**APPENDIX A**

# EXETER CITY COUNCIL

# TREASURY MANAGEMENT STRATEGY 2021/22

## 1. Introduction

1.1. The Council's strategy is based on the requirements of the MHCLG's Guidance on Local Government Investments ("Guidance"), 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. 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.

1.3. 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.

1.4. 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 economy had been recovering quite strongly from its contraction in 2020 of 10.2% due to the pandemic with GDP only 3.5% below its pre-pandemic level and the unemployment rate dropping below 7%. However, the rise in new cases to the highest levels poses a threat that the recovery in the economy could stall.

**Brexit.** While the UK has been gripped by the long running narrative of whether or not a deal would be made by 31 December 2020, the final agreement on 24 December 2020, followed by ratification by Parliament and all 27 EU countries in the following week, has eliminated a significant downside risk for the UK economy. The initial agreement only covers trade so there is further work to be done on the services sector where temporary equivalence has been granted in both directions between the UK and EU; that now needs to be formalised on a permanent basis.

**Inflation**. The Consumer Price Index (CPI) measure of inflation fell to 0.2% in August 2020 and has marginally increased since, but remains low. The bank has stated that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably". The current forecast is that Iinflation is expected to briefly peak at just over 2% towards the end of 2021, but this is a temporary short lived factor and so not a concern at this stage.

2.1. **Interest rate forecasts**

The Council has appointed Link Asset Services 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 Asset Services forecast to March 2024.

| Link Group Interest Rate View 9.11.20 | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| These Link forecasts have been amended for the reduction in PWLB margins by 1.0% from 26.11.20 | | | | | | | | | | | | | | |
| | Dec-20 | Mar-21 | Jun-21 | Sep-21 | Dec-21 | Mar-22 | Jun-22 | Sep-22 | Dec-22 | Mar-23 | Jun-23 | Sep-23 | Dec-23 | Mar-24 |
| BANK RATE | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 |
| 3 month ave earnings | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 |
| 6 month ave earnings | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 |
| 12 month ave earnings | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 |
| 5 yr PWLB | 0.80 | 0.80 | 0.80 | 0.80 | 0.80 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 1.00 | 1.00 | 1.00 | 1.00 |
| 10 yr PWLB | 1.10 | 1.10 | 1.10 | 1.10 | 1.10 | 1.20 | 1.20 | 1.20 | 1.20 | 1.20 | 1.30 | 1.30 | 1.30 | 1.30 |
| 25 yr PWLB | 1.50 | 1.50 | 1.60 | 1.60 | 1.60 | 1.60 | 1.70 | 1.70 | 1.70 | 1.70 | 1.80 | 1.80 | 1.80 | 1.80 |
| 50 yr PWLB | 1.30 | 1.30 | 1.40 | 1.40 | 1.40 | 1.40 | 1.50 | 1.50 | 1.50 | 1.50 | 1.60 | 1.60 | 1.60 | 1.60 |

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 subsequent meetings to January 2020, 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.

## 3. Current and Expected Treasury Portfolios

3.1. <u>Investments</u>

The Council's current investments as at 20 December 2020 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 | 0.12% | 16/11/20 | 16/02/21 | 92 |
| £3,000,000 | Standard Chartered – Sustainable deposit | 0.04% | 13/11/20 | 15/02/21 | 92 |
| £2,000,000 | Surrey Heath Borough Council | 0.10% | 23/10/20 | 23/04/21 | 94 |
| £3,000,000 | Surrey Heath Borough Council | 0.10% | 14/12/20 | 14/06/21 | 182 |
| £5,000,000 | Flintshire County Council | 0.06% | 30/09/20 | 05/01/21 | 97 |
| £5,000,000 | Wirrell Metropolitan Borough Council | 0.03% | 26/10/20 | 26/01/21 | 92 |
| £2,000,000 | Monmouthshire County Council | 0.07% | 23/11/20 | 23/05/21 | 182 |
| £5,000,000 | Wokingham Borough Council | 0.10% | 27/11/20 | 27/05/21 | 181 |

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 | 4.37% |

Note: Dividend yield as at 30 September 2020

**Money Market Funds**

| Amount | Investment | Interest rate* |
|---|---|---|
| £10,000,000 | Federated Investors | 0.15% |
| £10,000,000 | Aberdeen Standard Investments | 0.17% |
| £nil | CCLA - The Public Sector Deposit Fund | 0.19% |
| £nil | Black Rock Asset Management | 0.12% |

* Interest rate is variable (therefore rates quoted are an average to 31 December 2020)

3.2. Borrowings

The Council's long term borrowing is currently £126.044 million (£53.8 million General Fund and £72.244 HRA) and there is currently no short-term borrowings. Details of current loans are set out below.

3.3. The Council made a one-off payment on 28 March 2012, to buy itself out of the HRA subsidy system. The final settlement figure of £56.884 million was confirmed in February 2012. The amount was borrowed from the Public Works Loans Board over a 50 year period and in repayable on maturity at the end of the loan term. The interest rate was 3.48% fixed for the term of the loan.

3.4. The Public Works Loan Board (PWLB) long-term borrowing rates fell during the period, prompting a decision on 26 September 2019 to borrow in readiness for the on-going capital programme. This was a timely decision as there was an announcement on 9 October 2019 to increase the interest rates offered on new PWLB loans by 1% with immediate effect.

3.5. At Spring Budget 2020, the Government announced a new, discounted rate of PWLB lending to support social housing, which enables the Council to borrow at 1% below the rate at which the local authority would usually borrow from the PWLB, specifically for social housing projects.

3.6. On 25 November 2020, there was a further announcement by the Chancellor regarding PWLB loan rates; the standard and certainty rates were reduced by 1% but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three year capital programme. This means that the Council now has access to more favourable borrowing rates, comparable to those received pre-October 2019.

Existing loans

| Amount | Lender | Interest rate | End date |
|---|---|---|---|
| £56,884,000 | PWLB maturity (HRA) | 3.48% | 28/03/2062 |
| £2,200,000 | PWLB 25 year annuity | 2.34% | 11/01/2044 |
| £2,150,000 | PWLB 25 year annuity | 2.08% | 04/04/2044 |

| | | | |
|---|---|---|---|
| £4,650,000 | PWLB 30 year annuity | 1.61% | 26/09/2049 |
| £8,800,000 | PWLB 35 year annuity | 1.71% | 26/09/2054 |
| £36,000,000 | PWLB 50 year annuity | 1.80% | 26/09/2069 |
| £15,360,000 | PWLB maturity (HRA) | 1.31% | 14/04/2070 |

3.7. Expected changes

The current financing forecast includes planned borrowing of £14.76 million as part of the 2021/22 General Fund capital programme and £4.83 million for the HRA 2021/22 capital programme. 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.

3.8. Budget implications

The net budget for interest payments in 2021/22 is £150,000 in respect of the General Fund and £2.26m 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 MHCLG 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 MHCLG 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]<br>Upper Tier<br>Lower Tier | <br>£5m each<br>£5m each | <br>12 months<br>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.

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.

4.10. Other information on the security of investments

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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 2021/22 – 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. However, on occasion, money has been invested for a longer period up to 364 days. 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, where significant payments are to be made, 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 2021 is expected to be £186.15 million, and is forecast to rise to £200.36 million by March 2022 as capital expenditure is incurred.

6.2. The maximum expected long-term borrowing requirement for 2021/22 is:

| | £m |
|---|---:|
| Borrowed in prior years | 53.80 |
| Long term borrowing (HRA) | 72.26 |

| | |
|---|---|
| Not borrowed in previous years | 45.88 |
| Forecast increase in CFR | 14.21 |
| TOTAL | **186.15** |

6.3. Despite taking out new borrowings during the year, 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 to mitigate exposure to counterparty risk.

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 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 will be undertaken in 2021-22, 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 2021/22, 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 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 MHCLG 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 contracts with Link Asset Services to provide advice and information relating to its investment and borrowing activities. However, responsibility for final decision making remains with the Council and its officers. 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 needs of the Council's 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 Asset Services 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 – to be determined in accordance with local priorities.)
- 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. At the end of the financial year, the Council will prepare a report on its investment activity as part of its Annual Treasury Report. Progress will also be reported after six months of the financial year.

DIRECTOR FINANCE
DECEMBER 2020