Finance Department
7 Newington Barrow Way
London N7 7EP

Report of: **Director of Service Finance**

Meeting of	Date	Agenda Item	Ward(s)
Audit Committee	28 January 2020		

Delete as appropriate	~~Exempt~~	Non-exempt

SUBJECT: Annual Treasury Management and Investment Strategy 2020-2021

1. Synopsis

1.1 This report discusses the council's 2020-2021 annual treasury management strategy and investment strategy.

2. Recommendations

2.1 To consider the Council's 2020-2021 annual treasury management and investment strategy before full council's approval at its budget and council tax setting meeting on 27th February 2020. The strategy covers

- The balance sheet and treasury position
- Prospects for interest rates
- Borrowing requirement and strategy
- Debt rescheduling
- Investment strategy and policy
- HRA Self Financing

2.2 To note the key points of the treasury strategy summarised below:

Summary of the key points of the treasury strategy

- £239.8m is estimated to be required to be borrowed over the next 3 years
  £64.4million to replace existing borrowing that matures
  £175.4million of new borrowing to fund capital expenditure

- The borrowing strategy is to minimise borrowing costs, through
  - Using surplus internal cash, and
  - Borrowing at optimal times at either variable or fixed rates which can include borrowing in advance of need

- It is expected that sums for investments will be minimal. Investment activity is restricted to institutions set in para 3.7.

- The Council's investment priorities in order of importance are:

  -security of the invested capital;
  -liquidity of the invested capital;
  -an optimum yield which is commensurate with security and liquidity

3. Background

3.1 **INTRODUCTION**

3.1.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) has defined treasury management as "the management of the organisations' investments and cashflow, its banking, money market and capital market transactions; the effective control of the risks associated with these activities and the pursuit of optimum performance consistent with those risks.

3.1.2 Treasury management activities are strictly regulated by statutory requirements and a professional code of practice (the CIPFA Code of Practice on Treasury Management). Treasury risk management is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code. This Council adopted the Code of Practice on Treasury Management on 26th February 2002.

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3.1.3 The treasury management function is an important part of the overall financial management of the Council's affairs. Its importance has increased as a result of the freedoms provided by the Prudential Code. The Council is required to set out an Annual Treasury Strategy outlining at the least the expected treasury activity for the forthcoming three years.

3.1.4 Investments held for service purposes or for commercial profit are considered in a different report, Investment Strategy report and approved by full Council at its budget and council tax setting meeting on 27th February 2020

3.1.5 A key requirement of this report is to explain both the risks, and the management of the risks, associated with treasury management that include:

- Liquidity Risk (Inadequate cash resources).
- Market or Interest Rate Risk (Fluctuations in interest rate levels).
- Inflation Risk (Exposure to inflation).
- Credit and Counterparty Risk (Security of Investments).
- Refinancing Risk (Impact of debt maturing in future years).
- Legal and Regulatory Risk.

3.2 **Scope**

3.2.1 This Treasury Management Strategy considers the impact of the Council's revenue budget and capital programme on the balance sheet position, the prospects for interest rates, borrowing requirement and strategy, debt rescheduling, investment strategy and policy, monitoring, members training and advisors.

Balance sheet and treasury position

3.2.2 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR). The CFR represents the level of borrowing for capital purposes. Revenue expenditure cannot be financed from borrowing. Net physical external borrowing should not exceed the CFR other than for short-term cash flow requirements. It is permissible under the Prudential Code to borrow in advance of need, up to the level of the estimated CFR over the term of the Prudential Indicators. Where this takes place, the cash will form part of the invested sums until the related capital expenditure is incurred. This being the case net borrowing should not exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years other than in the short term due to cash flow requirements.

3.2.3 The CFR together with balances and reserves are the core drivers of Treasury Management activity. The estimates, based on the current revenue budget and capital programmes and in advance of any changes to the 2020/21 budget to be considered in February, are set out in **Table 1** below:

Table 1 – Capital Financing, Balances and Reserves Forecasts

	31/03/2020 Estimate £m	**31/03/2021 Estimate £m**	**31/03/2022 Estimate £m**	**31/03/2022 Estimate £m**
General Fund CFR	138.3	171.4	156.1	154.4
Long term Liabilities- PFI	109.9	94.8	81.5	76.9
HRA CFR	475.7	516.2	568.2	608.3
Total CFR	**723.9**	**782.4**	**805.8**	**839.6**

Less Balances and Reserves	(247.7)	(223.3)	(211.6)	(223.7)
Net Balance Sheet Position	**476.2**	**559.1**	**594.2**	**615.9**

3.2.4 The Council's level of physical debt and investments is linked to these components of the balance sheet. Market conditions, affordability, interest rate expectations and credit risk considerations will influence the Council's strategy in determining the borrowing and investment activity against the underlying Balance Sheet position.

3.3 Prospects for interest rates

3.3.1 Treasury management activities such as borrowing, introduce risk to the Council via the impact of unexpected adverse movements in interest rates. The Council employs Arlingclose treasury consultants, to advice on the treasury strategy, to provide economic data and interest rate forecasts, to assist planning and reduce the impact of unforeseen adverse movements. **Appendix A** draws together a number of current forecasts for short-term and longer-term fixed interest rates. The major external influence on the authority's treasury management strategy for 2020/21 will be the UK's progress in negotiating and agreeing future trading arrangements in the limited transitional period currently set by the UK government. Global and UK economic growth outlook is forecast to remain relatively soft up to 2022. The central case forecast is for UK Bank Rate to remain at 0.75% with a downside risk of a cut to 0.50%. Gilt yields will remain low due to the soft UK and global economic outlooks. The central case is for 10-year and 20-year gilt yields to rise to around 1.00% and 1.40% respectively US monetary policy and UK government spending will be key influences alongside UK monetary policy**.**

3.4 Borrowing Strategy

3.4.1 The Council's underlying need to borrow for capital purposes is measured by reference to its Capital Financing Requirement (CFR). To ensure that this expenditure is ultimately financed, local authorities are required to make a Minimum Revenue Provision (MRP) for debt redemption from within the revenue budget each year.

3.4.2 Capital expenditure not financed from internal resources (i.e. capital receipts, capital grants and contributions, revenue or reserves) will produce an increase in the CFR (the underlying need to borrow) and in turn produce an increased requirement to charge MRP in the revenue account. The Council's borrowing requirement is shown in the **Table 2** below.

	2019-20	2020-21	2021-22	2022-23
	Revised estimate £M	Estimate £M	Estimate £M	Estimate £M
New Borrowing	32.5	76.1	57.2	42.1
Replacement borrowing	11.1	12.5	33.3	18.6
TOTAL	**43.6**	**88.6**	**90.5**	**60.7**

3.4.3 For the purpose of setting the budget, it has been assumed that new treasury management investments will be made at an average rate of 1.25%, and that new long-term loans will be borrowed at an average rate of 2.5%.

3.4.4 In conjunction with advice from our treasury advisor, Arlingclose Ltd, the Council will keep under review the options it has in borrowing from the Public Works Loan Board (PWLB), our previously main provider who unfortunately increased their rates by 1% in November 2019, other local authorities and their pension funds, the market, capital market bond investors, UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues and other sources up to the available capacity within the Authorised Limit (contained within the Prudential Indicators in **Appendix B** to be adopted in the 2020-21 budget).

3.4.5 The chief objective of the council when borrowing money is to achieve an appropriate risk balance between securing low interest rates and cost certainty over the periods for which funds are required. Given the significant cuts to public expenditure and in particular local government funding, the council's borrowing strategy continues to address the key issue of affordability without compromising the longer term stability of the debt portfolio.

3.4.6 The council's strategy is to minimise its borrowing costs over the medium to longer term and maintain maximum control over its borrowing activities as well as flexibility on its loans' portfolio. The use of internal resources in lieu of borrowing and short to medium term borrowing will continue because of the "cost of carry" (that is the differential between debt costs and investment earnings). Exposure to variable loans including PWLB rates will be kept under regular review, The Bank Rate is expected to stay at 0.75% throughout the year. As at 31st December 2019, the council had agreed £15m of PWLB and £69.5m non-PWLB long term loans. All these non-PWLB loans are from other local authorities over outstanding periods of up to 3 years at an average rate of 1.5%.

3.4.7 Capital expenditure levels, cash flow projections, market conditions and interest rate levels will be monitored in conjunction with our treasury advisors, Arlingclose, to determine the most appropriate options.

3.4.8 The Council's borrowing requirement over the next three years is estimated to be around £239.8million, £64.4million of this borrowing will be used to replace existing PWLB debt taken in the 1980's that matures over the next three years. If market rates were to fall considerably or future rates were expected to rise, then some borrowing could be taken ahead of spend. The borrowing strategy will therefore consider opportunities to borrow not only for 2020-21 but ahead for the next two financial years.

3.5 **Debt rescheduling**

3.5.1 The factors affecting any decision on debt rescheduling will include, the generation of cash savings and / or discounted cash flow savings in interest cost, helping to fulfil the strategy outlined in the paragraphs above; enhancing the balance of the fixed to variable rate debt in the portfolio and, amending the maturity profile. All rescheduling activity will comply with the accounting requirements of the local authority Statement Of Recommended Practice (SORP) and regulatory requirements of the Capital Finance and Accounting Regulations (SI 2007 No. 573 as amended by SI 2008/414).

3.6 **Investment strategy and policy**

3.6.1 To comply with the Government's guidance and CIPFA Code, the Council's general policy objective is to invest its surplus funds prudently.

3.6.2 The Council's investment priorities, in order of importance, are:

- security of the invested capital.
- liquidity of the invested capital.
- an optimum yield which is commensurate with security and liquidity.

3.6.3 The borrowing of monies purely to invest or on-lend and make a return is unlawful and the Council does not engage in such activity.

3.6.4 **Business model**

Under the new IFRS 9 standard, the accounting for certain investments depends on our business model for managing them. The Council aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore where other criteria are also met, these investments will continue to be accounted for at amortised cost.

3.7 **Investment instruments approved counterparties.**

3.7.1. Potential instruments for the Council's use within its investment strategy are UK Government, local authorities or government backed public organisations, banks, corporates and registered providers.

3.7.2 The Council has reviewed the way it formulates its counterparty criteria. The lending list criteria is devised from the use of rating agencies which will include) as well as other factors. The main sovereign states whose banks are to be included are Australia, Canada, Finland, France, Denmark, Germany, Netherlands, Switzerland and the US. These countries and the Banks within them have been selected after analysis and careful monitoring of:

- Credit Ratings (minimum long-term A+ minimum short term F1).
- Credit Default Swaps.
- GDP; Net Debt as a Percentage of GDP.
- Sovereign Support Mechanisms / potential support from a well-resourced parent institution.
- Share Price.

3.7.3 The Council will also take into account information on corporate developments and market sentiment towards the counterparties. The Council and its Treasury Advisors, Arlingclose, will continue to analyse and monitor these indicators and credit developments on a regular basis and respond as necessary to ensure security of the capital sums invested.

3.7.4 The Council's internally managed investments as at 2nd January totalled £123.7million and the forecast position for the end of March through 2020 will average £75million. The Council has restricted its investment activity to the following institutions while conditions in the financial sector are monitored for stability and cashflow positions are averaging around £95m:

- The Debt Management Agency Deposit Facility (The rates of interest from the DMADF are below equivalent money market rates. However, the returns are an acceptable trade-off for the guarantee that the Council's capital is secure).
- AAA-rated Money Market Funds with a Constant Net Asset Value (CNAV).
- Deposits with other local authorities.
- Business reserve accounts and term deposits. These have been primarily restricted to UK institutions that are rated at least A+ long term.

3.7.5 If the cash flow positions were to increase because of forward borrowing, then investments criteria will revert to credit ratings as stated in paragraph 3.7.2

3.7.6 A copy of the Council's current Approved lending list and the institutions actually lent to as at 2nd January 2020 is attached as **Appendix C** for information. In addition, the Council has borrowed £44m at an average rate of 0.7% short term, from other Local Authorities & Public Bodies to cover cashflow positions. The outstanding temporary borrowing position by year end will be £10m.

3.7.7 The economic interest rate outlook provided by the Council's treasury advisor, Arlingclose, is attached as **Appendix A**. The Council will reappraise its strategy with evolving market conditions and expectations for future interest rates.

3.7.8 The Corporate Director Resources under delegated powers will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements and Prudential Indicators. All investments will be made in accordance with the Council's investment policies and prevailing legislation and regulations.

3.8 **Housing Revenue Account policy on apportioning interest**

3.8.1 Central Government completed its reform of the Housing Revenue Account Subsidy system at the end of 2011/12. Local authorities are required to recharge interest expenditure and income attributable to the HRA in accordance with determinations issued by the Department for Communities and Local Government. The CIPFA Code recommends that authorities present this policy in their TMSS.

3.8.2 On 1st April 2012, the Council notionally split each of its existing long-term loans into General Fund and HRA pools. New long-term loans borrowed are assigned in their entirety to one pool or the other. Interest payable and other costs/income arising from long-term loans (e.g.

premiums and discounts on early redemption) are charged/ credited to the respective revenue account.

3.9.3 **Internal borrowing**

Where the HRA or GF has surplus cash balances which allow either account to have external borrowing below its level of CFR (internal borrowing), the rate charged on this internal borrowing will be based on the 14.5 -15year PWLB fixed loan rate to reflect the assumed opportunity cost forgone.

3.10 **Monitoring**

3.10.1 Treasury management monitoring will be incorporated in the regular Executive financial monitoring reports. The Executive Member for Finance is regularly briefed on treasury activities. At the end of the financial year, an outturn report will be prepared on the Council's investment activity as part of its Annual Treasury Report. The Audit committees will scrutinise the Annual Treasury Strategy Statement before Council approval at its budget and council tax setting meeting.

3.11 **Members Training**

3.11.1 CIPFA's revised Code requires the Director of Finance to ensure that all Members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities. Training on treasury management is available to Members and can be tailored to their needs and should be assessed regularly to ensure knowledge and skills are maintained at appropriate levels

3.11 Advisors

3.11.1 Arlingclose, our appointed treasury advisors, undertake their role as advisors to enable the Council to make informed decisions.

3.12 Markets in Financial Instruments Directive

3.12.1 The council has opted up to professional client status with its providers of financial services, including advisors, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies**.** The Director of Resources believes this to be the most appropriate status given the size and range of our treasury management activities.

4 **Implications**

4.1 **Financial Implications**

The activities of the treasury management function has resource implications on the council's revenue budget. The paramount objective of the treasury management function is capital security and the pursuit of optimum performance must be consistent with the risk undertaken.

4.2 **Legal Implications**

Local authorities have restricted freedoms with regard to the investment of surplus funds. The rules are prescribed by statute and are laid out under section 15(1)(a) of the Local Government Act 2003.Local authorities are also required to have regard to supplementary guidance provided by the Office of the Deputy Prime Minister (ODPM; now Communities and

Local Government) and by CIPFA. CIPFA's guidance is defined as a proper practice for these purposes.

4.3 **Resident Impact Assessment**

4.3.1 The council must, in the exercise of its functions, have due regard to the need to eliminate discrimination, harassment and victimisation, and to advance equality of opportunity, and foster good relations, between those who share a relevant protected characteristic and those who do not share it (section 149 Equality Act 2010). The council has a duty to have due regard to the need to remove or minimise disadvantages, take steps to meet needs, in particular steps to take account of disabled persons' disabilities, and encourage people to participate in public life. The council must have due regard to the need to tackle prejudice and promote understanding.

4.3.2 A resident equalities impact assessment has not been undertaken at this stage because this report is an update on an existing policy that is agreed at the annual council tax and budget setting.

4.4 **Environmental Implications and contribution to achieving a net zero carbon Islington by 2030:**

None applicable to this report.

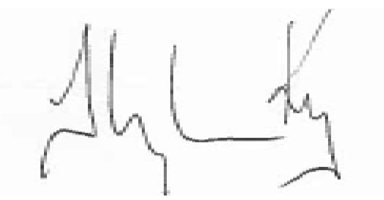
5. Conclusion and reasons for recommendations

5.1 This is the annual treasury and investment strategy statement report discussing the council's strategy on borrowing and investment and also reviewing current investment policy. Members are asked to consider this strategy before it is presented for approval at the council budget and council tax setting meeting on 27 February 2019.

Apendices: Appendix A- Arlingclose Economic and Interest Rate Forecast as at January 2020
Appendix B- Prudential Indicators
Appendix C- Current Lending List and Counterparty Schedule

Background papers:
Audit Commission National Report 2009; Council Budget Report on 27 February 2019
CIPFA guidance on treasury management issued in November 2009

Final Report Clearance



Signed by …………………
Director Service Finance Date

Report author: Joana Marfoh (head of treasury and pensions)

Tel: 020- 7527 2382
Fax: 020- 7527 2056
E-mail: joana.marfoh@islington.gov.uk

Appendix A- Arlingclose Economic and Interest Rate Forecast as at January 2020

Underlying assumptions:

- **The global economy has entered a period of weaker growth in response to political issues. The UK economy continues to experience slower growth due to both Brexit uncertainty and the downturn in global activity. In response, global and UK interest rate expectations are low.**
- Some improvement in global economic data and a more positive outlook for US/China trade negotiations has prompted worst case economic scenarios to be pared back.
- The new UK government will progress with achieving Brexit on 31st January 2020. The more stable political environment will prompt a partial return in business and household confidence in the short term, **but the subsequent limited Brexit transitionary period, which the government is seeking to enforce, will create additional economic uncertainty.**
- UK economic growth stalled in Q4 2019. Inflation is running below target at 1.5%. The inflationary consequences of the relatively tight labour market have yet to manifest, while slower global growth should reduce the prospect of externally driven pressure, although escalating geopolitical turmoil could continue to push up oil prices.
- The first few months of 2020 will indicate whether the economy benefits from restored confidence. The government will undertake substantial fiscal easing in 2020/21, which should help support growth in the event of a downturn in private sector activity.
- The weak outlook for the UK economy and current low inflation have placed **pressure on the MPC to loosen monetary policy**. Two MPC members voted for an immediate cut in the last two MPC meetings of 2019. The evolution of the economic data and political moves over the next few months will inform policy, but **upside risks to Bank Rate are very limited**.
- Central bank actions and escalating geopolitical risks will produce volatility in financial markets, including bond markets.
- **We have maintained our Bank Rate forecast at 0.75% for the foreseeable future. Substantial risks to this forecast remain, arising primarily from the government's policy around Brexit and the transitionary period.**
- **Arlingclose judges that the risks are weighted to the downside.**
- **Gilt yields remain low due to the soft UK and global economic outlooks. US monetary policy and UK government spending will be key influences alongside UK monetary policy.**
- **We expect gilt yields to remain at relatively low levels for the foreseeable future and judge the risks to be broadly balanced.**

	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Official Bank Rate													
Upside risk	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Case	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Downside risk	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
3-month money market rate													
Upside risk	0.10	0.10	0.25	0.25	0.25	0.25	0.25	0.25	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Downside risk	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
1yr money market rate													
Upside risk	0.10	0.20	0.20	0.20	0.20	0.20	0.20	0.25	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85
Downside risk	0.30	0.50	0.55	0.65	0.65	0.65	0.65	0.65	0.65	0.65	0.65	0.65	0.65
5yr gilt yield													
Upside risk	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.45	0.45	0.45
Arlingclose Central Case	0.50	0.50	0.55	0.55	0.55	0.60	0.60	0.65	0.65	0.70	0.75	0.75	0.75
Downside risk	0.35	0.50	0.55	0.55	0.55	0.60	0.60	0.65	0.65	0.70	0.75	0.75	0.75
10yr gilt yield													
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45
Arlingclose Central Case	0.75	0.80	0.80	0.85	0.85	0.90	0.90	0.95	0.95	1.00	1.05	1.10	1.10
Downside risk	0.40	0.40	0.40	0.40	0.45	0.45	0.45	0.45	0.50	0.50	0.50	0.50	0.50
20yr gilt yield													
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45
Arlingclose Central Case	1.20	1.25	1.25	1.25	1.30	1.30	1.30	1.35	1.35	1.35	1.40	1.40	1.40
Downside risk	0.40	0.40	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.50	0.50
50yr gilt yield													
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45
Arlingclose Central Case	1.20	1.25	1.25	1.25	1.30	1.30	1.30	1.35	1.35	1.35	1.40	1.40	1.40
Downside risk	0.40	0.40	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.50	0.50