ANNUAL TREASURY MANAGEMENT STRATEGY STATEMENT 2021/22

(INCLUDING ANNUAL INVESTMENT STRATEGY 2021/22, PRUDENTIAL INDICATORS AND MINIMUM REVENUE PROVISION POLICY STATEMENT)

1. INTRODUCTION

1.1. The Council is required by statute to operate a balanced revenue budget, which broadly means that cash raised during the year will meet cash expenditure. The primary function of the Treasury section within the Finance team, is to manage the cash flow planning (both in the short and longer term) to ensure that the Council can meet its revenue and capital spending obligations. In terms of capital spending, this may involve arranging long or short term loans (i.e. borrowing), or using longer term cash balances, in lieu of external borrowing. Finance must:

- ensure the Council's short term cash reserves are securely held (i.e. security of principal);
- ensure appropriate levels of cash are available to manage day to day payments (i.e. liquidity); and
- after both the above have been considered to maximise investment returns (i.e. income generation).

1.2. The Council follows the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice for Treasury Management in Public Services (the CIPFA TM Code) and the Prudential Code for the management of its Treasury functions. 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."

1.3. The CIPFA TM Code and Prudential Code require that local authorities determine their Treasury Strategy and Prudential Indicators on an annual basis in advance of the new financial year. To ensure compliance with this requirement, this paper sets out the draft Treasury Strategy for operations during 2021/22 for consideration by Council. The report is separated into four sections:-

Treasury Management Strategy (Section 2) – This details the estimated value and rates at which borrowing may be undertaken to finance current and future capital spend. The main objective is to manage risk effectively while minimising interest costs. The value of the Capital Programme and how it's financed i.e. long term borrowing; revenue financing; grants; etc. is therefore intrinsically linked. As such borrowing strategies are dependent on the decisions made about the revenue and capital budgets and the two should be considered together.

Annual Investment Strategy (Section 3) – The Annual Investment Strategy sets out the policies which govern the management of the Council's investments. The Council's investment strategy has always been risk averse with security and liquidity of cash assets taking precedence over returns. To do this the Council uses a prescriptive list of counterparties with whom investments can be placed. This list has reduced significantly in recent years due to the uncertainty in the financial markets (leading to many banks being downgraded). Money is placed across a range of the highest rated counterparties possible to maximise security.

Capital Plans and Prudential Indicators (Section 4) – The Local Government Act 2003 includes the requirement that Local Authorities have regard to the Prudential Code (the Code). The Code requires the Council to assess its capital investment plans and ensure they are affordable, prudent and sustainable. This must be substantiated by the production of a range of prudential indicators, which cover capital investment and treasury management plans for the forthcoming three years.

Minimum Revenue Provision (MRP) Policy Statement (Section 5) – This sets out how the Council will pay for the financing of capital assets by way of an annual charge to the revenue budget, hence the reason that approval of the annual budget must be considered in tandem to the Treasury Management Strategy and MRP Policy Statement.

1.4. In December 2017, CIPFA produced a revised version of The Prudential Code for Capital Finance in Local Authorities ("the Code"). The Code obligated Councils to demonstrate that "the authority takes capital expenditure and investment decisions in line with service objectives and properly takes account of stewardship, value for money, prudence, sustainability and affordability, authorities should have in place a capital strategy that sets out the long-term context in which capital expenditure and investment decisions are made and gives due consideration to both risk and reward and impact on the achievement of priority outcomes".

1.5. To this aim, the Council is recommended to approve the Capital Strategy for the period 2021-2026. This Capital Strategy is presented as a separate appendix to the Medium Term Financial Strategy report.

2 TREASURY MANAGEMENT STRATEGY FOR 2021/22

2.1 The Treasury Strategy for 2021/22 covers the current debt and investment portfolios, interest rates, the borrowing strategy/policy and rescheduling, training, use of specialist advisers, and reporting.

2.2 Current Debt and Investment Portfolio

2.2.1 The Council's current long term borrowing and investments as at 30 September 2020:

External borrowing and investments	Principal (as at 30 Sept '20) £m	Average Interest Rate %	Average Life Years	Principal (as at 31 Mar '20) £m	Average Interest Rate %	Average Life Years
Total External Borrowing	386.2	3.83	28.3	393.7	3.83	28.3
Total Investments	148.5	0.20	< 1 year	112.4	0.73	< 1 year
Net Debt	237.7			281.3		

2.2.2 Existing Council borrowing is primarily from the Public Works Loan Board (PWLB) at fixed rates determined at the time the borrowing was undertaken, and £24m taken from the Money Market. Annex A provides a graphical analysis and full list of the Council's debt portfolio, including the maturity profile and rates of interest.

2.2.3 Treasury activity and planning over recent years has provided a stable debt portfolio. This stability has allowed the Council to maintain an under-borrowed position, using temporary cash balances, instead of externalising borrowing. This policy has helped reduce the interest cost of funding the capital programme whilst also reducing counterparty risk. An increased level of internal borrowing does however bring additional interest rate risk.

2.3 Prospects for Interest Rates

2.3.1 The Council's treasury adviser, Link Asset Services, has provided the following forecast as at 23rd September 2020.

Interest Rate Forecasts								
Bank Rate	**Sep-20**	**Dec-20**	**Mar-21**	**Jun-21**	**Sep-21**	**Dec-21**	**Mar-22**	**Jun-22**
Link	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%
Cap Econ	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	-	-
5Y PWLB RATE								
Link	1.90%	1.90%	2.00%	2.00%	2.00%	2.00%	2.00%	2.10%
Cap Econ	1.80%	1.85%	1.85%	1.85%	1.85%	1.85%	-	-
10Y PWLB RATE								
Link	2.10%	2.10%	2.10%	2.10%	2.10%	2.20%	2.20%	2.20%
Cap Econ	1.95%	1.95%	1.95%	1.95%	1.95%	1.95%	-	-
25Y PWLB RATE								
Link	2.50%	2.50%	2.50%	2.50%	2.60%	2.60%	2.60%	2.70%
Cap Econ	2.40%	2.30%	2.30%	2.30%	2.30%	2.30%	-	-
50Y PWLB RATE								
Link	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%
Cap Econ	2.35%	2.20%	2.20%	2.20%	2.20%	2.20%	-	-

2.3.2 The MPC has left the Bank Rate at 0.10% since March 2020. The Link Asset Services forecast includes a projection that the Bank Rate will remain unchanged throughout 2021 and 2022, but acknowledges that disruption to the economy from COVID-19 and/or other political uncertainties could lead to a reduction in the Bank Rate, i.e. to nil or negative. Given the current economic environment, investment returns are forecast to remain low for the immediate future.

2.3.3 The current economic outlook and structure of market interest rates and government debt yields have several key treasury management implications:

- In a low interest rate environment, overall investment returns in 2021/22 are difficult to forecast, furthermore actual returns will be dependent upon the levels of cash available for investment;

- The policy of delaying new borrowing by running down available cash balances has served the Council well over the last few years. However this continues to be carefully reviewed to avoid incurring higher borrowing costs in the future, when the Council will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt;

- There is a 'cost of carry' to any new borrowing which causes an increase in the net interest budget, (i.e. incurring a short term revenue cost due to borrowing costs currently being higher than investment returns). As such the proposed strategy continues the measured approach to balancing this short term saving against forecast longer term increased costs, but with a continual review of the underlying interest rates.

2.4 Borrowing Strategy

2.4.1 The Prudential Code only permits the Council to borrow in the long term to finance capital spend. In accordance with this the borrowing strategy details the Council's approach to funding the expected need detailed in the Capital Programme. The Treasury Management function ensures that the Council's cash is managed in accordance with the relevant professional codes and to ensure that sufficient cash is available to fund those plans. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities.

2.4.2 The Capital Programme 2021/22, set within the overall Capital Programme 2021-2026, will be approved by Council in February 2021 and reviewed quarterly by Cabinet.

2.4.3 The Council's prudent borrowing strategy over the past decade has been influenced by the relationship between long and short-term interest rates. Whilst long term borrowing rates are expected to rise very slowly, they are still significantly higher than investment rates. This variance creates a 'cost of carry' for any new borrowing, if the cash borrowed is then temporarily held as investments.

2.4.4 This 'cost of carry' has effectively driven the borrowing strategy over the past decade during which the Council has maintained an under-borrowed position (i.e. rather than borrowing externally, the Council borrowed internally using short term cash balances). It is projected that as at 31 March 2021 c. £80m of cash balances will be used in lieu of external borrowing.

2.4.5 Offsetting the need for external borrowing with cash balances (i.e. internal borrowing) has enabled the Council to maximise short term savings (i.e. through reducing the cost of carry) and minimise the counterparty risk to investments without losing significant investment income. This has enabled the Treasury Management function to support the Council's revenue budget savings strategy through a reduced cost of external borrowing in 2020/21.

2.4.6 Since 2010, the Council has had long term loans of £61.5m mature. The redemption of these loans has been funded by balancing the use of cash reserves (i.e. internal borrowing) and making tactical decisions to take new borrowing when rates were low. As noted in previous years, the Council's capacity to continue indefinitely with internal borrowing is limited.

2.4.7 Taking the tactical decision to borrow when rates are favourable for the Council (most recently in 2019) has seen the average weighted interest rate for the Council's external borrowing reduce from 4.52% in March 2018 to 3.83% at September 2020.

2.4.8 Looking ahead, the Council has a £5m loan due to mature in November 2022 and two loans totalling £10.7m due to mature during 2022/23. Consideration will be given as to the affordability of refinancing these loans at or before their maturity dates if interest rates are favourable and the most effective means by which to arrange this borrowing.

2.4.9 The Director of Finance (Section 151 Officer) has delegated responsibility within the Constitution for the execution and administration of treasury management decisions including all borrowing, investment or financing decisions, including the use of short-term borrowing as a management tool for cash flow purposes. In accordance with this, the Director of Finance (Section 151 Officer) will continue to monitor this position and may decide to further externalise some of this requirement if it is felt that there are increasing risks relative to budgetary exposure. Aside from rising interest rates another key factor will be the expected use of cash over this period, i.e. predominantly the use of reserves.

2.4.10 Holding prudent levels of internal borrowing as proposed above, but keeping this and the market rates of interest under review, will enable the Council to continue to take tactical borrowing decisions by entering into long term loans when rates are low rather than being forced to refinance the borrowing when interest rates are higher.

2.4.11 Under normal circumstances the main sensitivities of the interest rate forecast are likely to be the two scenarios noted below. Officers will continually monitor market conditions and forecast rates in conjunction with the Council's advisers and:

- *if it was felt that there was a significant risk of a sharp* ***FALL*** *in long and short term rates,* e.g. due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

- *if it was felt that there was a significant risk of a much sharper* ***RISE*** *in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks,* then the portfolio position will be re-appraised with the likely action that fixed rate borrowing will be taken whilst interest rates were still relatively cheap.

2.4.12 In view of these factors in 2021/22 the Council will continue with the strategy of using cash balances for internal borrowing whilst possible, but to also take tactical decisions to take external borrowing where considered appropriate in order to protect against rising interest rates in the future and as required for cash flow purposes. Such decisions are delegated in the Constitution to the Director of Finance (Section 151 Officer) who will approve new borrowing in consultation with the Council's external Treasury Management adviser. Any new long term borrowing will be reported through quarterly reporting to Cabinet as per the Medium Term Financial Plan.

2.4.13 As noted above, the ability to defer borrowing in this way is also limited by the actual use of reserves and balances (i.e. available cash). During 2021/22, this will continue to be monitored, against forecast levels, on a regular basis.

2.4.14 HM Treasury raised all the PWLB borrowing rates by 1.00% in October 2019, with the aim of reducing demand for new PWLB borrowing. The Council will take advice from its external Treasury adviser to review all alternative options for future borrowing arrangements, i.e. to compare borrowing from external markets to that available from PWLB. If these arrangements require amendments to the Council's borrowing strategy, these amendments will be brought to Council for agreement before agreeing to the loans.

2.4.15 The table in para 2.3.1 above sets out the current forecast rates for borrowing from the PWLB and these are summarised in the table below. Should economic conditions lead to an expectation that borrowing rates will rise, then the Council will consider the affordability of externalising borrowing at that time.

	2021/22 (Sep'21)	**2022/23** (Sep'22)	**2023/24**
10 years	2.10%	2.30%	TBC
25 years	2.60%	2.70%	TBC
50 years	2.40%	2.50%	TBC

2.5 Policy on Borrowing in Advance of Need

2.5.1 As is the requirement under the Code, the Council will not borrow in advance of need simply to benefit from earning more interest on investing the cash than is being paid on the loan. Any decision to borrow in advance will be within the approved Capital Finance Requirement estimates and then only if value for money can be demonstrated and the cash can be invested securely until it is required.

2.5.2 In determining whether borrowing will be taken in advance of need the Council will;

- ensure that there is a clear link between the capital programme and maturity profile of existing debt which supports taking financing in advance of need;
- ensure that the ongoing revenue implications of the borrowing, and the impact on future plans and budgets have been considered;
- evaluate the economic and market factors which might influence the manner and timing of any decision to borrow;
- consider the merits (or otherwise) of other forms of funding; and
- consider the impact borrowing could have on investment balances if it results in increased exposure to counterparty risk.

2.6 Debt Rescheduling

2.6.1 As it is anticipated that short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from existing long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

2.6.2 The reasons for any rescheduling of existing debt to take place will include:

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

2.6.3 The rescheduling options currently available are not considered viable within the current market conditions, but the situation will be kept under constant review.

2.7 Training

2.7.1 The Director of Finance (Section 151 Officer) ensures that any Officer involved in the operation of the Treasury Management function, receives appropriate training relevant to their needs to ensure they fully understand their roles and responsibilities. Treasury staff will continue to attend regular courses and seminars provided through the Council’s membership of the CIPFA Treasury Management Forums (TMF) of both England and Scotland, its Treasury advisers and other ad hoc events including treasury software supplier forums.

2.7.2 In addition the Director of Finance (Section 151 Officer) ensures that elected Members who have responsibliity for scrutinising the Treasury Management Strategy Statement have access to training to give them the appropraite skills to undertake this task.

2.8 Treasury management advisers

2.8.1 The Council recognises that there is value in employing external providers of treasury management advisers in order to acquire access to specialist skills and has commissioned Link Asset Services in that role. However, the Council recognises that responsibility for treasury management decisions remains with the Council at all times.

2.9 Reporting Arrangements

2.9.1 The Council follows the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management which lays down reporting requirements to ensure best practice. The minimum reporting requirements are for three main reports, which incorporate a variety of policies, estimates and actuals as follows:

- An annual Treasury Strategy in advance of the new financial year – (**this report)** which covers the annual Treasury and Investment Strategies, the Treasury and Capital Prudential Indicators and the Minimum Revenue Provision Policy Statement.

- A mid-year Strategy Review – This will update Members with the progress of the capital programme, amending prudential indicators as necessary, and will discuss whether the Treasury Strategy is still appropriate or requires revision (e.g. Council received the 2020/21 Half-Year Update Report in November 2020).

- An annual review following the end of the year comparing actual activity to the strategy (e.g. Council received the 2019/20 Annual Review in September 2020).

2.9.2 In addition to the minimum criteria set by CIPFA, Cabinet will receive regular treasury management activity reports within the quarterly revenue monitoring reports.

3 ANNUAL INVESTMENT STRATEGY

3.1 The Investment Strategy for 2021/22 covers the investment policy, creditworthiness policy and counterparty selection/limits, interest rates, and reporting.

3.2 The Investment Policy

3.2.1 The Council acts with regard to the Ministry of Housing, Communities and Local Government's (MHCLG) Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public

Services Code of Practice and Cross Sectoral Guidance Notes (“the CIPFA TM Code”). The Council’s investment priorities will be security first, liquidity second, then return.

3.2.2 In accordance with guidance from the MHCLG and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk.

3.2.3 In accordance with the Markets in Financial Instrument Directive II (MiFID II), all local authorities must be classified by financial institutions as a ‘retail client’ unless they are ‘opted up’ by firms to an ‘elective professional client’ status. Being a ‘retail client’ would result in the Council not being able to access the investment opportunities that it currently uses to implement the Treasury Management Strategy as approved annually by Council. To ensure the Council can continue to deliver on this strategy, the appropriate financial institutions have opted up the Council to elective professional client status. This approach is consistent with other local authorities with similar Treasury Management strategies. It should be noted that this European Directive will remain in force following the UK’s departure from the European Union.

3.3 Creditworthiness Policy and Counterparty Selection

3.3.1 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.

3.3.2 As with previous practice, credit ratings will not be the sole determinant of the quality of an institution and it is important to continually assess and monitor the financial sector in relation to the economic environments in which institutions operate. This total assessment will also take account of information that reflects the opinion of the markets. To this end the Council will continue to engage with its advisers to maintain a monitor on market pricing such as “credit default swaps” and overlay that information on top of the credit ratings.

3.3.3 Other information sources used will include, but not be limited to 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.

3.3.4 The end product is a series of credit bands (provided by the Council’s independent external advisers) which indicate the relative creditworthiness of counterparties. These bands are used by the Council to determine the recommended counterparty list, which includes limits on both period of investment and maximum value of deposits. These are detailed at 3.8.

3.3.5 Rating changes, rating watches (notification of a likely change), and rating outlooks (notification of a possible longer term change) are provided by the advisers as they occur and this information is always considered before dealing.

3.3.6 If a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use for new investments will be suspended immediately. A risk assessment of the portfolio will immediately be undertaken, to consider other investments placed with the counterparty, to determine the necessity to request their immediate repayment, if possible.

3.3.7 The primary focus of the Investment Policy is to provide security of investments and to minimise risk. Investment instruments identified for use in the financial year are listed in 3.7 under the 'specified' and 'non-specified' investments categories.

3.4 Country, Group and Sector limits

3.4.1 Due care will be taken to consider the country, group and sector exposure of the Council's investments. In addition:

- Country limits:
    - where the country of registration of an institution has an average credit rating (i.e. an average sovereign credit rating) equal to, or better than that of the UK; it will enable the Council to consider the placement of investments on the same basis applied for UK-registered institutions (i.e. subject to the overarching counterparty criteria as set out at 3.7 and 3.8 below (Specified Investments, Non-Specified Investments and Counterparty Criteria); and
    - where an institution meets the approved counterparty status* but the country of registration has an average credit rating below that of the UK; limit such investments in total to such rated non-UK countries to be no more than 20% or £20m (whichever is the lesser) of the portfolio.
      * i.e. it meets the overarching counterparty criteria as set out at 3.7 and 3.8 below (Specified Investments, Non-Specified Investments and Counterparty Criteria).
- No more than 20% will be placed with any company or group of companies (subject to the overarching requirement with regards to credit ratings as set out at 3.7 and 3.8 below (Specified Investments, Non-Specified Investments and Counterparty Criteria)), and
- Sector limits will be monitored regularly for appropriateness.

3.5 Investment Strategy

3.5.1 Investments will be made with reference to the core cash balance and cash flow requirements and the outlook for short-term interest rates.

3.5.2 **Interest rate outlook**: The Bank of England responded to the risks presented to the UK economy from the COVID pandemic by making two emergency cuts in the Base Rate in March 2020, first from 0.75% to 0.25% and then to 0.10%. Base Rate has remained at 0.10% throughout the period to 31 October 2020. Bank Rate forecasts at March year-ends are as follows (as at October 2020):-

- March 2021 0.10%
- March 2022 0.10%
- March 2023 0.10%

3.5.3 It should be noted that these are forecast rates and actual interest rates may differ from these projections. Should interest rates increase sooner than projected, the Council would receive better rates of return on its investments but the rate of new borrowing may also increase. Conversely, should interest rates fall or future forecast increases not materialise, the return on investments will reduce but the cost of borrowing may reduce (or remain low for longer).

3.5.4 The Council's average investment rate as at 30 September 2020 is 0.20%. The bank rate (base rate), currently 0.10%, is the key determinant as to the expected rate of return for the investment portfolio. It is expected that the bank rate will remain low for at least the next 5 years, and is expected to **average** as follows;

- 2020/21 0.10%
- 2021/22 0.10%
- 2022/23 0.10%
- 2023/24 TBC
- 2024/25 TBC

3.5.5 As deals taken before a bank rate rise mature, opportunities for new deposits will be available at higher rates of return. The average rate received will increase over time as deals mature, assuming cash balances remain sufficiently high to ensure opportunities for longer term investments. If bank rates are expected to fall, the reverse is true, and investment returns decrease.

3.5.6 To assess the performance of the investment portfolio in 2021/22, the Council will continue to use an investment benchmark of three month LIBID rate. However, this rate is due to cease at the end of 2021. Officers will liaise with Link Asset Services to assess a new appropriate benchmark for investments.

3.6 End of year Investment report

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

3.7 Investment instruments – Specified / Non-specified Investments

3.7.1 <u>Specified investments</u>: (All such investments will be sterling denominated, with maturities, meeting the minimum 'high' rating criteria where applicable).

	Minimum allowable Credit Criteria	**Use**
Debt Management Agency Deposit Facility – UK Government	N/A (Government Backed)	In-house. Max period 6 months.

	Minimum allowable Credit Criteria	Use
UK Government Gilts	UK sovereign rating	In-house buy and hold. Max period 5 years.
UK Government Treasury Bills	UK sovereign rating	In-house buy and hold. Max period 5 years.
Gilt Funds	UK sovereign rating	In-house. Liquid.
Deposits - local authorities	High level of security	In-house. Max period of 5 years.
UK Part nationalised Banks (the 'ring-fenced' entity)	Adviser blue category	In house. Maturity per counterparty matrix.
Term deposits – banks and building societies	Adviser green category	In-house. Maturity per counterparty matrix.
Certificates of deposit issued by rated banks and building societies	Adviser green category	In-house. Maturity per counterparty matrix.
Bonds issued by multilateral development banks	AAA	In-house buy and hold. Max period 6 months.
Low Volatility Net Asset Value Money Market Funds (formerly called Money Market Funds)	AAA Credit score of 1	In-house – liquid
Ultra-Short-Dated Bond Funds (formerly called Enhanced Money Market Funds)	AAA Credit score of 1.5	In-house – liquid

3.7.2 Non-specified investments: These are any investments which do not meet the specified requirements above. A maximum of £20m (or 20% if lower) can be held in aggregate in non-specified investments, as follows:

1. All specified investments with maturity periods in excess of 1 year;
2. Maturities of ANY period, instruments below.

	Minimum allowable Credit Criteria	Use
Fixed term deposits with variable rate and variable maturities: Structured deposits	Adviser green category	In-house. Maturity per counterparty matrix.

3.7.3 In addition, consideration may be given to offering commercial loans to third parties where the purpose of the loan is to provide community benefit. Such loans would be considered in accordance with the concept of security, liquidity and return. Loans would be made at commercial rates to ensure that such loans would not breach State Aid regulations.

3.7.4 Recipients of this type of investment are unlikely to be a financial institution and therefore unlikely to be subject to a credit rating as outlined in the creditworthiness policy above. In order to ensure security of the Council's capital, financial due diligence must be completed prior to any loan or investment being agreed. The Council will use its external Treasury Management advisers to complete financial checks to ascertain the creditworthiness of the third party and associated risks to the Council. Where deemed necessary, additional guarantees will be sought. This may be via security against assets and/or through guarantees from a parent company.

	Maximum Term:	**Maximum Loan:**
Third Party Commercial Loans	364 days	£5,000,000 (Maximum of 5% of portfolio in total)

3.7.5 The Council recognises that investment in other financial assets taken for non-treasury management purposes requires careful investment management. Such activity includes loans supporting service outcomes and investments in subsidiaries.

3.7.6 The Council will ensure that all the organisation's investments are covered in the capital strategy and / or investment strategy, and will set out, where relevant, the organisation's risk appetite and specific policies and arrangements for non-treasury investments. It is recognised that the risk appetite for these activities may differ from that for treasury management.

3.7.7 The Council will maintain a schedule setting out a summary of existing material investments, subsidiaries, joint ventures and liabilities including financial guarantees and the organisation's risk exposure.

3.7.8 During 2021/22 the Council will continue to explore potential financial instruments with a longer duration that may increase the return on the Council's cash holdings. Where it is considered that additional financial instruments may be appropriate for Cumbria, these will be recommended for inclusion in an updated Treasury Management Strategy Statement and Council approval would be sought.

3.8 Counterparty Criteria and Limits

3.8.1 The recommended counterparty criteria and limits are detailed below. These limits are applicable as at the time an investment commences.

Bank of England (Debt Management Deposit Account Facility DMADF) - No maximum limit or period.
Other Local Authorities – At the time the deposit is made, up to 20% of portfolio per counterparty, for period of up to 2 years.
Yellow – Low Volatility NAV Money Market Funds (LVMMF) with a matrix credit score of 1 or above. Subject to a maximum of £20m per MMF.

Pink – Ultra-Short-Dated Bond Funds (USDBF) with a matrix credit score of 1.5 or better (i.e. 1, 1.25, or 1.5). Subject to maximum of £20m principal per USDBF (and per counterparty in total with any other MMF held).
Purple – At the time the deposit is made**,** up to 20% of portfolio per counterparty, for period of up to 2 years. Subject to maximum of £20m principal per banking group.
Blue – Deposit maximum of £25m per banking group for period of up to 1 year. *Part-nationalised UK banks, must be the 'ring-fenced' entity.*
Orange – At the time the deposit is made**,** up to 20% of portfolio per counterparty, for period of up to 1 year. Subject to maximum of £20m principal per banking group.
Red – At the time the deposit is made**,** up to 15% per counterparty for period up to 6 months. Subject to maximum of £15m per banking group.
Green – At the time the deposit is made, up to 10% per counterparty for period up to 100 days. Subject to maximum of £10m per banking group.

4 CAPITAL PLANS AND PRUDENTIAL CODE INDICATORS

4.1 Introduction:

4.1.1 The key objective of the Prudential Code is to provide a framework for local authority capital finance to ensure that:

- capital expenditure plans are affordable;
- all external borrowing and other long term liabilities are within prudent and sustainable levels, and;
- treasury management decisions are taken in accordance with professional good practice and in full understanding of the risks involved and how these risks will be managed to levels that are acceptable to the organisation.

4.1.2 The Prudential Code specifies a range of indicators that must be used, and other factors that must be taken into account. They should be evaluated as a coherent entity, because changes in any one indicator often impact on others. They must also be considered in conjunction with other annual strategic financial plans, such as the annual revenue and capital budgets. The effects that any alternative options in these budgets might have on the indicators must also be considered before approval is given to the final financial strategic plan.

4.1.3 Proposals in the Capital Programme form the basis for the Prudential Indicators.

4.1.4 A schedule of all of the Prudential Indicators is attached at 4.3, a summary of which will be included in the Medium Term Financial Plan (MTFP).

4.2 Prudential Indicators – Affordability and Capital Programme

4.2.1 **Affordability** - These indicators are calculated to help Members assess the overall affordability of the proposed Capital Programme by providing an indication of the impact it will have on the Council's overall resources.

4.2.2 **Capital Programme** - The Council's capital expenditure plans are a key driver to treasury management activity. This prudential indicator is a summary of the Council's draft capital expenditure plans, both those agreed previously, and those forming part of this budget cycle.

4.2.3 **The Council's Borrowing Need - Capital Financing Requirement** - The Council's Capital Financing Requirement (CFR) is the outstanding capital spend which has not yet been paid for from either revenue or capital resources, such as grants or property sales. It is essentially a measure of the Council's underlying need to borrow. Any capital spend which has not been paid for during the year, will increase the CFR. The CFR does not increase indefinitely, as the Minimum Revenue Provision (MRP) (which is a statutory annual revenue charge) makes principal repayments in line with the life cycle of the assets financed from borrowing. The Council's gross debt over the next 3 years should not, except in the short term, exceed the estimated Capital Financing Requirement for the next 3 years. Although some flexibility is permitted for limited early borrowing, officers must ensure that long term borrowing is not undertaken for revenue purposes.

4.2.4 Following accounting changes in 2009/10 the CFR includes any other long term liabilities (e.g. Public Private Partnerships (PPP), Private Finance Initiatives (PFI), finance leases) brought onto the balance sheet. Whilst this increases the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has £114m of such schemes within the CFR.

4.2.5 **Affordability – Ratio of Financing Costs to Net Revenue Stream** - This indicator shows the full revenue cost of projects in the draft capital programme financed by borrowing.

- The ratio has been split to separately identify finance charges attributable to the Private Finance Initiatives (PFI) and the Public Private Partnerships (PPP) from the financing costs that are attributable to the Corporate net interest budget.
- The financing costs of both the PFI/PPP and the Corporate net interest budget are currently charged against the revenue budget albeit under separate budgets. The PFI costs for the fire station redevelopment and the Carlisle Northern Development Route (CNDR) and the PPP costs for waste services are currently charged within the unitary fee and is direct charge against the Highways & Infrastructure Directorate whereas the Corporate interest budget is charged centrally.

4.2.6 **Authorised Limit** - The Authorised Limit is the statutory limit determined under section 3(1) of the Local Government Act 2003, through which 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. It represents a control on the absolute maximum level of borrowing and is a key control over treasury activity which ensures that, over the medium term, net borrowing will only be undertaken to finance capital spend. It is set to ensure that external borrowing doesn't exceed the Council's estimated CFR for the 3 years covered by the Medium Term Financial Plan, allowing some flexibility for limited early borrowing for future years where appropriate.

4.2.7 The limit reflects the level of borrowing which, while not desired, could be afforded in the short term to allow borrowing to cover for any extraordinary treasury activities. This additional headroom to borrow would be used in exceptional circumstances only.

4.2.8 **Limits to Borrowing – Operational Boundary** - This indicator sets the expected maximum amount of borrowing that would under normal circumstances be undertaken at any time during the financial year.

4.2.9 **Treasury Management Limits on Activity** - There are three debt related treasury activity limits. Their purpose is to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs/improve performance.

4.3 The Council's Prudential Indicators and Treasury Management Indicators half year update 2020/21

Prudential Indicators are determined under Section 3(1) and (2) of the Local Government Act 2003 and produced in accordance with CIPFA's Prudential Code. The Prudential Indicators detailed below represent the 2020/21 half year position for the Council.

The table below will be replaced with the Prudential Indicators to 2025/26 before presentation to Council in February 2021.

		2020/21 Revised Estimate*	2020/21 Original Estimate**
	PRUDENTIAL INDICATORS – Affordability	**£.pp**	£.pp
1		**£m**	£m
	Estimate of proposed capital expenditure	120.492	90.894
	Estimate of proposed capital expenditure to be funded by prudential borrowing	27.779	27.822
	The original and forecast capital expenditure (as included within the Qtr1 2020 Monitoring report) and amount of capital expenditure to be funded by prudential borrowing for 2020/21.		
2		**£m**	£m
	Capital Financing requirement (CFR) excluding PFI & other long term liabilities– the borrowing need	462.35	466.47
	Capital Financing requirement (CFR) including PFI & other long term liabilities– the borrowing need	574.59	578.54
	The Capital financing requirement indicator is a measure of the Council's underlying need to borrow for a capital purposes.		
		%	%
3a	**Ratio of Finance costs to Net Revenue Stream exclusive of PPPI**	5.14	5.00
3 b	**Ratio of Finance costs to Net Revenue Stream Inclusive of PPPI**	8.89	8.77
	This indicator shows the proportion of income received from grant and Council Tax that is spent on paying for the consequences of borrowing to fund capital borrowings.		

	PRUDENTIAL INDICATORS - Prudence	**2020/21 Approved Limit ****	**Revised limits proposed**	**2020/21 Forecast Actual**
4	**Authorised limit for external debt**	**£m**	**£m**	**£m**
	Borrowing	508	no change	386
	Other Long term Liabilities	135	no change	112
	Total	**643**	**no change**	**498**

	This is the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit (Legal Limit) determined under section 3 (1) of the Local Government Act 2003.

	Operational Boundary for external debt	2020/21 Approved Limit **	Revised limits proposed	2020/21 Forecast Actual
5		**£m**	**£m**	**£m**
	Borrowing	483	no change	386
	Other Long term Liabilities	125	no change	112
	Total	**608**	**no change**	**498**
	The Operational Boundary is based on the Council's prudent estimate of the maximum level of external debt. It is only a guide and may be breached temporarily on occasion without significant concern, due to variations in cash flow and/or interest rates. Any sustained or regular trend above the operational boundary will be investigated and action taken as appropriate. The forecast expects no external borrowing to be taken in the 2020/21 year.			

	Upper Limit on Net Sums Borrowed	2020/21 Approved Limit ** £m	Revised limits proposed	2020/21 Actual at 30/09/20
6	**Fixed interest rates**	483	no change	362
7	**Variable interest rates**	100	no change	(125) ***
	**** Net borrowing is negative as variable investments (£149m) exceed variable borrowing (£24m). All investments maturing within one year are classed as variable.* The purpose of this indicator is to contain the Council's exposure to unfavourable movements in future interest rates. The indicators are expressed as Fixed Rate Debt less Fixed Rate Investments and Variable Rate Debt less Variable Rate Investments. The Council defines variable rate as including those instruments maturing within each year, as the replacement of those instruments will be subject to prevailing rates of interest.			

9	**Upper limit for total principal sums invested for over 364 days (per maturity date)**	Lower of £20m or 20% of the portfolio at any time during the financial year (Actual £0m)
	The purpose of this indicator is to ensure that the Council has protected itself against the risk of loss arising from the need to seek early redemption of principal sums invested. Only core cash will be invested for periods greater than 1 year.	

10	**Maturity Structure of fixed interest rate borrowing**	**Upper**	**Lower**	**Actual 30/09/20**
	Under 12 months	30%	0%	0%
	12 months to 2 years	40%	0%	0%
	2 years to 5 years	40%	0%	8.3%
	5 years to 10 years	40%	0%	8.8%
	10 years and above	100%	30%	82.8%
	The maturity of borrowing is determined by the earliest date on which the lender can require payment. The indicator is designed to exercise control over the Council having large concentrations of fixed rate debt needing to be replaced at any one time.			

* 2020/21 Budget Monitoring Update at June 2020, to Cabinet in September 2020
** 2020/21 Original Estimate as presented to Council in February 2020

5 MINIMUM REVENUE PROVISION (MRP) POLICY STATEMENT

5.1 The Council is required to pay off an element of the accumulated General Fund capital spend each year (the Capital Financing Requirement (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).

5.2 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:

- **In the case of capital spend incurred before 1 April 2008 and spend financed by "supported" borrowing in all the following years**; from 1 April 2009 this will be charged on a 2% straight line basis, net of "Adjustment A". This ensures that the debt will be repaid within 50 years. Previously, the Council charged MRP in line with former MHCLG Option 1. This option provided for an approximate 4% reduction in the supported borrowing need (CFR) each year.

- **In the case of all capital spend financed by Prudential Borrowing;** this will be subject to MRP under *option 3: Asset life method – equal instalments charged over the estimated life of the asset.* 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).

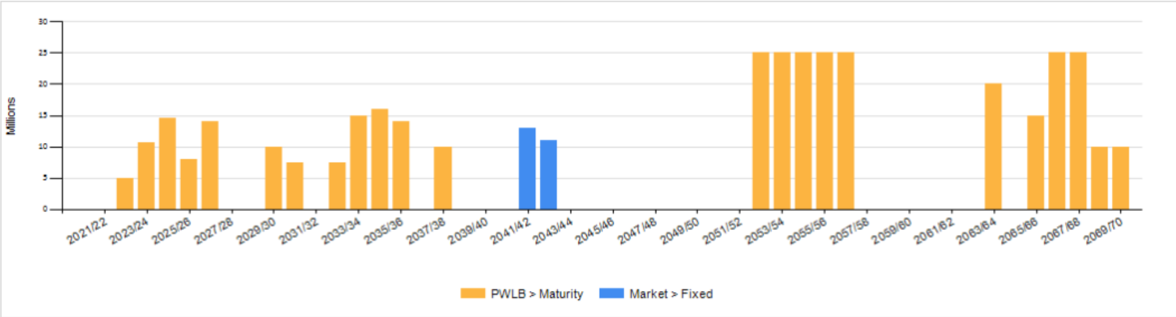
- Repayments included in annual **Public, Private Partnerships (PPP), Public Finance Initiative (PFI) or finance leases** are applied as MRP.

5.3 Estimated life periods will be determined under delegated powers in accordance with the Council's Accounting Policy on depreciation of assets. To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Council. However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

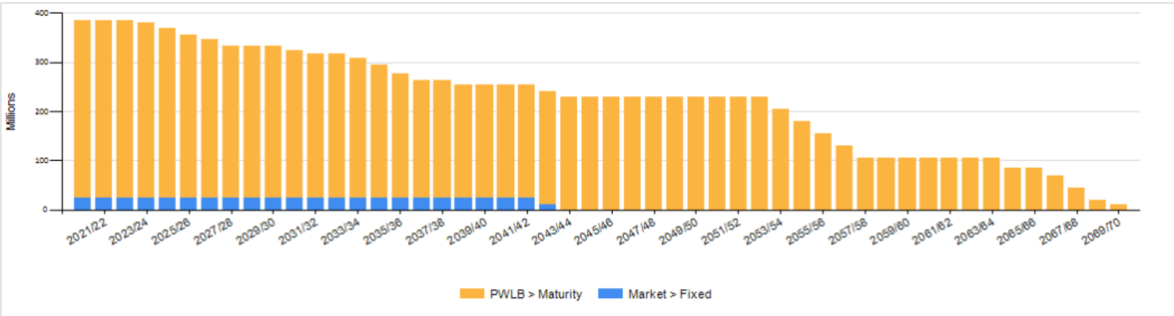
5.4 As some types of capital expenditure incurred by the Council are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

<u>Forecast Long term borrowing (Debt Portfolio) at 31 December 2020</u>

Maturity Profile of Individual Loans:



Total Loan Duration:



PWLB > Maturity Market > Fixed

Key: Dark colour = Market Loans (LOBO's), medium colour = Public Works Loans Board (PWLB)

Note: Lender Option Borrower Options (LOBOs) are long term 'market loans' (i.e. a loan from a bank for a fixed period repaid at maturity). The interest rate in the initial periods of these loans are at a discount to the market rate. The lender has the option to change the terms, at which point the Council has the option to repay the loan early. Due to this, the loans are classed as 'variable' rate.

The LOBOs taken out between 1999 and 2003 total £24m (6.2%) of the Council's total long term borrowing as at 31 December 2020.

Debt portfolio forecast at 31 December 2020:

Lender	Original Loan Start Date	Maturity Date	Principal	Interest Rate
P W L B	04-May-95	15-Nov-22	5,000,000	8.50
P W L B	24-Dec-97	15-May-23	5,700,000	6.25
P W L B	04-May-95	15-Nov-23	5,000,000	8.50
P W L B	24-Sep-98	15-May-24	9,500,000	5.00
P W L B	04-May-95	15-Nov-24	5,000,000	8.50
P W L B	14-Nov-01	14-Nov-25	3,000,000	4.50
P W L B	29-May-03	15-Nov-25	5,000,000	4.45
P W L B	14-Nov-01	13-Nov-26	14,000,000	4.50
P W L B	04-Sep-19	01-Sep-29	10,000,000	1.21
P W L B	22-Oct-18	22-Oct-30	7,500,000	2.50
P W L B	22-Oct-18	22-Oct-32	7,500,000	2.60
P W L B	27-Aug-10	27-Aug-33	15,000,000	3.92
P W L B	20-Dec-04	15-May-34	16,000,000	4.50
P W L B	19-May-05	15-May-35	14,000,000	4.50
P W L B	10-Dec-07	15-Nov-37	10,000,000	4.49
FMSWERTM	25-Jan-02	27-Jan-42	13,000,000	4.73
FMSWERTM	31-Jan-03	30-Jan-43	11,000,000	4.45
P W L B	25-Jan-07	15-May-52	25,000,000	4.25
P W L B	25-Jan-07	15-May-53	25,000,000	4.25
P W L B	25-Jan-07	15-May-54	25,000,000	4.25
P W L B	25-Jan-07	14-May-55	25,000,000	4.25
P W L B	08-Mar-07	15-May-56	25,000,000	4.25
P W L B	10-Jun-19	10-Jun-63	20,000,000	2.16
P W L B	22-Oct-18	22-Oct-65	15,000,000	2.67
P W L B	28-Mar-18	28-Mar-67	25,000,000	2.32
P W L B	28-Mar-18	28-Mar-68	25,000,000	2.32
P W L B	31-May-18	31-May-68	10,000,000	2.25
P W L B	04-Sep-19	01-Sep-69	10,000,000	1.67
			386,200,000	**3.83**

Note: The FMSWERTM borrowing above relates to market loans with FMS Wertmanagement Bank Germany. Initially taken from Depfa Bank Plc (Dublin) and subsequently transferred by the lender to FMS.

Investment Portfolio as at 30 September 2020

The Council's investment portfolio with the average deposit rate as at 30 September 2020 is shown below. The Council's investment strategy is to first provide security and adequate liquidity, before considering optimising investment return. The aim is for an appropriate balance of instant access, short-term investments and longer, three to twelve month deposits (earning higher rates). The Council is committed to this policy but it must be acknowledged that it lowers the potential interest rate available.

Investment Portfolio as at 30 September 2020

Credit Limit Group / Counterparty	Country	Credit Rating	Deposit Type	Start Date	Maturity Date	Interest Rate (%)	Principal (£)
LOCAL AUTHORITY (20% MAX, UP TO 2 YRS)							
PLYMOUTH CITY COUNCIL	UK	AA-	Term Deposit	23/09/2020	23/06/2021	0.27	10,000,000
MERSEYSIDE PCC	UK	AA-	Term Deposit	30/09/2020	29/09/2020	0.30	10,000,000
THURROCK COUNCIL	UK	AA-	Term Deposit	21/10/2019	19/10/2020	1.10	10,000,000
YELLOW (£20m MAX)							
ABERDEEN STANDARD LIQUIDITY FUND	UK	AAA	MMF*			0.11	20,000,000
FEDERATED LIQUIDITY MMF	UK	AAA	MMF*			0.08	20,000,000
J P MORGAN LIQUIDITY FUND	UK	AAA	MMF*			0.01	19,200,000
BNP PARIBAS MMF - INSTICASH FUND	UK	AAA	MMF*			0.05	4,300,000
PINK (£20m MAX)							
ROYAL LONDON CASH PLUS FUND	UK	AAA	USDBF**			0.21	20,000,000
ORANGE (£20m MAX, UP TO 1 YEAR)							
BANK OF SCOTLAND	UK	A+	Term Deposit	05/08/2020	10/12/2020	0.15	20,000,000
RED (£15m MAX, UP TO 6 MTHS)							
STANDARD CHARTERED BANK	UK	A+	Term Deposit	11/08/2020	13/01/2021	0.27	15,000,000
*Money Market Fund (instant access)		Average Rate and Total Investments				**0.20**	**148,500,000**

**Ultra Short Dated Bond Fund (2-3 days access)