**6.199**
Financed by:					
Capital receipts - GF	1.155	6.442	0.789	0.808	0.314
Capital receipts - HRA	1.809	2.223	1.300	0.000	0.000
Capital grants - GF	5.078	7.708	3.642	3.880	3.000
Capital grants - HRA	0.876	0.719	0.000	0.000	0.000
Reserves - GF	0.111	2.665	0.427	0.020	0.000
Reserves - HRA	3.497	13.765	11.711	1.908	1.880
Revenue - GF	0.000	0.104	0.000	0.000	0.000
Revenue - HRA	0.152	0.548	0.408	0.416	0.425
Net financing need for the year	**4.795**	**9.633**	**3.635**	**0.600**	**0.580**

Other long term liabilities: The above financing need excludes other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments.

2.2 The Council's borrowing need (the Capital Financing Requirement)

The second prudential indicator is the council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the council's indebtedness and so its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the indebtedness in line with each asset's life, and so charges the economic consumption of capital assets as they are used.

The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the council's borrowing requirement, these types of scheme include a borrowing facility from the provider and so the council is not required to separately borrow for these schemes. The council had £2.778m of long term liabilities (excluding pensions) as at 31 March 2020.

The council is asked to approve the CFR projections below:

£m	2019-20 Actual	2020-21 Estimate	2021-22 Estimate	2022-23 Estimate	2023-24 Estimate
Capital Financing Requirement					
CFR – General Fund	25.836	29.076	48.249	47.341	46.402

CFR – HRA	24.200	29.362	32.216	31.936	31.606
Total CFR	**50.036**	**58.438**	**80.465**	**79.277**	**78.008**
Movement in CFR	**2.753**	**8.402**	**22.027**	**(1.188)**	**(1.269)**

Net financing need for the year (above)	4.795	9.633	3.635	0.600	0.580
Less loan / liability repayments	(0.839)	(0.000)	(0.179)	(0.280)	(0.330)
Less MRP/VRP and other financing movements*	(1.203)	(1.231)	18.571	(1.508)	(1.519)
Movement in CFR	**2.753**	**8.402**	**22.027**	**(1.188)**	**(1.269)**

**2021-22 includes an estimate for the recognition of leases under International Financial Reporting Standard 16 (IFRS 16).*

2.3 Core funds and expected investment balances

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Year End Resources £m	2019-20 Actual	2020-21 Estimate	2021-22 Estimate	2022-23 Estimate	2023-24 Estimate
Fund balances / reserves	26.168	17.319	8.656	8.656	8.656
Capital receipts	8.544	4.895	3.595	3.595	3.595
Earmarked reserves	13.528	9.403	9.403	9.403	9.403
Total core funds	**48.240**	**31.617**	**21.654**	**21.654**	**21.654**
Balances incl working capital*	7.897	6.359	14.149	10.761	10.250
(Under)/over borrowing	(22.233)	(14.976)	(12.803)	(9.415)	(8.904)
Expected investments	**33.904**	**23.000**	**23.000**	**23.000**	**23.000**

**Working capital balances shown are estimated year end; these may be different mid-year.*

2.4 Minimum revenue provision (MRP) policy statement

The council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

MHCLG regulations have been issued which require the full council to approve **an MRP Statement** in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The council is recommended to approve the following MRP Statement:

For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:

- **Existing practice -** MRP will follow the existing practice outlined in former MHCLG regulations (option 1).

This option provides for an approximate 4% reduction in the borrowing need (CFR) each year.

From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be:

- **Asset life method –** MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction) (option 3);

This option provides for a reduction in the borrowing need over approximately the asset's life.

There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made.

Repayments included in annual PFI or finance leases are applied as MRP.

MRP Overpayments - A change introduced by the revised MHCLG MRP Guidance was the allowance that any charges made over the statutory minimum MRP, VRP or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, this policy must disclose any cumulative overpayment made each year.

3 BORROWING

The capital expenditure plans set out in Section 2 provide details of the service activity of the council. The treasury management function ensures that the council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity and the council's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 Current portfolio position

The overall treasury management portfolio as at 31 March 2020, and the position as at 30 September 2020, are shown below for both borrowing and investments.

TREASURY PORTFOLIO				
	Actual 31 March 2020	Actual 31 March 2020	Actual 30 Sept 2020	Actual 30 Sept 2020

Treasury Investments	£m	%	£m	%
Banks	17.939	52.91	14.123	33.35
Money Market Funds	15.965	47.09	28.224	66.65
Total (all managed in-house)	**33.904**	**100.00**	**42.347**	**100.00**
Treasury External Borrowing				
PWLB	20.503	81.93	20.192	81.72
LOBOs	4.500	17.98	4.500	18.21
Salix	0.022	0.09	0.017	0.07
Total	**25.025**	**100.00**	**24.709**	**100.00**
Net treasury investments / (borrowing)	**8.879**		**17.638**	

The Council's forward projections for borrowing are summarised below. The table shows the actual external debt against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

£m	2019-20 Actual	2020-21 Estimate	2021-22 Estimate	2022-23 Estimate	2023-24 Estimate
External Debt					
Debt at 1 April	30.456	25.025	41.025	46.447	48.997
Expected change in Debt	(5.431)	16.000	5.423	2.549	(0.549)
Other long-term liabilities (OLTL) at 1 April	2.148	2.778	2.437	21.223	20.883
Expected change in OLTL*	0.630	(0.341)	18.786	(0.340)	(0.200)
Gross debt at 31 March	**27.803**	**43.462**	**67.671**	**69.879**	**69.131**
The Capital Financing Requirement*	50.036	58.438	80.465	79.227	78.008
Under / (over) borrowing	**22.233**	**14.976**	**12.794**	**9.348**	**8.877**

**2021-22 includes an estimate for the recognition of leases under International Financial Reporting Standard 16 (IFRS 16).*

Within the range of prudential indicators there are a number of key indicators to ensure that the council operates its activities within well defined limits. One of these is that the council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2021-22 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes.

The Section 151 Officer reports that the council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

3.2 Treasury Indicators: limits to borrowing activity

The operational boundary. This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

Operational boundary £m	2020-21 Estimate	2021-22 Estimate	2022-23 Estimate	2023-24 Estimate
Debt	69.000	76.000	76.000	76.000
Other long term liabilities (incl leases)	30.000	35.000	35.000	35.000
Total	99.000	111.000	111.000	111.000

The authorised limit for external debt. This is a key prudential indicator and represents a control on the maximum level of borrowing. This represents a legal limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

1. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.
2. The council is asked to approve the following authorised limit:

Authorised limit £m	2020-21 Estimate	2021-22 Estimate	2022-23 Estimate	2023-24 Estimate
Debt	74.000	81.000	81.000	81.000
Other long term liabilities (incl leases)	35.000	45.000	45.000	45.000
Total	109.000	126.000	126.000	126.000

Composition of Operational Boundary and Authorised Limit

Debt (in both the Operational Boundary and Authorised Limit above) for 2020-21 onwards includes:

a) An allowance for capital expenditure being incurred in advance of generating capital receipts to fund this expenditure (£3.0m for 2020-21 increasing to £4.0m from 2021-22 onwards). As this is anticipated to be a relatively short-term timing difference it has not been reflected elsewhere in this report.

b) £5m to allow for any commercial activities/non-financial investments that the council may pursue (in addition to any such amounts already included within the capital and treasury estimates). This has not been reflected elsewhere in this report, pending the formulation and approval of any such items.

Other long term liabilities (in both the Operational Boundary and Authorised Limit above) includes an estimate for the recognition of leases under International Financial Reporting Standard 16 (IFRS 16). Once full details are known, the Operational Boundary and/or Authorised Limit may need to be revised for approval.

3.3 Link's economic and interest rate forecast (issued by Link on 27 October 2020)

The council has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Link provided the following forecasts on 11 August 2020 (PWLB rates are certainty rates, gilt yields plus 180bps):

Link Group Interest Rate View 11.8.20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month average earnings	0.05	0.05	0.05	0.05	0.05	-	-	-	-	-
6 month average earnings	0.10	0.10	0.10	0.10	0.10	-	-	-	-	-
12 month average earnings	0.15	0.15	0.15	0.15	0.15	-	-	-	-	-
5yr PWLB Rate	1.90	2.00	2.00	2.00	2.00	2.00	2.10	2.10	2.10	2.10
10yr PWLB Rate	2.10	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.30
25yr PWLB Rate	2.50	2.50	2.50	2.60	2.60	2.60	2.70	2.70	2.70	2.70
50yr PWLB Rate	2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50	2.50	2.50

The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its last meeting on 6th August, although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected in the forecast table above as economic recovery is expected to be only gradual and, therefore, prolonged.

Gilt yields / PWLB rates

There was much speculation during the second half of 2019 that bond markets were in a bubble which was driving bond prices up and yields down to historically very low levels. The context for that was a heightened expectation that the US could have been heading for a recession in 2020. In addition, there were growing expectations of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China, together with inflation generally at low levels in most countries and expected to remain subdued. Combined, these conditions were conducive to very low bond yields. While inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers. This means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. The consequence of this has been the gradual lowering of the overall level of interest rates and bond yields in financial markets over the last 30 years. Over the year prior to the coronavirus crisis, this has seen many bond yields up to 10 years turn negative in the Eurozone. In addition, there has, at times, been an inversion of bond yields in the US whereby 10 year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities.

Gilt yields had therefore already been on a generally falling trend up until the coronavirus crisis hit western economies during March. After gilt yields spiked up during the financial crisis in March, we have seen these yields fall sharply to unprecedented lows as investors panicked during March in selling shares in anticipation of impending recessions in western economies, and moved cash into safe haven assets i.e. government bonds. However, major western central banks took rapid action to deal with excessive stress in financial markets during March, and started massive quantitative easing purchases of government bonds: this also acted to put downward pressure on government bond yields at a time when there has been a huge and quick expansion of government expenditure financed by issuing government bonds. Such unprecedented levels of issuance in “normal” times would have caused bond yields to rise sharply. Gilt yields and PWLB rates have been at remarkably low rates so far during 2020-21.

As the interest forecast table for PWLB certainty rates above shows, there is likely to be little upward movement in PWLB rates over the next two years as it will take economies, including the UK, a prolonged period to recover all the momentum they have lost in the sharp recession caused during the coronavirus shut down period. From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.

Investment and borrowing rates

- **Investment returns** are likely to remain exceptionally low during 2021-22 with little increase in the following two years.

- **Borrowing interest rates** fell to historically very low rates as a result of the COVID crisis and the quantitative easing operations of the Bank of England: indeed, gilt yields up to 6 years were on negative yields during most of the first half of 20-21. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years. However, the unexpected increase of 100 basis points (bps) in PWLB rates on top of the then current margin over gilt yields of 80 bps, required an initial major rethink of local authority treasury management strategy and risk management. However, in March 2020, the Government started a consultation process for amending the margins over gilt rates for PWLB borrowing for different types of local authority capital expenditure. *(Please note that Link has concerns over this approach, as the fundamental principle of local authority borrowing is that borrowing is a treasury management activity and individual sums that are borrowed are not linked to specific capital projects).* It also introduced the following rates for borrowing for different types of capital expenditure: -

    - **PWLB Standard Rate** is gilt plus 200 basis points (G+200bps)
    - **PWLB Certainty Rate** is gilt plus 180 basis points (G+180bps)
    - **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
    - **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
    - **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

- In view of the consultation process which ended on 31 July 2020, local authorities may wish to exercise caution and delay any new long-term General Fund borrowing until such time as new borrowing margins and regulations have been decided and announced, unless there is a desire for certainty in respect of long-term funding rates from a budgetary perspective.

- **Borrowing not for HRA or infrastructure capital expenditure.** As Link's long-term forecast for Bank Rate is 2.00%, and all PWLB non-HRA certainty rates (i.e. gilts plus 180bps) are close to, or under 1% above, 2%, there is little value in borrowing from the PWLB at present. Accordingly, the Council will reassess its risk appetite in terms of either seeking cheaper alternative sources of borrowing or switching to short term borrowing in the money markets until such time as the Government reconsiders the margins charged over gilt yields for non-HRA capital expenditure. Longer-term borrowing could also be undertaken for the purpose of certainty, where that is desirable, or for flattening the profile of a heavily unbalanced maturity profile.

- **Borrowing for HRA and infrastructure capital expenditure.** As Link's long-term forecast for Bank Rate is 2.00%, and all PWLB HRA and infrastructure certainty rates are below 2.00%, there is value in borrowing from the PWLB, especially as current rates are at historic lows.

- While authorities may not be able to avoid borrowing to finance new capital expenditure, to replace maturing debt and the rundown of reserves, there will be a cost of carry (the difference between higher borrowing costs and lower investment returns) to any new short or medium-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

3.4 Borrowing strategy

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

Against this background and the risks within the economic forecast, caution will be adopted with the 2021-22 treasury operations. The Section 151 Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *if it was felt that there was a significant risk of a sharp FALL in borrowing rates*, then borrowing will be postponed.

- *if it was felt that there was a significant risk of a much sharper RISE in borrowing rates than those currently forecast,* perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

Any decisions will be reported to the appropriate decision making body at the next available opportunity.

3.5 Policy on borrowing in advance of need

The council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the council can ensure the security of such funds.

Borrowing in advance will be made within the constraints that:

- The authority would not look to borrow more than 18 months in advance of need.

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

3.6 Debt rescheduling

Rescheduling of current borrowing in our debt portfolio is unlikely to occur as the 100 basis points increase in PWLB rates only applied to new borrowing rates and not to premature debt repayment rates.

If rescheduling were done, it will be reported to Cabinet at the earliest meeting following its action.

3.7 New financial institutions as a source of borrowing and / or types of borrowing

Following the decision by the PWLB on 9 October 2019 to increase its margin over gilt yields by 100 basis points to 180 basis points on all certainty rate loans lent to local authorities, consideration will need to be given to sourcing funding at cheaper rates from the following in order to finance capital expenditure for non-HRA and infrastructure purposes:

- Local authorities (primarily shorter dated maturities)
- Financial institutions (primarily insurance companies and pension funds but also some banks, out of spot or forward dates)
- Municipal Bonds Agency

The degree to which any of these options proves cheaper than PWLB Certainty Rate is still evolving at the time of writing but our advisors will keep us informed.

3.8 Approved Sources of Long and Short term Borrowing

The council may make use of borrowing from internal sources, PWLB, local authorities, financial institutions and/or the Municipal Bonds Agency as and when appropriate.

4 ANNUAL INVESTMENT STRATEGY

4.1 Investment policy - management of risk

The MHCLG and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with financial investments (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy and Non-Treasury Investments Report (separate reports).

The Council's investment policy has regard to the following: -

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

The Council's investment priorities will be security first, portfolio liquidity second and then yield (return).

The above guidance from the MHCLG and CIPFA place a high priority on the management of risk. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -

1. Minimum acceptable **credit criteria** are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus

avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.

2. **Other information:** ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as **"credit default swaps"** and overlay that information on top of the credit ratings.

3. **Other information sources** used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

4. This authority has defined the list of **types of investment instruments** that the treasury management team are authorised to use. There are two lists in annex 2 under the categories of 'specified' and 'non-specified' investments.

- **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year (or have less than a year left to run to maturity if originally they were classified as being non-specified investments solely due to the maturity period exceeding one year).

- **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.

5. **Non-specified investments limit.** The Council has determined that it will limit the maximum total exposure to non-specified investments at £5m (see paragraphs 4.2, 4.3 and 4.4).

6. **Lending limits** (amounts and maturity) for each counterparty will be set through applying the matrix table in paragraph 4.2.

7. This authority will set a limit for the amount of its investments which are invested for maturities **longer than 365 days**, (see paragraphs 4.2 and 4.4).

8. Investments will only be placed with counterparties from foreign countries which have a specified minimum **sovereign rating**, (see paragraph 4.3). This does not apply to pooled investment vehicles.

9. This authority has engaged **external consultants**, (see paragraph 1.5) to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.

10. All investments will be denominated in **sterling**.

11. As a result of the change in accounting standards under **IFRS 9,** this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. In November 2018, The Ministry of Housing, Communities and Local Government (MHCLG) concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of investments by announcing a statutory override to delay implementation of IFRS 9 for five years ending 31 March 2023.

However, this authority will also pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance (see paragraph 4.5). Regular monitoring of investment performance will be carried out during the year.

Changes in risk management policy from last year.
The above criteria are unchanged from last year, apart from incorporating the amendment as per the Treasury Management and Annual Investment Strategy Mid Year 2020-21 Review; that the council may use investment counterparties with a minimum long term credit rating from at least one of Fitch, Moody's and Standard and Poors (where rated) of A- (or equivalent), where this was previously given as A in the TMSS, and that any such investments be included as specified investments.

4.2 Creditworthiness policy

The primary principle governing the council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the council will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the council's prudential indicators covering the maximum principal sums invested.

The Section 151 Officer will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the council may use, rather than defining what types of investment instruments are to be used.

Credit rating information is supplied by Link Asset Services, our treasury advisors, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of the longer term bias outside the central rating view) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating watch applying to a counterparty at the minimum council criteria may be suspended from use, with all others being reviewed in light of market conditions.

The criteria for providing a pool of high quality investment counterparties (both specified and non-specified investments) is:

- Banks 1 - good credit quality **–** the council will only use banks which:
  i. are UK banks; and/or
  ii. are non-UK and domiciled in a country which has a minimum sovereign long term rating of AA-

  and have, as a minimum, the following credit rating from at least one of Fitch, Moody's and Standard and Poors (where rated):
  i. Short term – F1 (or equivalent)
  ii. Long term – A-(or equivalent)
- Banks 2 – Part nationalised UK bank – Royal Bank of Scotland Group ring-fenced operations. This bank can be included provided it continues to be part nationalised or it meets the above criteria.
- Banks 3 – The council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time invested.
- Bank subsidiary and treasury operations: If separately rated, the council will use those that meet the ratings/criteria for banks outlined above. If not separately rated, the council will use these where the parent bank has the necessary ratings/criteria outlined above.
- Building societies: The council will use all societies which meet the ratings/criteria for banks outlined above.
- Money market funds, enhanced money market funds, bond funds – AAA
- UK Government (including gilts, treasury bills and the DMADF)
- Local authorities, parish councils, community councils, companies controlled by the council (either alone or with other public sector organisations) etc
- Housing associations
- Supranational institutions
- Multi-asset funds

A limit of £5m will be applied to the use of non-specified investments.

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

Time and monetary limits applying to investments. The time and monetary limits for institutions on the council's counterparty list are as follows (these will cover both specified and non-specified investments):

	Fitch Long Term Rating (or equivalent)*	Money Limit	Time Limit (settlement period)
Level 1 (previously called Higher Quality)	**AA-**	**£6m per institution**	**370 days**
Level 2 (previously called Medium Quality)	**A**	**£5m per institution**	**370 days**
Level 3	**A-**	**£4m per institution**	**185 days**
Part nationalised	**N/A**	**£7m per institution**	**370 days**
Debt Management Account Deposit Facility	**UK sovereign rating**	**unlimited**	**6 months**
Money market funds, enhanced money market funds, bond funds	**AAA**	**£6m per fund**	**370 days**
Local authorities, parish councils, community councils, companies controlled by the council (either alone or with other public sector organisations), housing associations, supranational institutions etc	**N/A**	**£4m per institution**	**5 years**
Multi-asset funds	**N/A**	**£5m per fund**	**370 days**

**The institution must have this minimum credit rating from at least one of Fitch, Moody's, and Standard and Poors (where rated).*

The proposed criteria for specified and non-specified investments are shown in Annex 2 for approval.

Creditworthiness
Although the credit rating agencies changed their outlook on many UK banks from Stable to Negative during the quarter ended 30 June 2020 due to upcoming risks to banks' earnings and asset quality during the economic downturn caused by the pandemic, the majority of ratings were affirmed due to the continuing strong credit profiles of major financial institutions, including UK banks. However, during Q1 and Q2 2020, banks made provisions for *expected* credit losses and the rating changes reflected these provisions. As we move into future quarters, more information will emerge on *actual* levels of credit losses. (Quarterly earnings reports are normally announced in the second half of the month following the end of the quarter). This has the potential to cause rating agencies to revisit their initial rating adjustments

earlier in the current year. These adjustments could be negative or positive, although it should also be borne in mind that banks went into this pandemic with strong balance sheets. This is predominantly a result of regulatory changes imposed on banks following the Great Financial Crisis. Indeed, the Financial Policy Committee (FPC) report on 6th August revised down their expected credit losses for the UK banking sector to “somewhat less than £80bn”. It stated that in its assessment, “banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC’s central projection”. The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC’s projection, with unemployment rising to above 15%.

All three rating agencies have reviewed banks around the world with similar results in many countries of most banks being placed on Negative Outlook, but with a small number of actual downgrades.

4.3 Other limits

Due care will be taken to consider the exposure of the council’s total investment portfolio to non-specified investments, countries, groups and sectors.

a) **Non-specified investment limit.** The council has determined that it will limit the maximum total exposure to non-specified investments at £5m.

b) **Country limit.** The council has determined that it will only use approved counterparties from the UK (irrespective of the UK sovereign credit rating) or other countries with a minimum sovereign credit rating of AA- from Fitch (or equivalent). This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

c) **Other limits.** In addition:

- no more than £5m will be placed with any non-UK country at any time (this limit applies to each non-UK country individually and not to non-UK countries in total);
- limits in place above will apply to a group of companies;
- secor limits will be monitored regularly for appropriateness.

The above restrictions do not apply to pooled investment vehicles (including multi-asset funds (apart from the non-specified investment limit), money market funds, enhanced money market funds and bond funds). The council only invests in sterling denominated pooled investment vehicles.

4.4 Investment strategy

In-house funds: Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.
- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

Link's Investment returns expectations (issued by Link on 27 October 2020):

Bank Rate is unlikely to rise from 0.10% for a considerable period. It is very difficult to say when it may start rising so it may be best to assume that investment earnings from money market-related instruments will be sub 0.50% for the foreseeable future.

The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows (the long term forecast is for periods over 10 years in the future):

2020-21	0.10%
2021-22	0.10%
2022-23	0.10%
2023-24	0.25%
2024-25	0.75%
Long term later years	2.00%

- The overall balance of risks to economic growth in the UK is probably relatively even, but is subject to major uncertainty due to the virus. It may also be affected by what, if any, deal the UK agrees as part of Brexit.
- There is relatively little UK domestic risk of increases or decreases in Bank Rate and shorter term PWLB rates until 2023-24 at the earliest.

Negative investment rates

While the Bank of England said in August / September 2020 that it is unlikely to introduce a negative Bank Rate, at least in the next 6 -12 months, some deposit accounts are already offering negative rates for shorter periods. As part of the response to the pandemic and lockdown, the Bank and the Government have provided financial markets and businesses with plentiful access to credit, either directly or through commercial banks. In addition, the Government has provided large sums of grants to local authorities to help deal with the COVID crisis; this has caused some local authorities to have sudden large increases in cash balances searching for an investment home, some of which was only very short term until those sums were able to be passed on.

As for money market funds (MMFs), yields have continued to drift lower. Some managers have already resorted to trimming fee levels to ensure that net yields for investors remain in positive territory where possible and practical. Investor cash flow uncertainty, and the need to maintain liquidity in these unprecedented times, has meant there is a surfeit of money at the very short end of the market. This has seen a number of market operators, now including the DMADF, offer nil or negative rates for very short term maturities. This is not universal, and MMFs are still offering a marginally positive return, as are a number of financial institutions for investments at the very short end of the yield curve.

Inter-local authority lending and borrowing rates have also declined due to the surge in the levels of cash seeking a short-term home at a time when many local authorities are probably having difficulties over accurately forecasting when disbursements of funds received will occur or when further large receipts will be received from the Government.

Investment treasury indicator and limit - total principal funds invested for maturities greater than 365 days. These limits are set with regard to the council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

The council is asked to approve the following treasury indicator and limit: -

Upper limit for principal sums invested for maturities longer than 365 days			
£m	**2021-22**	**2022-23**	**2023-24**
Principal sums invested for maturities longer than 365 days	£5m	£5m	£5m

Investments as at 31 September 2020 invested for maturities longer than 365 days were £nil.

For its cash flow generated balances, the council will seek to utilise its instant access and notice accounts, pooled investment vehicles and term deposits in order to benefit from the compounding of interest.

4.5 Investment performance / risk benchmarking

These benchmarks are simple guides to maximum risk, so they may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmarks is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the mid-year or Annual Report.

Security - The council's maximum security risk benchmark for the current portfolio, when compared to historic default tables, is:

- 0.05% historic risk of default when compared to the whole portfolio (excluding unrated investments).

Liquidity – in respect of this area the council seeks to maintain:

- Liquid short term deposits of at least £10m available with a week's notice.

- Weighted average life benchmark is expected to be in the range of 0 to 1 years, with a maximum of 5 years.

Yield - local measures of yield benchmarks are:

- Investments – internal returns above the 7 day LIBID rate

And in addition that the security benchmark for each individual year is (excluding unrated investments):

	1 year	2 years	3 years	4 years	5 years
Maximum	**0.05%**	**0.05%**	**0.05%**	**0.05%**	**0.05%**

Note: This benchmark is an average risk of default measure, and would not constitute an expectation of loss against a particular investment.

The council is appreciative that the provision of LIBOR and associated LIBID rates is expected to cease at the end of 2021. It will work with its advisors in determining suitable replacement investment benchmark(s) ahead of this cessation and will report back to members accordingly.

4.6 End of year investment report

At the end of the financial year, the council will report on its investment activity as part of its Annual Treasury Report.

4.7 Use of external fund managers

It is the council's policy not to use external fund managers on a discretionary basis for any part of its investment portfolio.

The council may use pooled investment vehicles and fully appreciates the importance of monitoring the activity and resultant performance of such investments. In order to aid this assessment, the council is provided with a suite of regular reporting from its providers.

4.8 Ethical investing

Although investment guidance, both statutory and from CIPFA, makes clear that all investing must adopt the principles of security, liquidity and yield (in that order) the council is committed to ethical high standards and declared a climate emergency on 1 July 2019; doing what is within its power to become carbon neutral by 2030 within its estates and activities.

Environmental, Social and Governance (ESG) metrics are incorporated into the credit rating agency assessments, which the council uses in its investment strategy.

Typical ESG considerations are shown below.

Environmental: Emissions and air quality, energy and waste management, waste and hazardous material, exposure to environmental impact.

Social: Human rights, community relations, customer welfare, labour relations, employee wellbeing, exposure to social impacts.

Governance: Management structure, governance structure, group structure, financial transparency.

5 OPTIONS

That the Governance and Audit Committee:

a) Makes comments on this report and annexes as appropriate, and recommends this report and annexes, including each of the key elements listed below, to council for approval.

- The Capital Plans, Prudential Indicators and Limits for 2021-22 to 2023-24, including the Authorised Limit Prudential Indicator.
- The Minimum Revenue Provision (MRP) Policy.
- The Treasury Management Strategy for 2021-22 to 2023-24 and the Treasury Indicators.
- The Investment Strategy for 2021-22 contained in the Treasury Management Strategy, including the detailed criteria.
- The Capital Strategy for 2021-22.
- The Non-Treasury Investments Report for 2021-22.

b) Does not agree this report and annexes and does not recommend that it is approved by council (advising the reason(s) why); thereby not complying with the Treasury Management Code of Practice.

6 NEXT STEPS

Under the Treasury Management Code of Practice it is required that the Governance and Audit Committee, Cabinet and council consider this report and annexes.

This report and annexes is to go to Cabinet and then council for approval. The relevant Cabinet and council meetings are on 14 January 2020 and 11 February 2020 respectively.

7 DISCLAIMER

This report (including its annexes) is a technical document focussing on public sector investments and borrowings and, as such, readers should not use the information contained within the report to inform personal investment or borrowing decisions. Neither Thanet District Council nor any of its officers or employees makes any representation or warranty, express or implied, as to the accuracy or completeness of the information contained herein (such information being subject to change without notice) and shall not be in any way responsible or liable for the contents hereof and no reliance should be placed on the accuracy, fairness or completeness of the information contained in this document. Any opinions, forecasts or estimates herein constitute a judgement and there can be no assurance that they will be consistent with future results or events. No person accepts any liability whatsoever for any loss howsoever arising from any use of this document or its contents or otherwise in connection therewith.

Contact Officer: Tim Willis, Deputy Chief Executive & Section 151 Officer
Reporting to: Madeline Homer, Chief Executive

Annex List

Annex 1: The Capital Prudential and Treasury Indicators 2019-20 – 2023-24
Annex 2: Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

Annex 3: Guidance on Treasury Management Strategy Statement, Minimum Revenue Provision Policy Statement and Annual Investment Strategy (TMSS)
Annex 4: Capital Strategy 2021-22
Annex 5: Non-Treasury Investments Report 2021-22

Corporate Consultation Undertaken

Finance: Chris Blundell, Director of Finance and Deputy Section 151 Officer
Legal: Tim Howes, Director of Corporate Governance & Monitoring Officer