APPENDIX A

EXETER CITY COUNCIL

TREASURY MANAGEMENT STRATEGY 2022/23

1. Introduction

1.1. The Council's Treasury Management Strategy (TMS) is based on the requirements of the DLUHC's Guidance on Local Government Investments ("the Guidance"), the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the Code") and CIPFA Treasury Management Guidance Notes 2018.

1.2. CIPFA published revised CIPFA Treasury Management Code and Prudential Code on 20th December 2021 and has stated that formal adoption is not required until the 2023/24 financial year. However; the Council has to have regard to these codes of practice when it prepares the Treasury Management Strategy Statement and Annual Investment Strategy, and also related reports during the financial year. Members will be updated on how all these changes will impact our current approach and any changes required will be formally adopted within the 2023/24 TMS report.

1.3. 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 counterparties or instruments commensurate with the Council's risk appetite, providing adequate liquidity initially before considering investment return.

1.4. 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.

1.5. 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.

2. Economic Context

UK economy. The disappointing 0.1% month on month rise in Gross Domestic Product (GDP) in October which suggested that economic growth had already slowed even before the Omicron variant was discovered in late November. Early evidence suggests growth in November might have been marginally better. Nonetheless, at such low rates of growth, the government's "Plan B" COVID-19 restrictions could cause the economy to contract in December.

- **Inflation**. The Consumer Price Index (CPI) measure of spiked up further to 5.1% in November 2021, confirming again how inflationary pressures have been building sharply. However, Omicron also caused a sharp fall in world oil and other commodity prices. The current expectation is for inflation to peak at 6% in April 2022 before starting to fall towards the 2% Bank of England target, however, there has been no recent reference that this will be within the next 2 years.

Interest rate forecasts

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. The following table gives Link Group forecast to March 2025.

Link Group Interest Rate View	20.12.21													
	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
BANK RATE	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25
3 month ave earnings	0.20	0.30	0.50	0.50	0.60	0.70	0.80	0.90	0.90	1.00	1.00	1.00	1.00	1.00
6 month ave earnings	0.40	0.50	0.60	0.60	0.70	0.80	0.90	1.00	1.00	1.10	1.10	1.10	1.10	1.10
12 month ave earnings	0.70	0.70	0.70	0.70	0.80	0.90	1.00	1.10	1.10	1.20	1.20	1.20	1.20	1.20
5 yr PWLB	1.40	1.50	1.50	1.60	1.60	1.70	1.80	1.80	1.80	1.90	1.90	1.90	2.00	2.00
10 yr PWLB	1.60	1.70	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10	2.20	2.30
25 yr PWLB	1.80	1.90	2.00	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.40	2.40	2.50	2.50
50 yr PWLB	1.50	1.70	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.20	2.20	2.30	2.30

In December the Bank of England became the first major western central bank to put interest rates up as recovery progresses from the Covid recession of 2020. The next increase in Bank Rate could be in February or May, dependent on how severe an impact there is from Omicron.

It is not expected that Bank Rate will go up fast after the initial rate rise as the supply potential of the economy is not likely to have taken a major hit during the pandemic: it should, therefore, be able to cope well with meeting demand after supply shortages subside over the next year, without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the MPC's 2% target after the spike up to around 5%. The forecast includes four increases in Bank Rate over the three-year forecast period to March 2025, ending at 1.25%. However, these forecasts could require revising within a relatively short time frame as they are dependent on several changeable factors.

It should also be borne in mind that Bank Rate being cut to 0.25% and then to 0.10%, were emergency measures to deal with the Covid crisis hitting the UK in March 2020. At any time, the MPC could decide to simply take away such emergency cuts on no other grounds than they are no longer warranted, and as a step forward in the return to normalisation. In addition, any Bank Rate under 1% is both highly unusual and highly supportive of economic growth.

3. Current and Expected Treasury Portfolios

3.1. <u>Investments</u>

The Council's current investments as at 31 December 2021 was as follows:

<u>Fixed Term Deposits - Current</u>

Amount	Investment	Interest rate	Date Invested	Maturity Date	No. of Days
£5,000,000	Thurrock Council	0.17%	17/05/21	17/02/22	276
£3,000,000	Standard Chartered – Sustainable deposit	0.29%	15/10/21	14/04/22	181
£3,000,000	Goldman Sachs	0.37%	15/12/21	15/06/22	182
£5,000,000	Plymouth City Council	0.10%	28/06/21	28/06/22	365
£3,000,000	Barclays Green 95 day notice account	0.10%	02/12/20	95 days from notice date	Min: 95
£5,000,000	London Borough of Croydon	0.10%	18/11/21	18/05/22	181
£5,000,000	Slough Borough Council	0.08%	12/11/21	12/05/22	181
£5,000,000	Blackpool Council	0.07%	24/08/21	24/05/22	273
£5,000,000	Royal Borough of Windsor & Maidenhead	0.03%	17/11/21	17/05/22	181

£3,000,000	Surrey Heath Borough Council	0.05%	15/12/21	14/06/22	
£5,000,000	Wrexham County Borough Council	0.06%	22/10/22	22/04/22	182
£35,000,000	Debt Management Office (DMO)	-0.05%	24/12/22	20/01/22	27

The Standard Chartered Sustainable deposit guarantees that investment is referenced against sustainable assets aligned to the United Nations' Sustainable Development Goals (SDGs).

Property Funds

Amount	Investment	Dividend Yield
£5,000,000	CCLA – LAMIT Property Fund	3.91%

Note: Dividend yield as at 30 September 2021

Money Market Funds

Amount	Investment	Interest rate*
£10,000,000	Federated Investors	0.01%
£10,000,000	Aberdeen Standard Investments	0.01%
£10,000,000	CCLA - The Public Sector Deposit Fund	0.04%
£7,000,000	Black Rock Asset Management	0.01%

* Interest rate is variable (therefore rates quoted are an average to 31 December 2021)

3.2. Borrowings

The Council's long term borrowing is currently £168.183 million (£95.939 million General Fund and £72.244 HRA) and there is currently no short-term borrowings. Details of current loans are set out below.

Existing loans

Amount	Lender	Interest rate	End date
£56,884,000	PWLB maturity (HRA)	3.48%	28/03/2062
£2,033,000	PWLB 25 year annuity	2.34%	11/01/2044
£1,981,517	PWLB 25 year annuity	2.08%	04/04/2044
£4,404,697	PWLB 30 year annuity	1.61%	26/09/2049
£8,425,853	PWLB 35 year annuity	1.71%	26/09/2054
£35,093,894	PWLB 50 year annuity	1.80%	26/09/2069
£15,360,000	PWLB maturity (HRA)	1.31%	14/04/2070
£44,000,000	PWLB 50 year annuity	1.78%	24/12/2071

3.3. Expected changes

The current capital programme indicates further borrowing requirement of £76.876 million for the General Fund and £6.9 million for the HRA. The decision of whether to take external long-term borrowing will be made in light of current and forecast interest rates and the decision is delegated to the section 151 Officer and Leader of the Council.

3.4. Budget implications

The net budget for interest payments in 2022/23 is £300,000 in respect of the General Fund and £2.307 million in respect of the HRA. The HRA covers the interest costs relating to the long term borrowing of £56.9 million and the interest on any other borrowings directly related to the HRA. If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will differ correspondingly.

4. Investment Strategy

4.1. The Council holds surplus funds, which represent income received in advance of expenditure plus balances and reserves held. Both the CIPFA Code and the DLUHC Guidance require the Council to invest its funds prudently, and to have regard to the **security** and **liquidity** of its investments before seeking the highest rate of return, or **yield**.

4.2. Specified Investments

Specified investments are those expected to offer relatively high security and liquidity, and can be entered into with the minimum of formalities. The DLUHC Guidance defines specified investments as those:

- denominated in pounds sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
  - the UK Government,
  - a UK local authority, parish council or community council, or
  - a body or investment scheme of "high credit quality".

4.3. The Council defines the following as being of "high credit quality" for making specified investments, subject to the monetary and time limits shown.

In-house investment	Monetary limit[1]	Time limit
UK owned banks and building societies holding short-term credit ratings no lower than F1+ and P-1	£4m each	12 months
Foreign owned banks that deal in sterling holding short-term credit ratings no lower than F1+ and P-1	£3m each	9 months
UK owned banks and building societies holding short-term credit ratings no lower than F1 and P-1	£3m each	6 months
Money market funds[2] and similar pooled vehicles holding the highest possible credit ratings (AAA)	£10m each	3 months
Property Funds	£10m each	3 months
UK Central Government	no limit	12 months
UK Local Authorities[3] Upper Tier Lower Tier	 £5m each £5m each	 12 months 12 months

[1] banks within the same group ownership are treated as one bank for limit purposes

[2] as defined in the Local Authorities (Capital Finance and Accounting) Regulations 2003
[3] as defined in the Local Government Act 2003

4.4. The maximum that will be lent to any one organisation (other than the UK Government) will be £5 million, with the exception of Property Funds and Money Market Funds where the limit is £10m. For an individual bank, the limit is £4 million. A group of banks under the same ownership will be treated as a single organisation for limit purposes.

4.5. Non specified Investments

No non specified investments will be made by the Council.

4.6. Foreign countries

Investments in foreign countries will be limited to those that hold a AAA or AA+ sovereign credit rating from all three major credit rating agencies, and to a maximum of £3 million per country. Only banks that are domiciled in the UK but are owned in another country will be used and need to meet the rating criteria of and will count against the limit for both countries. There is no limit on investments in the UK.

4.7. Liquidity management

The Council uses purpose-built cash flow forecasting to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a pessimistic basis, with receipts under-estimated and payments over-estimated to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments.

Limits on long-term investments are set by reference to the Council's medium term financial plan and cash flow forecast.

4.8. Credit ratings

The Council uses credit ratings from two main rating agencies Fitch Ratings Ltd and Moody's Investors Service to assess the risk of loss of investments. The lowest available credit rating will be used to determine credit quality.

Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. Where an institution has its credit rating downgraded so that it fails to meet the above criteria then:

- no new investments will be made,
- any existing investments that can be recalled at no cost will be recalled, and
- full consideration will be given to the recall of any other existing investments

Where a credit rating agency announces that it is actively reviewing an organisation's credit ratings with a view to downgrading it so that it is likely to fall below the above criteria, then no further investments will be made until the outcome of the review is announced.

Sole reliance will not be placed on the use of this external service. In addition, this Council will also use market data and market information, as well as information on any external support for banks to help support its decision-making process.

4.9. Other information on the security of investments

Full regard will be given to other available information on the credit quality of banks and building societies, including credit default swap prices, financial statements and rating agency reports. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the above criteria.

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4.11. Investment instruments

Investments may be made using any of the following instruments:

- interest paying bank accounts
- fixed term deposits
- call or notice deposits (where the Council can demand repayment)
- certificates of deposit
- treasury bills and gilts issued by the UK Government
- bonds issued by multilateral development banks
- shares in money market funds

5. Planned investment strategy for 2022/23 – In-House

5.1. The cash flow forecast will be used to divide surplus funds into three categories:

- Short-term – cash required to meet known cash outflows in the next month, plus a contingency to cover unexpected cash flows over the same period.
- Medium-term – cash required to manage the annual seasonal cash flow cycle, including amounts to cover forecast shortages, planned uses of reserves, and a longer-term contingency.
- Long-term – cash not required to meet cash flows, and used primarily to generate investment income.

5.2. The Council's in-house managed funds are based on the likely cash-flow position. Investments will be made to ensure that cash flow is protected and borrowing is minimised. In the current economic climate, it is considered appropriate to keep investments short term to cover cash flow needs. However, where appropriate (from an internal as well as external perspective), the Council will also consider investments for a longer period up to 12 months. These are funds which are not required for day-to-day cash management purposes.

5.3. The Council will seek to utilise money market funds (Aberdeen, Blackrock, Federated, and CCLA) and use short-dated deposits to ensure liquidity of assets for day-to-day cashflow. Although these are essentially cash, a monetary limit in line with the banks credit rating is retained on the accounts. The Council can also make use of the Government's Debt Management Office to ensure the highest possible security for cash. Additionally, the Council will hold a balance on its general account to cover any payments due. On occasion, to facilitate cash flow requirements, there may be in excess of £3 million in this account.

6. Borrowing Strategy

6.1. The Council's capital financing requirement (CFR, or underlying need to borrow) as at 31 March 2022 is expected to be £244.97 million, and is forecast to rise to £295.33 million by March 2023 as capital expenditure is incurred.

6.2. The maximum expected long-term borrowing requirement for 2022/23 is:

	£m
Borrowed in prior years	95.94
Long term borrowing (HRA)	72.24
Not borrowed in previous years	76.79
Forecast increase in CFR	50.36
TOTAL	**295.33**

6.3. The Council is expected to be in an under-borrowed position as at 31 March 2022. 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 to mitigate exposure to counterparty risk.

Against this background and the risks within the economic forecast, caution will be adopted with the 2022/23 treasury operations. The section 151 Officer will monitor interest rates in financial markets and adopt a pragmatic approach to any change in circumstances.

6.4. To reduce risk and minimise cost on the General Fund, it has been decided to defer borrowing where possible, however some targeted long term borrowing may be undertaken in 2022-23, where the costs will be offset against future income streams.

6.5. In addition, the Council may borrow for short periods of time (normally up to two years) to cover cash flow shortages.

6.6. If borrowing is required advice will be sought from the treasury management advisors in order that the most cost effective form of borrowing can be secured.

6.7. Sources of borrowing

The approved sources of long-term and short-term borrowing will be:
- Public Works Loan Board
- any institution approved for investments above
- any other bank or building society on the Financial Services Authority list.

6.8. Debt instruments

Loans will be arranged by one of the following debt instruments:
- fixed term loans at fixed or variable rates of interest
- lender's option borrower's option (LOBO) loans.

As an alternative to borrowing loans, the Council may also finance capital expenditure and incur long-term liabilities by means of:
- leases
- Private Finance Initiative.

6.9. Borrowing strategy to be followed

With short-term interest rates currently much lower than long-term rates, it continues to be more cost effective in the short-term to not borrow and reduce the level of investments held instead, or to borrow short-term loans. However, with long-term rates forecast to rise in the coming years, any such short-term savings will need to be balanced against potential longer-term costs.

If required, the council may arrange forward starting loans during 2022/223, where the interest rate is fixed in advance, but the cash is received in a later period.

7. Policy on Use of Financial Derivatives

7.1. Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans).

7.2. The Localism Bill 2011 includes a general power competence that removes the uncertain legal position over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment). The latest CIPFA Code requires authorities to clearly detail their policy on the use of derivatives in the annual strategy.

7.3. The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

7.4. Derivative counterparties
Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

7.5. In reality, whilst the Council is required to include the above policy, the only type of transaction that might be used is the forward deal, which means the Council agrees to borrow funds at a set price for a set period, in advance of the date the loan is actually taken. This is done to ensure the availability of funds at the time that they are needed.

8. Treasury Management Prudential Indicators

8.1. The Council sets each year, in February, prudential indicators for Treasury Management, to ensure that proper control of borrowing and investing is maintained. These indicators can be found in the Council's budget book.

9. Other Matters

9.1. The revised DLUHC Investment Guidance also requires the Council to approve the following matters each year as part of the investment strategy:

9.2. <u>Investment consultants</u>

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 the services of our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers. The services received include:

- advice and guidance on relevant policies, strategies and reports,
- advice on investment decisions,
- notification of credit ratings and changes,
- other information on credit quality,
- advice on debt management decisions,
- accounting advice,
- reports on treasury performance,
- forecasts of interest rates, and
- training courses.

The quality of the advisory service is monitored by the Director Finance.

9.3. <u>Investment training</u>

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This is covered by the Director Finance as part of the induction process.

The needs of the Council's members and treasury management staff for training in investment management are assessed annually as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change. Staff regularly attend training courses, seminars and conferences provided by Link Group and CIPFA.

9.4. Investment of money borrowed in advance of need

The Council may, from time to time, borrow in advance of spending need, where this is expected to provide the best long term value for money. Since amounts borrowed will be invested until spent, the Council is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Council's overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit. The maximum periods between borrowing and expenditure is expected to be two years, although the Council does not link particular loans with particular items of expenditure.

9.5. The Treasury Management Role of the Section 151 Office

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.
- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe (say 20+ years)
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority
- ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing
- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees
- ensuring that members are adequately informed and understand the risk exposures taken on by an authority
- ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above
- creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed, to include the following

- Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;

- Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;

- Decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;

- Reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken;

- Training and qualifications (TMP10 and schedules), including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.

10. Investment Reports

10.1. 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 (in budget book) - 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 Executive Committee.

DIRECTOR FINANCE
DECEMBER 2021