Appendix E4: Islington Treasury Management Strategy Statement 2021/22

Introduction

Treasury management is the management of the authority's cash flows, borrowing and investments, and the associated risks. The authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the authority's prudent financial management.

Treasury risk management at the authority 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 authority to approve a treasury management strategy before the start of each financial year. This report fulfils the authority's legal obligation under the *Local Government Act 2003* to have regard to the CIPFA Code.

Investments held for service purposes or for commercial profit are considered in a different report, the Investment Strategy (**Appendix E5**).

External Context

Economic background by our advisors, Arlingclose: The impact on the UK from coronavirus, lockdown measures, the rollout of vaccines, as well as the new trading arrangements with the European Union (EU), will remain major influences on the authority's treasury management strategy for 2021/22.

The Bank of England (BoE) maintained Bank Rate at 0.10% in December 2020 and Quantitative Easing programme at £895 billion having extended it by £150 billion in the previous month. The Monetary Policy Committee (MPC) voted unanimously for both, but no mention was made of the potential future use of negative interest rates. In the November Monetary Policy Report (MPR) forecasts, the Bank expects the UK economy to shrink -2% in Q4 2020 before growing by 7.25% in 2021, lower than the previous forecast of 9%. The BoE also forecasts the economy will now take until Q1 2022 to reach its pre-pandemic level rather than the end of 2021 as previously forecast. By the time of the December MPC announcement, a COVID-19 vaccine was approved for use, which the Bank noted would reduce some of the downside risks to the economic outlook outlined in the November MPR.

UK Consumer Price Inflation (CPI) for November 2020 registered 0.3% year on year, down from 0.7% in the previous month. Core inflation, which excludes the more volatile components, fell to 1.1% from 1.5%. The most recent labour market data for the three months to October 2020 showed the unemployment rate rose to 4.9% while the employment rate fell to 75.2%. Both measures are expected to deteriorate further due to the ongoing impact of coronavirus on the jobs market, particularly when the various government job retention schemes start to be unwound in 2021, with the BoE forecasting unemployment will peak at 7.75% in Q2 2021. In October, the headline 3-month average annual growth rate for wages were 2.7% for total pay and 2.8% for regular pay. In real terms, after adjusting for inflation, total pay growth was up by 1.9% while regular pay was up 2.1%.

GDP growth rebounded by 16.0% in quarter 3, 2020 having fallen by -18.8% in the second quarter, with the annual rate rising to -8.6% from -20.8%. All sectors rose quarter-on-quarter, with dramatic gains in construction (41.2%), followed by services and production (both 14.7%). Monthly GDP estimates have shown the economic recovery slowing and remains well below its pre-pandemic peak. Looking ahead, the BoE's November MPR forecasts economic growth will rise in 2021 with GDP reaching 11% in Q4 2021, 3.1% in Q4 2022 and 1.6% in Q4 2023.

GDP growth in the euro zone rebounded by 12.7% in Q3 2020 after contracting by -3.7% and -11.8% in the first and second quarters, respectively. Headline inflation however, remains extremely weak, registering -0.3% year-on-year in November, the fourth successive month of deflation. Core inflation registered 0.2% year-on-year in November, well below the European Central Bank's (ECB) target of 'below, but close to 2%'. The ECB is expected to continue holding its main interest rate of 0% and deposit facility rate of -0.5% for some time but expanded its monetary stimulus in December 2020, increasing the size of its asset purchase scheme to €1.85 trillion and extended it until March 2022.

The US economy contracted at an annualised rate of 31.4% in Q2 2020 and then rebounded by 33.4% in q. The US Federal Reserve bank maintained the Fed Funds rate at between 0% and 0.25% and announced a change to its inflation targeting regime to a more flexible form of average targeting. The Fed also provided strong indications that interest rates are unlikely to change from current levels over the next three years.

Former vice-president Joe Biden won the 2020 US presidential election. Mr Biden is making tackling coronavirus his immediate priority and has reversed several executive orders signed by his predecessor and take the US back into the Paris climate accord and the World Health Organization.

Credit outlook: After spiking in late March as coronavirus became a global pandemic and then rising again in October/November, credit default swap (also known as CDS and is a financial product or contract that allows an investor to "swap" or offset his or her credit risk with that of another investor) prices for the larger UK banks have steadily fallen back to almost pre-pandemic levels. Although uncertainly around COVID-19 related loan defaults lead to banks provisioning billions for potential losses in the first half of 2020, drastically reducing profits, reported impairments for Q3 were much reduced in some institutions. However, general bank profitability in 2020 and 2021 may be significantly lower than in previous years.

The credit ratings for many UK institutions were downgraded on the back of downgrades to the sovereign rating. Credit conditions more generally though in banks and building societies have tended to be relatively benign, despite the impact of the pandemic.

Looking forward, the potential for bank losses to be greater than expected when government and central bank support starts to be removed remains a risk, suggesting a cautious approach to bank deposits in 2021/22 remains advisable.

Interest rate forecast: The authority's treasury management adviser Arlingclose is forecasting that BoE Bank Rate will remain at 0.1% until at least the first quarter of 2024. The risks to this forecast are judged to be to the downside as the BoE and UK government continue to react to the coronavirus pandemic and the new EU trading arrangements. The BoE extended its asset purchase programme to £895 billion in November while keeping Bank Rate on hold and maintained this position in December. However, further interest rate cuts to zero, or possibly negative, cannot yet be ruled out but this is not part of the Arlingclose central forecast.

Gilt yields are expected to remain very low in the medium-term while short-term yields are likely remain below or at zero until such time as the BoE expressly rules out the chance of negative interest rates or growth/inflation prospects improve. The central case is for 10-year and 20-year to rise to around 0.60% and 0.90% respectively over the time horizon. The risks around the gilt yield forecasts are judged to be broadly balanced between upside and downside risks, but there will almost certainly be short-term volatility due to economic and political uncertainty and events.

A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix A.

For the purpose of setting the budget, it has been assumed that new treasury investments will be made at an average rate of 0.50% and that new long-term loans will be borrowed at an average rate of 2.5%

Local Context

On 15 January the authority held £383m of borrowing and £208m of treasury investments. This is set out in further detail at ***Appendix B.*** Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance sheet summary and forecast

	31.3.20 Actual £m	31.3.21 Estimate £m	31.3.22 Forecast £m	31.3.23 Forecast £m	31.3.24 Forecast £m
Total CFR	**712.411**	**717.801**	**726.193**	**782.777**	**842.700**
Less: Other debt liabilities *	-110.674	-96.373	-84.030	-80.561	-77.428
	601.800	**621.428**	**642.163**	**702.216**	**765.272**
Less: External borrowing **	-302.100	-346.100	-477.200	-641.000	-709.500
Internal (over) borrowing	**299.637**	**275.328**	**164.963**	**61.216**	**55.772**
Less: Usable reserves	-281.000	-255.100	-234.200	-228.400	-249.800
[Less/Plus]: Working capital	-132.800	-132.800	-132.800	-132.800	-132.800
Treasury investments (or New borrowing)	**-114.163**	**-112.572**	**-202.037**	**-299.984**	**-326.828**

* leases and PFI liabilities that form part of the authority's total debt
** shows only loans to which the authority is committed and excludes optional refinancing

The underlying need to borrow or finance from other long term liabilities for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the authority's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the authority expects to comply with this recommendation during 2021/22.

Liability benchmark: To compare the council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as table 1 above, but that cash and investment balances are kept to a minimum level of £10m at each year-end to maintain sufficient liquidity but minimise credit risk.

Table 2: Liability benchmark

	31.3.20 Actual £m	31.3.21 Estimate £m	31.3.22 Forecast £m	31.3.23 Forecast £m	31.3.24 Forecast £m
Total CFR	712.400	717.801	726.193	782.777	842.700
Less: Usable reserves	-281.000	-255.100	-234.200	-228.400	-249.800
Less: Working capital	-132.800	-132.800	-132.800	-132.800	-132.800
Plus: Minimum investments	10.000	10.000	10.000	10.000	10.000
Liability benchmark	**308.600**	**339.901**	**369.193**	**431.577**	**470.100**

Borrowing Strategy

The authority currently holds £361.5million of loans, an increase of £20 million on the previous year, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 1 shows that the authority expects to borrow up £477.2m in 2021/22. The figure of £477.2m includes a provision by the authority to pre-fund future years' requirements, if it is deemed that rates are on the rise and providing this does not exceed the authorised limit for borrowing of£ 536 million.

Objectives: The authority's principal objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the authority's long-term plans change is a secondary objective.

Strategy: The authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead. 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 difference between debt costs and investment earnings where cash is held).

By doing so, the authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal and short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Its output may determine whether the authority borrows additional sums at long-term fixed rates in 2021/22 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

The authority has previously raised the majority of its long-term borrowing from the PWLB but will consider long-term loans from other sources including banks, pensions and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the authority intends to avoid this activity in order to retain its access to PWLB loans.

Alternatively, the authority may arrange forward starting loans, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

In addition, the authority may borrow short-term loans to cover unplanned cash flow shortages.

Sources of borrowing: The approved sources of long-term and short-term borrowing are:

- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- any other UK public sector body
- UK public and private sector pension funds (except your local Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

Other sources of debt finance: In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- Leasing-a contract outlining the terms under which one party agrees to rent a property owned by another party
- Hire purchase-financing where you make monthly payments but do not own until the last payment is made
- Private Finance Initiative –is a procurement method which uses private sector investment to deliver public sector infrastructure
- Sale and leaseback- selling a property you own and occupy and entering a lease arrangement with the purchaser

PWLB : On 25 November 2020, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates; the standard and certainty margins 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. The new margins over gilt yields are as follows: -.

- **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)

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

Municipal Bonds Agency: The UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It issues bonds on the capital markets and lends the proceeds to local authorities. This is a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a guarantee to refund their investment if the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to full council

LOBOs: The authority holds no LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the authority has the option to either accept the new rate or to repay the loan at no additional cost.

Debt rescheduling: The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The authority may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

Treasury Investment Strategy

The authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the authority's treasury investment balance has ranged between £100m and £200 million, and similar levels are expected to be maintained in the forthcoming year.

Objectives: The CIPFA Code requires the authority to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the authority will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

Negative interest rates: The COVID-19 pandemic has increased the risk that the Bank of England will set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. Since investments cannot pay negative income, negative rates will be applied by reducing the value of investments. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

Strategy: Given the increasing risk and very low returns from short-term unsecured bank investments, the authority aims to reduce its temporary debt and majority of the authority's surplus cash currently remains invested in short-term unsecured bank deposits, DMO and other local authorities and money market funds. This diversification will represent a continuation of the strategy

Business models: Under the new IFRS 9 standards, the accounting for certain investments depends on the authority's 'business model' for managing them. The authority aims to achieve value from its 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.

Approved counterparties: The authority may invest its surplus funds with any of the counterparty types in **Appendix** -Approved counterparty List, subject to the limits shown.

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- a financial contract that allows investor to offset their credit risk
- GDP; Net Debt as a Percentage of GDP.
- Sovereign Support Mechanisms / potential support from a well-resourced parent institution.
- Share Price.

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 £100m.

- 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.

Government: Loans to, and bonds and bills issued or guaranteed by, national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in (where burden of failure is shared with creditors) and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Government are deemed to be zero credit risk due to its ability to create additional currency and therefore may be made in unlimited amounts for up to 50 years.

Banks and building societies (unsecured): Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

Registered providers (unsecured): Loans to, and bonds issued or guaranteed by, registered providers of social housing or registered social landlords, formerly known as housing associations. These bodies are regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

Money market funds: Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the authority will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

Strategic pooled funds: Bond, equity and property funds that offer enhanced returns over the longer term but are more volatile in the short term. These allow the authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the authority's investment objectives will be monitored regularly.

Real estate investment trusts: Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.

Net Zero Carbon

As a responsible investor, the council is committed to considering environmental, social, and governance issues, and has a particular interest in taking action to contribute to our strategy of Building a Net Zero Carbon Islington by 2030.

However, investment guidance, both statutory and from professional guidelines (CIPFA), dictates that investment activities must adopt 'SLY' principles – prioritising security, liquidity and yield.

There are already touch points with local authority investing, including the incorporation of Environment, Social and Governance (ESG) metrics into credit rating agency assessments. There are also a small, but growing number of financial institutions and fund managers promoting ESG products. Advisors are looking at ways in which to incorporate these factors into their creditworthiness assessment service that will be shared and adopted. The council will continue to monitor this as the market develops, noting that the lack of consistency and coverage in current market products alongside the treasury management 'SLY' priorities means that it is not currently practicable to formally include ESG targets as part of our treasury management or investment strategies.

It is the councils intention to exploit the treasury strategy to further the aims of the council and it will therefore actively consider appropriate ESG products as they emerge.

Operational bank accounts: The authority may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be kept below 30million per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the authority maintaining operational continuity.

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

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "negative watch") so that it may fall below the approved rating criteria, then only investments that can be withdrawn] will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

Other information on the security of investments: The authority understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the authority's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the authority will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the authority's cash balances, then the surplus will be deposited with the UK Government, or with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

Investment limits: The authority's revenue reserves available to cover investment losses are forecast to be £255 million on 31st March 2021. In order that no more than 10% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £15 million. A group of entities under the same ownership will be treated as a single organisation for limit purposes.

Limits are also placed on fund managers, investments in brokers' nominee accounts and foreign countries. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Liquidity management: The authority uses purpose-built database cash flow forecasting software and excel to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the authority's medium-term financial plan and cash flow forecast.

Treasury Management Indicators

The authority measures and manages its exposures to treasury management risks using the following indicators.

Security: The authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

Credit risk indicator	Target
Portfolio average credit	*A+*

Liquidity: The authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling one month period, without additional borrowing.

Liquidity risk indicator	Target
Total cash available within 1 months	£25m

Interest rate exposures: This indicator is set to control the authority's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates will be:

Interest rate risk indicator	Limit(£m)
Upper limit on one-year revenue impact of a 1% rise in interest rates	£3.430
Upper limit on one-year revenue impact of a 1% fall in interest rates	£1.470

The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.

Maturity structure of borrowing: Local Authorities are exposed to the risk of having to refinance debt at a time in the future when interest rates may be volatile or uncertain. The maturity structure of borrowing indicator is designed to assist Authorities in avoiding large concentrations of debt that has the same maturity structure and would therefore need to be replaced at the same time. The indicator is calculated as the amount of projected borrowing that is maturing in each period expressed as a percentage of total projected borrowing. For each maturity period an upper and lower limit is set. The upper and lower limits on the maturity structure of borrowing will be:

Refinancing rate risk indicator	Upper limit	Lower limit
Under 12 months	100%	12%
12 months and within 24 months	100%	5%
24 months and within 5 years	100%	16%
5 years and within 10 years	100%	7%
10 years and within 20 years	100%	20%
More than 20 years	100%	40%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Principal sums invested for periods longer than a year: The purpose of this indicator is to control the authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

Price risk indicator	2021/22	2022/23	2023/24
Limit on principal invested beyond year end	£30m	£20m	£20m

<u>Related Matters</u>

The CIPFA Code requires the authority to include the following in its treasury management strategy.

Financial derivatives: 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 and callable deposits). The general power of competence in section 1 of the *Localism Act 2011* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

The authority 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 authority 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. Existing derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria, assessed using the appropriate credit rating for derivative exposures. An allowance for credit risk calculated using the methodology in the Treasury Management Practices document will count against the counterparty credit limit and the relevant foreign country limit.

In line with the CIPFA Code, the authority will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.

Housing Revenue Account On 1st April 2012, the authority notionally split each of its existing long-term loans into General Fund and HRA pools. In the future, new long-term loans borrowed will be 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) will be charged/ credited to the respective revenue account. Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. This balance will be measured each month and interest transferred between the General Fund and HRA at the authority's average interest rate on investments.

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.

Markets in Financial Instruments Directive: The authority has opted up to professional client status (versus retail status) with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but with the greater regulatory protections afforded to individuals and small companies (retail clients). Given the size and range of the authority's treasury management activities, the Corporate Director of Resources believes this to be the most appropriate status.

Financial Implications

The budget for investment income in 2021/22 is £0.95 million. Presently the investment portfolio has averaged a balance of £100 million and an interest rate of 0.5% however both of these variables move throughout the year. The budget for debt interest paid in 2021/22 is £12 million, based on an average debt portfolio of £461 million at an average interest rate of 3.7%. If actual levels of investments and borrowing, or actual interest rates, differ from those forecasts, performance against budget will be correspondingly different.

Other Options Considered

The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Corporate Director of Resources having consulted the Executive Member for Finance and Performance, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management

Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

Appendix A – Arlingclose Economic & Interest Rate Forecast – December 2020

Underlying assumptions:

- The medium-term global economic outlook has improved with the distribution of vaccines, but the recent upsurge in coronavirus cases has worsened economic prospects over the short term.
- Restrictive measures and further lockdowns are likely to continue in the UK and Europe until the majority of the population is vaccinated by the second half of 2021. The recovery period will be strong thereafter, but potentially longer than previously envisaged.
- Signs of a slowing UK economic recovery were already evident in UK monthly GDP and PMI data, even before the second lockdown and Tier 4 restrictions. Employment is falling despite an extension to support packages.
- The need to support economic recoveries and use up spare capacity will result in central banks maintaining low interest rates for the medium term.
- Brexit will weigh on UK activity. The combined effect of Brexit and the after-effects of the pandemic will dampen growth relative to peers, maintain spare capacity and limit domestically generated inflation. The Bank of England will therefore maintain loose monetary conditions for the foreseeable future.
- Longer-term yields will also remain depressed, anchored by low central bank policy rates, expectations for potentially even lower rates and insipid longer-term inflation expectations. There is a chance yields may follow a slightly different path in the medium term, depending on investor perceptions of growth and inflation, or the deployment of vaccines.

Forecast:

- Arlingclose expects Bank Rate to remain at the current 0.10% level.
- Our central case for Bank Rate is no change, but further cuts to zero, or perhaps even into negative territory, cannot be completely ruled out, especially with likely emergency action in response to a no-deal Brexit.
- Gilt yields will remain low in the medium term. Shorter term gilt yields are currently negative and will remain around zero or below until either the Bank expressly rules out negative Bank Rate or growth/inflation prospects improve.
- Downside risks remain, and indeed appear heightened, in the near term, as the government reacts to the escalation in infection rates and the Brexit transition period ends.

	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
Official Bank Rate													
Upside risk	0.00	0.00	0.15	0.15	0.15	0.15	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	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
Downside risk	0.30	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
3-month money market r													
Upside risk	0.05	0.05	0.10	0.10	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.10	0.10	0.15	0.15	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
Downside risk	0.30	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
1yr money market rate													
Upside risk	0.05	0.05	0.10	0.10	0.15	0.20	0.40	0.40	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	0.15	0.15	0.25	0.25	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Downside risk	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15
5yr gilt yield													
Upside risk	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.00	0.00	0.05	0.10	0.15	0.20	0.20	0.20	0.25	0.25	0.25	0.25	0.25
Downside risk	0.40	0.45	0.50	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60
10yr gilt yield													
Upside risk	0.30	0.35	0.40	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.25	0.30	0.35	0.35	0.40	0.40	0.45	0.45	0.50	0.55	0.55	0.55	0.60
Downside risk	0.50	0.50	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55
20yr gilt yield													
Upside risk	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.70	0.70	0.75	0.75	0.75	0.80	0.80	0.85	0.85	0.85	0.85	0.90	0.90
Downside risk	0.30	0.30	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40
50yr gilt yield													
Upside risk	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.60	0.60	0.65	0.65	0.65	0.70	0.70	0.75	0.75	0.75	0.75	0.80	0.80
Downside risk	0.30	0.30	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%
PWLB Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

Appendix B – List of Institutions Lent To & Approved Counter Party List 2021/22

List of Institutions Lent to As At 15 January 2021

Class	Type	Counterparty	Outstanding Balance	Profile
Deposit	Fixed	Birmingham City Council	-£5,000,000.00	Maturity
Deposit	Fixed	DMADF (Debt Management Account Deposit Facility)	-£25,000,000.00	Maturity
Deposit	Fixed	DMADF (Debt Management Account Deposit Facility)	-£39,800,000.00	Maturity
Deposit	Fixed	Surrey County Council	-£10,000,000.00	Maturity
Deposit	Fixed	Windsor and Maidenhead Royal Borough Council	-£5,000,000.00	Maturity
Deposit	Fixed	Swale Borough Council	-£5,000,000.00	Maturity
Deposit	Fixed	Wokingham Borough Council	-£10,000,000.00	Maturity
Deposit	Fixed	Kirklees Council	-£5,000,000.00	Maturity
Deposit	Fixed	Kirklees Council	-£5,000,000.00	Maturity
Deposit	Fixed	Kirklees Council	-£5,000,000.00	Maturity
Deposit	Fixed	Swindon Borough Council	-£10,000,000.00	Maturity
Deposit	Fixed	Cherwell District Council	-£5,000,000.00	Maturity
Deposit	Fixed	Eastleigh Borough Council	-£5,000,000.00	Maturity
Deposit	Fixed	Liverpool City Council	-£5,000,000.00	Maturity
Deposit	Fixed	Birmingham City Council	-£10,000,000.00	Maturity
Deposit	Fixed	Gloucester City Council	-£3,700,000.00	Maturity
Deposit	Fixed	Thurrock Borough Council	-£15,000,000.00	Maturity
Deposit	Fixed	Cambridgeshire County Council	-£10,000,000.00	Maturity
Deposit	Fixed	Warrington Borough Council	-£15,000,000.00	Maturity
Deposit	Fixed	London Borough of Croydon	-£5,000,000.00	Maturity
Deposit	Fixed	Liverpool City Council	-£10,000,000.00	Maturity
		Deposits	**-£208,500,000.00**	

Minimum criteria	A+	F1	A1	P-1	A+	A-1								
	Fitch L/T	Fitch S/T	Moodys L/T	Moodys S/T	S & P L/T	S & P S/T	Sovereign Rating - F/M/S&P	5 year CDS	Share Price	Maximum Limit - £	Maximum Term	LBI	Arlingclose Current Advice	Lending at 15/01/2021
UK Banks														
Barclays	A+	F1	A1	P-1	A	A-1	AA-/Aa2/Aau	54	64	30,000,000	36 Months	Council Bankers from Mar 2015 - overnight liquidity only	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	
HSBC	AA-	F1+	Aa3	P-1	A+	A-1	AA-/Aa2/Aau	48	60	30,000,000	36 Months	Limit to 6 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	
Lloyds	A+	F1	A1	P-1	A+	A-1	AA-/Aa2/Aau	42	75	30,000,000	36 Months	Limit to 6 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	
RBS	A+	F1	A1	(P)P-1	A	A-1	AA-/Aa2/Aau	52	58	30,000,000	36 Months	Limit to 6 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	
Santander UK	A+	F1	A1	P-1	A	A-1	AA-/Aa2/AAu/	51	42	30,000,000	36 Months	Limit to 6 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	
Standard Chartered	A+	F1	A1	P-1	A	A-1	AA-/Aa2/Aau	48	32	30,000,000	36 Months	Limit to 6 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	
Ulster Bank Limited	A+	F1	A1	P-1	A	A-1	AA-/Aa2/Aau	52	58					
UK Building Societies														
Coventry	A-	F1	A2	P-1			AA-/Aa2/Aau	N/A	N/A	30,000,000	34 Months	Limit to 6 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	
Leeds	A+	F1	A3	P-2			AA-/Aa2/Aau	N/A	N/A	30,000,000	35 Months	Limit to 6 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	
Nationwide	A+	F1	A1	P-1	A	A-1	AA-/Aa2/Aau	N/A	N/A	30,000,000	36 Months	Limit to 6 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	
Yorkshire	A+	F1	A3	P-2	NR	NR	AA-/Aa2/Aau	N/A	N/A	30,000,000	37 Months	Limit to 6 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	
Non UK Banks														
Australia														
Australia & NZ Banking Group	A+	F1	Aa3	P-1	AA-	A-1+	AAA/Aaa/AAAu	35	N/A	15,000,000	36 Months	Limit to 6 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	
Commonwealth Bank of Australia	A+	F1	Aa3	P-1	AA-	A-1+	AAA/Aaa/AAAu	N/A	N/A	15,000,000	36 Months	Limit to 6 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	
National Australia Bank	A+	F1	Aa3	P-1	AA-	A-1+	AAA/Aaa/AAAu	35	N/A	15,000,000	36 Months	Limit to 6 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	
Westpac Banking Group	AA-	F1+	Aa3	P-1	AA-	A-1+	AAA/Aaa/AAAu	50	N/A	15,000,000	36 Months	Suspended.	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	
Canada														
Bank of Montreal	AA	F1+	Aa2	P-1	A+	A-1	AA+/Aaa/AAA	N/A	N/A	15,000,000	36 Months	Limit to 6 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	
Bank of Nova Scotia	AA	F1+	Aa2	P-1	A+	A-1	AA+/Aaa/AAA	N/A	N/A	15,000,000	36 Months	Limit to 6 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	
Canadian Imperial Bank of Commerce	AA	F1+	Aa2	P-1	A+	A-1	AA+/Aaa/AAA	N/A	N/A	15,000,000	36 Months	Limit to 6 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	
Royal Bank of Canada	AA+	F1+	Aa2	P-1	AA-	A-1+	AA+/Aaa/AAA	N/A	N/A	15,000,000	36 Months	Limit to 6 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	
Toronto-Dominion Bank	AA	F1+	Aaf1	P-1	AA-	A-1+	AA+/Aaa/AAA	N/A	N/A	15,000,000	36 Months	Limit to 6 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	
Finland														
Nordea Bank ABP	AA	F1+	Aa3	P-1	AA-	A-1+	AA+/Aa1/AA+	20	95	15,000,000	36 Months	Limit to 6 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	
Germany														
DZ BANK AG DEUTSCHE ZENTRAL-	AA-	F1+	Aa1	P-1	AA-	A-1+	AAA/Aaa/AAAu	35		15,000,000	36 Months	Limit to 6 Months	Limit to 35 days / %5 Deposits & CDs/ 10% Secured	
Netherlands														
ING Bank	A+	F1	Aa3	P-1	A+	A-1	AAA/Aaa/AAAu	40	N/A	15,000,000	36 Months	Suspended.	Suspended.	
Cooperative Rabobank	AA-	F1+	Aa3	P-1	A+	A-1	AAA/Aaa/AAAu	20	N/A	15,000,000	36 Months	Limit to 6 Months	Limit to 6 Months	
Sweden														
Handelsbanken	AA	F1+	Aa2	P-1	AA-	A-1+	AAA/Aaa/AAAu	25	N/A	15,000,000	36 Months	Suspended.	Suspended.	
Nordea Bank AB	AA-	F1+	Aa3	P-1	A+	A-1	AAA/Aaa/AAAu	25	N/A	15,000,000	36 Months	Suspended.	Limit to 6 Months	
Switzerland														
Credit Suisse	A	F1	A1	P-1	A	A-1	AAA/Aaa/AAAu	90	N/A	15,000,000	36 Months	Suspended.	Suspended.	
Other														
Deutsche Bank Global Liquidity Fund	AA+	F1+	AA2	(P)P-1			AAA/Aaa/AAAu	N/A	N/A	15,000,000	N/A	OK - Limit to 0.5% of Fund Size (approx £25M)	OK - Limit to 0.5% of Fund Size (approx £25M)	
UK Local Authorities							N/A	N/A	N/A	15,000,000(per authority)	24 Months - amended 11/12/18	OK	Limit to 24 Months - WEF 11/12/2018	143,700,000
Supra-National Bonds (EIB)	AAA	F1+	Aaa	P-1	AAA	A-1+	N/A	N/A	N/A	Unlimited	Unlimited	Limit to 6 Months	Limit to 15 years 10% of portfolio	
UK DMADF	AA		Aa2		AA		N/A	N/A	N/A	Unlimited	6 Months	OK	OK	64,800,000
													TOTAL FUNDS INVESTED	**208,500,000**