

## REPORT

<b>SUBJECT:</b>	<b>2021/22 Treasury Management Strategy</b>
<b>DIRECTORATE:</b>	<b>Resources</b>
<b>MEETING:</b>	<b>Council</b>
<b>DATE:</b>	<b>11<sup>th</sup> March 2021</b>
<b>DIVISION/WARDS AFFECTED:</b>	<b>Countywide</b>

### 1. PURPOSE

- 1.1. The purpose of this report is to approve the Treasury Management Strategy including Minimum Revenue Provision policy for the 2021/22 financial year. The report summarises and highlights the key areas relating to the strategy, alongside those areas of key implications and risks resulting from it.

### 2. RECOMMENDATIONS

- 2.1. That Council approves the Treasury Management Strategy 2021/22 (**Appendix 1**) including the:

- 2021/22 Treasury Management policy statement
- 2021/22 Minimum Revenue Provision Policy Statement
- 2021/22 Investment & Borrowing Strategies

- 2.1 To approve the Prudential Indicators supplied in **Appendix 5** and that will be used in the performance monitoring of the treasury function during 2021/22.

- 2.2 That Council agrees that Audit Committee should continue to review the Council's treasury activities on behalf of the Council by receiving & scrutinising the mid-year report and year-end report and also scrutinising the Treasury Policy & Strategy before passing to Council for approval.

### 3. KEY ISSUES

- 3.1. The draft Treasury Management Strategy proposals and recommendations were presented to Audit Committee on the 25th February 2021 as part of its delegated responsibility to scrutinise the draft proposals. Audit Committee debated its content and were asked for its views and responses and the Chair of the committee has been asked to provide feedback to Council.

## Treasury Management Strategy

- 3.2. The treasury management strategy sets out the Council's longer term borrowing requirement and plans, which is driven mainly by the capital programme requirements and the resulting impact on the revenue budget.
- 3.3. It includes how it will manage and invest its surplus cash which also have various targets/limits set as part of prudential indicators and also includes additional guidance of the Welsh Government Investment Guidance and the Minimum Revenue Provision Policy.
- 3.4. The strategy is a requirement of CIPFA's Prudential Code which sets out the requirement to ensure, within the frameworks set, that capital expenditure plans are:
  - **Affordable:** Capital spend and programmes are within sustainable limits. Councils are required to take into account of current and forecast funding available to them and the totality of their capital plans and their costs in assessing affordability.
  - **Prudent:** Councils need to set borrowing limits (called 'operational' and 'authorised limits' – as part of the suite of prudential indicators) which reflect the Councils plan for affordable capital plans and their financing costs. On investing activities, Councils need to consider the balance between security, liquidity and yield which reflects their own risk appetite but which prioritises security and liquidity over yield.
  - **Sustainable:** Council's capital plans and the revenue cost of financing the current and future forecast borrowing/debt taken out for that needs to be sustainable in terms of the Councils overall finances and its impact on that.
- 3.5. The Audit Committee in its role as the Council's delegated body must receive as a minimum a semi-annual report and an annual report after its close on treasury management activities.
- 3.6. Overall responsibility for treasury management remains with the full Council. In effect, that body delegates the execution and administration of treasury management decisions to the Section 151 officer or deputy who will act in accordance with the Treasury management strategy and Treasury management policy statement (**Appendix 1**) and treasury management practices and CIPFA's Standard of Professional Practice on treasury management.
- 3.7. The detailed Treasury strategy for 2021/22 is included at **Appendix 1**. Key points of interest are summarised below.

## Annual Minimum Revenue Provision (MRP) Policy Statement

- 3.8. The annual Minimum Revenue Provision is the mechanism used for spreading the capital expenditure financed by borrowing over the years to which benefit is provided. Regulations state that the authority must calculate for the current financial year an amount of minimum revenue provision which it considers to be prudent. In addition, there is the requirement for an Annual Minimum Revenue Provision Policy Statement to be drafted and submitted to full Council. This is attached in **Appendix 1**.

- 3.9. The Welsh Government issued revised MRP guidance in 2018. This is taken into account within the MRP Policy Statement.

### **Borrowing Strategy**

- 3.10. The current economic environment is unprecedented and very much represents the bottom of the treasury cost curve for an Authority like Monmouthshire who is a net borrower. Despite this, it remains very difficult to currently justify locking into longer term borrowing to provide additional certainty to long term treasury costs and budgets given the immediate negative impact it would have on the revenue budget.
- 3.11. However, the capacity for internal borrowing (where the Council utilises internal resources and cash balances to reduce net borrowing costs) is expected to reduce over the medium to long term as the Council is expected to undertake external borrowing both for the refinancing of maturing loans and to fund increasing capital spend in the existing capital programme. It will remain as much 'internally borrowed' as is possible and increase actual external borrowing only when needed to manage its cash requirements. However, the Council may, where it feels necessary to mitigate the risk of interest rate rises, undertake borrowing early to secure interest rates within agreed revenue budgets. This will be done in line with advice from our Treasury Advisors.

### **Investment Strategy**

- 3.12. Both the CIPFA Code and the WG Guidance require the Authority 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. 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.
- 3.13. Given the increasing risk and very low returns from short-term unsecured bank investments, the Authority will look to increase its diversification into higher yielding asset classes, such as pooled funds, during 2021/22. The Authority continues to hold £10m of investments to meet the requirements of a professional client under the Mifid II regulations (Markets in financial instruments directive) and therefore consideration will be given to investing this balance with a more medium to long term outlook.
- 3.14. The approved counterparty list and limits are shown table 3 of **Appendix 1**.
- 3.15. Following review and advice from our treasury advisors, the investment limits proposed in the 2021/22 treasury strategy (shown in table 3 of **Appendix 1**) have been simplified quite significantly from the 2020/21 strategy. Over time the existing set of limits had become cumbersome and unworkable on a practical level and the revised criteria provide much needed clarity to the comparatively small treasury team making already complex investment decisions on a daily basis.
- 3.16. It is important to note that the counterparty rating limits and investment maturities act as limits and not targets and are further informed by bespoke periodic advice from our treasury advisers as to sustainability and financial robustness of specific counterparties.

## **Other Considerations influencing the strategy**

3.17. The impact on the UK from coronavirus, together with its exit from the European Union and future trading arrangements with the bloc, will remain a major influence on the Authority's treasury management strategy for 2021/22.

- 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.
- Monthly GDP estimates have shown the economy is recovering but remains well below its pre-pandemic peak. Looking ahead, the BoE's November Monetary Policy Report 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.
- The Authority's treasury management adviser Arlingclose is forecasting that BoE Bank Rate will remain at 0.1% until at least the end of 2023. 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 Brexit transition period ends.

## **4. REASONS**

4.1. The Authority is required to produce a Treasury Management Strategy including a Treasury Management Policy Statement and annual investment and borrowing strategies in order to comply with the Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code").

4.2. The Authority is required to produce an MRP policy statement in order to comply with the Local Authorities (Capital Finance and Accounting) (Wales) Regulations, last amended in 2018.

## **5. OPTIONS APPRAISAL**

5.1. Not applicable.

## **6. EVALUATION CRITERIA**

6.1. Not applicable

## **7. RESOURCE IMPLICATIONS**

7.1. In summary, the Treasury Strategy remains very similar to previous years, such that the Council remains a net borrower, and utilises internal resources to reduce net borrowing costs, known as internal borrowing.

7.2. In order to keep the Authority's borrowing costs lower, the external borrowing total is split fairly equally between long and short term recurrent borrowing. The short term borrowing achieves a reduction in cost but causes an increase in interest rate risk. Although interest rates could rise, it is not expected that short term rates over the MTFP window will exceed current long term rates. The Treasury team continues to optimise its loans and investments to reduce the net cost of borrowing while ensuring that security and liquidity levels are maintained at a suitable level and the various risks are properly managed.

- 7.3. The levels of Treasury debt and investments at the 31<sup>st</sup> December 2020 are provided in **Appendix 3**.
- 7.4. The medium-term treasury budgets, contained within the 2021/22 revenue budget proposals to be presented to Council shortly, were constructed in accordance with the strategy documents appended to this report. Consequently, there are no additional resource implications directly arising from this report.
- 7.5. The Council's indicative treasury budgets for the next 4 years are:

	Indicative Base Budget 2021/22	Indicative Base Budget 2022/23	Indicative Base Budget 2023/24	Indicative Base Budget 2024/25
Interest and Investment Income	(131,803)	(211,299)	(211,299)	(211,299)
Interest Payable on external debt	3,651,179	3,963,942	4,027,980	3,848,669
Charges required under Regulation	6,425,898	6,562,013	6,509,187	6,716,279
<b>Total Treasury Budgets</b>	<b>9,945,274</b>	<b>10,314,656</b>	<b>10,325,868</b>	<b>10,353,649</b>
<b>Proportion of Net Revenue budget</b>	<b>6.2%</b>	<b>6.1%</b>	<b>5.8%</b>	<b>5.6%</b>

- 7.6. However, there are some key future financial risks on medium-term treasury budgets concerning:
- The capital medium term financial plan for 2021/22 has been shared with members as part of the capital budget setting process which won't conclude until 11<sup>th</sup> March. Should additions be required that are funded from borrowing, then Treasury figures and consequences on capital financing requirement and external borrowing requirement would need to be updated.
  - The risks associated with rising interest rates as indicated in the Treasury Strategy by the Interest rate risk indicator & limit. Base and short-term interest rates are expected to remain at current low levels in the medium term and the Treasury strategy allows for the use of short term borrowing once investment funds are exhausted to take advantage of these low rates. However, the current and future economic environment is extremely uncertain in light of the UK Government response to the pandemic and the ongoing complexities around Brexit agreements and the ongoing position will need to continue to be closely monitored.
  - The Authority continues to make plans to assess the capital receipts which can be obtained from selling property assets. Without these receipts being available to fund capital expenditure, new capital programmes will have to be funded by additional borrowing.

**8. WELLBEING OF FUTURE GENERATIONS (INCORPORATING EQUALITIES, SUSTAINABILITY, SAFEGUARDING AND CORPORATE PARENTING):**

- 8.1. There are no implications directly arising from the recommendations and decisions highlighted in this report.

**9. CONSULTEES:**

Chief Officer, Resources (Acting Section 151 officer)

Arlingclose – Treasury Management Advisors to Monmouthshire CC

Audit Committee

**10. BACKGROUND PAPERS:**

**Appendix 1** – Treasury Management Strategy Statement 2021/22 including the Treasury Management policy statement, Minimum Revenue Provision policy statement and Investment & Borrowing Strategies

**Appendix 2** – Arlingclose Economic & Interest Rate Forecast

**Appendix 3** - Existing Investment & Debt Portfolio Position

**Appendix 4** - Additional requirements of Welsh Government Investment Guidance

**Appendix 5** – Prudential Indicators

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**TREASURY MANAGEMENT STRATEGY STATEMENT 2021/22**

**1. Treasury Management Policy Statement**

- 1.1. The Council is required by law to have regard to CIPFA's Treasury Management in the Public Services: Code of Practice 2017 (The Code).
- 1.2. Accordingly, the Council will create and maintain, as the cornerstones for effective treasury management:
  - A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities
  - Suitable treasury management practices (TMPs), setting out the manner in which the Council will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.
- 1.3. The revised code allows the Audit Committee to approve the treasury strategy providing the Authority produces a capital strategy, while being clear that overall responsibility remains with full Council. Full Council is required to approve the investment strategy which is currently included in the same document as the treasury strategy and treasury policy and the combined document will continue to be approved by full Council in the current year.
- 1.4. The Council delegates responsibility for the implementation, monitoring and scrutiny of its treasury management policy, strategy and practices to the Audit Committee and for the execution and administration of treasury management decisions to the Section 151 officer or deputy, who will act in accordance with the organisations policy statement and TMPs and CIPFA's Standard of Professional Practice on Treasury Management.
- 1.5. As a minimum, the Audit Committee will receive reports on its treasury management policies, practices and activities including, an annual strategy and plan in advance of the year, a semi-annual report and an annual report after its close.
- 1.6. **Policies and objectives of treasury management activities**
- 1.7. The Council defines its treasury management activities as: "The management of the Council's investments, borrowing and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."
- 1.8. This Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.
- 1.9. This Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the

principles of achieving value for money in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.

1.10. ***Borrowing Strategy:*** The Council's borrowing will be affordable, sustainable and prudent and consideration will be given to the management of interest rate risk, refinancing risk and budgetary risk. The source from which the borrowing is taken and the type of borrowing should allow the Council transparency and control over its debt.

1.11. ***Investment Strategy:*** The Council's primary objective in relation to investments remains the security of capital. The liquidity or accessibility of the Authority's investments followed by the yield earned on investments remain important but are secondary considerations.

## 1.12. **Approach to Risk Management**

1.13. This section identifies the risks that the Council faces as a result of it undertaking treasury management activities.

- Liquidity risk
- Credit (or counterparty) risk
- Interest rate risk
- Inflation rate risk
- Exchange rate risk
- Market risk
- Refinancing risk
- Procedural risk
- Legal and regulatory risk

1.14. The Council manages these down to an acceptable level within the regulatory framework through the consideration and application of its treasury strategy and appropriate monitoring against agreed treasury & prudential indicators and limits.

## 2. **MRP Policy Statement 2020/21**

2.1. Where the Authority finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The Welsh Government's Guidance on Minimum Revenue Provision most recently issued in 2018 places a duty on local authorities to make a prudent provision for debt redemption. Local authorities are required to "have regard" to such Guidance under section 21(1A) of the Local Government Act 2003.

2.2. In line with WG guidance, this annual MRP Policy Statement will be submitted to Council before the start of the financial year it relates to. If it is ever proposed to vary the terms of the original MRP Policy Statement during the year, a revised statement should be submitted to Council.



- 2.3. Authorities are permitted discretion in terms of the charge levied, albeit within certain parameters. A “prudent” period of time for debt repayment is defined as being one which reflects the period over which the associated capital expenditure provides benefits or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.
- 2.4. MRP options recommended in the Guidance include:
- Option 1: Regulatory Method
  - Option 2: CFR Method
  - Option 3: Asset Life Method
  - Option 4: Depreciation Method

*Note: This does not preclude other prudent methods.*

### **MRP in 2021/22:**

- 2.5. Options 1 and 2 can only be used for supported Non-HRA capital expenditure funded from borrowing (i.e. financing costs deemed to be supported through Revenue Support Grant from Welsh Government). Methods of making prudent provision for unsupported Non-HRA capital expenditure include Options 3 and 4 (which may also be used for supported Non-HRA capital expenditure if the Authority chooses).
- 2.6. ***MRP on Supported Borrowing funded Expenditure:*** The Authority’s policy is to apply Option 3, the Asset life method in respect of supported capital expenditure funded from borrowing. The charge will be 2% per annum, equivalent to equal instalments over a 50 year life.
- 2.7. ***MRP on Unsupported Borrowing funded Expenditure:*** The Authority’s policy is to apply Option 3, the Asset life method in respect of unsupported capital expenditure funded from borrowing. The MRP is calculated on an annuity basis within the asset life method, whereby the MRP element increases over time to reflect a consistent charge over life of the assets taking into account the real value of money. The first MRP charge will be in the year after the asset becomes operational. MRP on purchases of freehold land will be charged over 50 years. MRP on expenditure not related to fixed assets but which has been capitalised by regulation or direction will be charged over 20 years. These lives may be reduced if it is prudent to do so because the resultant income stream or useful life to the Authority is shorter.
- 2.8. ***MRP in respect of leases and PFI:*** MRP in respect of leases and Private Finance Initiative schemes brought on Balance Sheet under the CIPFA Accounting Code of Practice will match the annual principal repayment for the associated deferred liability.
- 2.9. For capital expenditure loans to third parties that are repaid in annual or more frequent instalments of principal, the Council may make nil MRP, but will instead apply the capital receipts arising from principal repayments to reduce the capital financing requirement instead. In years where there is no principal repayment, MRP will be charged in accordance with the MRP policy for the assets funded by the loan, including where appropriate, delaying

MRP until the year after the assets become operational. While this is not one of the options in the WG Guidance, it is thought to be a prudent approach since it ensures that the capital expenditure incurred in the loan is fully funded over the life of the assets.

2.10. The 2021/22 budget proposals reflect these positions.

### 3. Treasury Strategy

#### 3.1. Introduction

3.2. 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.

3.3. 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. In addition, the Welsh Government (WG) issued revised Guidance on Local Authority Investments in November 2019 that requires the Authority to approve an investment 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 both the CIPFA Code and the WG Guidance.

3.4. **Revised strategy:** In accordance with the WG Guidance, the Authority will be asked to approve a revised Treasury Management Strategy Statement should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates, in the Authority's capital programme or in the level of its investment balance, or a material loss in the fair value of a non-financial investment identified as part of the year end accounts preparation and audit process.

#### 4. External Context

4.1. **Economic background:** The impact on the UK from coronavirus, together with its exit from the European Union and future trading arrangements with the bloc, will remain a major influence on the Authority's treasury management strategy for 2021/22.

4.2. The Bank of England (BoE) maintained Bank Rate at 0.10% in November 2020 and also extended its Quantitative Easing programme by £150 billion to £895 billion. The Monetary Policy Committee voted unanimously for both, but no mention was made of the potential future use of negative interest rates. Within the latest 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.

- 4.3. UK Consumer Price Inflation (CPI) for September 2020 registered 0.5% year on year, up from 0.2% in the previous month. Core inflation, which excludes the more volatile components, rose to 1.3% from 0.9%. The most recent labour market data for the three months to August 2020 showed the unemployment rate rose to 4.5% while the employment rate fell to 75.6%. 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 August, the headline 3-month average annual growth rate for wages were 0% for total pay and 0.8% for regular pay. In real terms, after adjusting for inflation, total pay growth fell by -0.8% while regular pay was up 0.1%.
- 4.4. GDP growth fell by -19.8% in the second quarter of 2020, a much sharper contraction from -2.0% in the previous three months, with the annual rate falling -21.5% from -1.6%. All sectors fell quarter-on-quarter, with dramatic declines in construction (-35.7%), services (-19.2%) and production (-16.3%), and a more modest fall in agriculture (-5.9%). Monthly GDP estimates have shown the economy is recovering but remains well below its pre-pandemic peak. Looking ahead, the BoE's November Monetary Policy Report 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.
- 4.5. 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 October, the third successive month of deflation. Core inflation registered 0.2% y/y, 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 with further monetary stimulus expected later in 2020.
- 4.6. The US economy contracted at an annualised rate of 31.7% in Q2 2020 and then rebounded by 33.1% in Q3. The Federal Reserve 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.
- 4.7. Former vice-president Joe Biden won the 2020 US presidential election. Mr Biden is making tackling coronavirus his immediate priority and will also be reversing several executive orders signed by his predecessor and take the US back into the Paris climate accord and the World Health Organization.
- 4.8. **Credit outlook:** After spiking in late March as coronavirus became a global pandemic, credit default swap (CDS) 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 is likely to be significantly lower than in previous years.

- 4.9. 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.
- 4.10. 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, as does the UK not achieving a Brexit deal, suggesting a cautious approach to bank deposits in 2021/22 remains advisable.
- 4.11. **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 end of 2023. 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 Brexit transition period ends. The BoE extended its asset purchase programme to £895 billion in November while keeping Bank Rate on hold. 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.
- 4.12. 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 0.5% and 0.75% 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.
- 4.13. A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix 2.

## 5. Local Context

- 5.1. On 31<sup>st</sup> December 2020, the Authority held £171.3m of borrowing and £22.7m of treasury investments. This is set out in further detail at **Appendix 3**. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.
- 5.2. The underlying need to borrow 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.

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

General Fund CFR	189.5	213.8	213.9	226.3	224.0
Less: Other debt liabilities *	(2.4)	(2.4)	(2.4)	(2.4)	(2.4)
<b>Loans CFR</b>	<b>187.0</b>	<b>211.4</b>	<b>211.5</b>	<b>223.9</b>	<b>221.6</b>
Less: External borrowing **	(183.8)	(176.5)	(90.0)	(96.9)	(93.8)
<b>Internal borrowing</b>	<b>3.3</b>	<b>34.9</b>	<b>121.6</b>	<b>127.0</b>	<b>127.8</b>
Less: Usable reserves	(18.5)	(21.8)	(22.0)	(20.6)	(20.4)
[Less/Plus]: Working capital	(9.3)	(13.1)	(13.1)	(13.1)	(13.1)
<b>(Investments) or External borrowing requirement</b>	<b>(24.5)</b>	<b>0.0</b>	<b>86.5</b>	<b>93.3</b>	<b>94.3</b>

\* leases and PFI liabilities that form part of the Authority's total debt

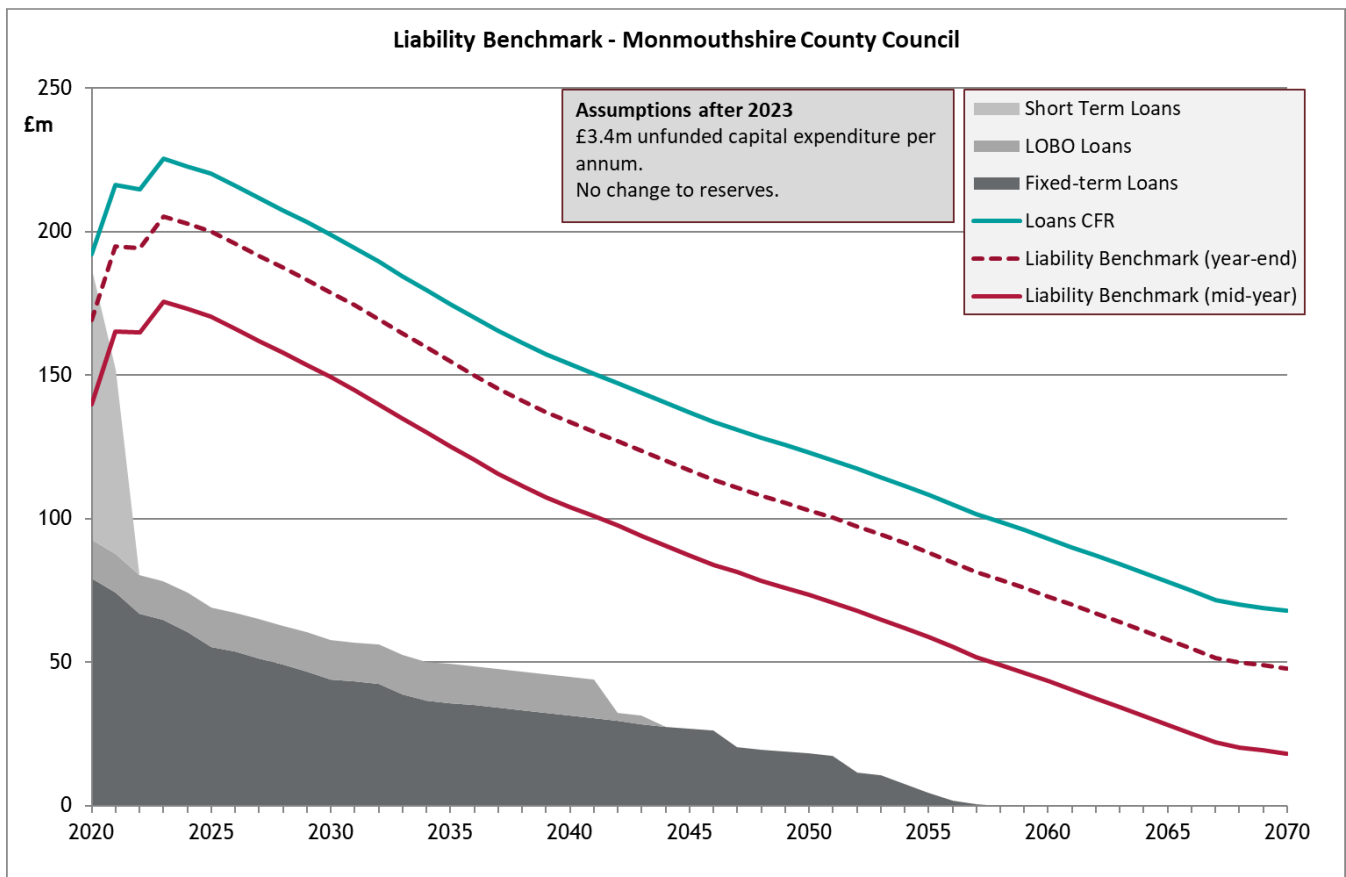
\*\* shows only loans to which the Authority is committed and excludes optional refinancing

- 5.3. The Authority has an increasing CFR due to the capital programme, but minimal investments and will therefore be required to borrow up to £94.3m over the forecast period.
- 5.4. 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.
- 5.5. **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
Loans CFR	187.0	211.4	211.5	223.9	221.6
Less: Usable reserves	-18.5	-21.8	-22.0	-20.6	-20.4
Less: Working capital	-9.3	-13.1	-13.1	-13.1	-13.1
Plus: Preferred investments	10.0	10.0	10.0	10.0	10.0
<b>Liability benchmark</b>	<b>169.2</b>	<b>186.5</b>	<b>186.4</b>	<b>200.2</b>	<b>198.1</b>

- 5.6. Following on from the medium-term forecasts in Table 2 above, the long-term liability benchmark, below assumes capital expenditure funded by borrowing is as the 2021/22 capital MTFP and thereafter £3.4m per year, minimum revenue provision on new capital expenditure is based on asset life as in the MTFP or 25 years and, income, expenditure and reserves held are not increasing or decreasing beyond the MTFP window. This is shown in the chart below:



5.7. Our underlying need to borrow is shown by the top blue line. However, due to the use of reserves and working capital, the Authority is expected to need total external borrowing between the full red lower line and the dotted line above it. As our existing loans portfolio (shown in grey) reduce as loans mature, new loans will therefore be required to fill the gap between the grey area and the red lines over the longer term. The Authority intends to maintain about a 50% level of short term loans which will partly fill this gap, but we will still need to take out longer term loans, mainly to fund the capital investment built into the Capital MTFP.

## 6. Borrowing Strategy

6.1. The Authority currently holds £171.3m of loans, 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 to a total £176.5m in 2021/22. The Authority may however borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £250.9m.

6.2. **Objectives:** The Authority's chief 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.

- 6.3. **Strategy:** Given the significant cuts to public expenditure over recent years and in particular to local government funding, 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. A roughly equal balance of long and short term debt is, at the time of writing, taken as the right balance to maintain sufficient long term stability.
- 6.4. 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 / 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. Arlingclose will assist the Authority with this 'cost of carry' and breakeven analysis. 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.
- 6.5. 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.
- 6.6. 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.
- 6.7. In addition, the Authority may borrow short-term loans to cover unplanned cash flow shortages.
- 6.8. **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 the Greater Gwent Pension Fund)
  - capital market bond investors
  - UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues
  - CSC Foundry Ltd

**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
  - hire purchase
  - Private Finance Initiative
  - sale and leaseback
- 6.9. **Municipal Bonds Agency:** 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 in the event that 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.
- 6.10. **LOBOs:** The Authority holds £13.6m of 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. All of these LOBOs have options during 2021/22, and although the Authority understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The Authority will take the option to repay LOBO loans at no cost if it has the opportunity to do so.
- 6.11. **Short-term and variable rate loans:** These loans leave the Authority exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below.
- 6.12. **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.

## 7. Treasury Investment Strategy

- 7.1. 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 £14.7m and £31.0m million, and similar levels are expected to be maintained in the forthcoming year.
- 7.2. Loans to organisations providing local public services and purchases of investment property are not considered to be treasury investments, and these are therefore covered separately in **Appendix 4**.
- 7.3. **Objectives:** Both the CIPFA Code and the WG Guidance require 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.

- 7.4. **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.
- 7.5. **Strategy:** Given the increasing risk and very low returns from short-term unsecured bank investments, the Authority will look to increase its diversification into higher yielding asset classes, such as pooled funds, during 2021/22. The Authority continues to hold £10m of investments to meet the requirements of a professional client under the Mifid II regulations (Markets in financial instruments directive) and therefore consideration will be given to investing this balance with a more medium to long term outlook.
- 7.6. **Business models:** Under the new IFRS 9 standard, 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.
- 7.7. **Approved counterparties:** The Authority may invest its surplus funds with any of the counterparty types in table 3 below, subject to the limits shown.

*Table 3: Treasury investment counterparties and limits*

Sector	Time limit	Counterparty limit	Sector limit
The UK Government	50 years	Unlimited	Unlimited
Local authorities & other government entities	5 years	£4m	Unlimited
Secured investments *	5 years	£4m	75%
Banks (unsecured) *	13 months	£2m (£3m total for the Councils operational bank)	50%
Building societies (unsecured) *	13 months	£2m	50%
Registered providers (e.g. Housing Associations) (unsecured) *	5 years	£2m	50%
Money market funds *	n/a	£4m	Unlimited

Sector	Time limit	Counterparty limit	Sector limit
Strategic pooled funds	n/a	£5m	£10m
Real estate investment trusts	n/a	£5m	£10m
Other Investments	13 months	£2m	£5m

Credit rating	Banks unsecured	Banks secured	Government	Corporates
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a
AAA	£3m 13 months	£4m 5 years	n/a	£4m 5 years
AA+	£3m 13 months	£4m 5 years	n/a	£4m 5 years
AA	£3m 13 months	£4m 5 years	n/a	£4m 5 years
AA-	£3m 13 months	£4m 3 years	n/a	£4m 3 years
A+	£3m 13 months	£4m 2 years	n/a	£4m 2 years
A	£3m 13 months	£4m 2 years	n/a	£4m 2 years
A-	£3m 13 months	£4m 13 months	n/a	£4m 13 months

This table must be read in conjunction with the notes below

**\* Minimum credit rating:** Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating is no lower than [A-]. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

**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, 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.

**Secured investments:** Investments secured on the borrower's assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments.

**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.

**Other investments:** This category covers treasury investments not listed above, for example unsecured corporate bonds and company loans. Non-bank companies cannot be bailed-in but can become insolvent placing the Authority's investment at risk.

**Operational bank accounts:** The Authority may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to its own banker. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be limited to £3m. 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.

7.8. **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. The credit rating agencies in current use are listed in the Treasury Management Practices document.

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.
- 7.9. 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 on the next working day 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.
- 7.10. **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.
- 7.11. 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.
- 7.12. **Investment limits:** The Authority’s revenue reserves available to cover investment losses are forecast to be £21.8m on 31<sup>st</sup> March 2021. In order that no more than 25% 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 £5m. A group of entities under the same ownership will be treated as a single organisation for limit purposes.
- 7.13. Limits are also placed on fund managers, investments in brokers’ nominee accounts and foreign countries as below. 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.

*Table 4: Additional investment limits*

	Cash limit
Any group of pooled funds under the same management	£5m per manager
Negotiable instruments held in a broker's nominee account	£5m per broker
Foreign countries	£4m per country

7.14. **Liquidity management:** The Authority is a net borrower and does not have an overdraft set up due to the high cost to do so. The treasury team maintain a cashflow model which calculates the net cashflow movements expected per year based on the capital medium term financial plan and informs the timing and amount of any longer term investment and borrowing decisions. The aim of short term liquidity management is to borrow only when the need arises and therefore to minimise net borrowing costs. The amount of investments, with duration over one day, held at any one time is a balance between increased returns and the time taken/dealing costs of identifying and implementing those investments.

## 8. Treasury Management Indicators

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

8.2. **Security:** The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating / credit score 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 rating / score	A- / 5.0

8.3. **Maturity structure of borrowing:** This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing will be:

Refinancing rate risk indicator	Upper limit	Lower limit
Under 12 months	60%	0%
12 months and within 24 months	30%	0%
24 months and within 5 years	30%	0%
5 years and within 10 years	30%	0%
10 years and within 20 years	30%	0%
20 years and within 30 years	30%	0%
30 years and within 40 years	30%	0%
40 years and within 50 years	30%	0%
50 years and above	30%	0%

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.

## 9. Related Matters

- 9.1. The CIPFA Code requires the Authority to include the following in its treasury management strategy:
- 9.2. **Financial derivatives:** In the absence of any explicit legal power to do so, the Authority will not use standalone financial derivatives (such as swaps, forwards, futures and options). Derivatives embedded into loans and investments, including pooled funds and forward starting transactions, may be used, and the risks that they present will be managed in line with the overall treasury risk management strategy.
- 9.3. **Markets in Financial Instruments Directive:** The Authority has opted up to professional client status with its providers of financial services, including advisers, 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. Given the size and range of the Authority's treasury management activities, the Section 151 officer or deputy believes this to be the most appropriate status.
- 9.4. **Government Guidance:** Further matters required by the WG Guidance are included in Appendix 4.

## 10. Financial Implications

- 10.1. The budget for investment income in 2021/22 is £132k, based on an average investment portfolio of £10m. The majority of returns are expected to come from pooled fund investments with returns from Government or secured/unsecured investments expected to be negligible. The budget for debt interest paid in 2021/22 is £3.65m, based on an average debt portfolio of £176.5m at an average interest rate of 2.07%. If actual levels of investments and borrowing, or actual interest rates, differ from those forecast, performance against budget will be correspondingly different.

## 11. Other Options Considered

- 11.1. The WG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Section 151 officer 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
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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

**Arlingclose Economic & Interest Rate Forecast - November 2020****Underlying assumptions:**

- The medium-term global economic outlook remains weak. Second waves of Covid cases have prompted more restrictive measures and further lockdowns in Europe and the UK. This ebb and flow of restrictions on normal activity will continue for the foreseeable future, at least until an effective vaccine is produced and importantly, distributed.
- The global central bank and government responses have been significant and are in many cases on-going, maintaining more stable financial, economic and social conditions than otherwise.
- Although these measures supported a sizeable economic recovery in Q3, the imposition of a second national lockdown in England during November will set growth back and likely lead to a fall in GDP in Q4.
- Signs of a slowing economic recovery were already evident in UK monthly GDP and PMI data, even before the latest restrictions. Despite some extension to fiscal support measures, unemployment is expected to rise when these eventually come to an end in mid-2021.
- This situation will result in central banks maintaining low interest rates for the medium term. In the UK, Brexit is a further complication. Bank Rate is therefore likely to remain at low levels for a very long time, with a distinct possibility of being cut to zero. Money markets continue to price in a chance of negative Bank Rate.
- Longer-term yields will also remain depressed, anchored by low central bank policy rates, expectations for potentially even lower rates and insipid 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, the development of a vaccine or if the UK leaves the EU without a deal.

**Forecast:**

- Arlingclose expects Bank Rate to remain at the current 0.10% level.
- Additional monetary loosening through increased financial asset purchases was delivered as we expected. 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.
- 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 in the near term, as the government continues to react to the escalation in infection rates and the Brexit transition period comes to an end.



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

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 1.80%    PWLB HRA Rate = Gilt yield + 0.80%  
PWLB Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

**Existing Investment & Debt Portfolio Position**

	<b>31st Dec 2020 Actual Portfolio £m</b>	<b>Average Rate %</b>
<b>External borrowing:</b>		
Public Works Loan Board	74.5	3.53
LOBO loans from banks	13.6	4.80
Welsh Government Loans	5.3	0.00
Local authority & other ST loans	77.9	0.15
<b>Total external borrowing</b>	<b>171.3</b>	<b>1.98</b>
<b>Treasury investments:</b>		
Banks & building societies (unsecured)	4.0	0.00
Government (incl. local authorities)	10.2	0.00
Money Market Funds	5.5	0.01
Strategic pooled funds	3.0	4.00
<b>Total treasury investments</b>	<b>22.7</b>	<b>0.53</b>
<b>Net debt</b>	<b>148.6</b>	

**Additional requirements of Welsh Government Investment Guidance**

The Welsh Government (WG) published revised Investment Guidance in November 2019 which places additional reporting requirements upon local authorities that are not integral to this Authority's treasury management processes. The guidance also covers investments that are not part of treasury management, for example investment property and loans to local organisations.

**Contribution:** The Authority's investments contribute to its service delivery objectives and/or to promote wellbeing as follows:

- treasury management investments support effective treasury management activities,
- loans to local organisations provide financial support to those organisations to enable them to deliver local public services that would otherwise be provided directly by the Authority, and
- investment property provides a net financial surplus that is reinvested into local public services and supports economic regeneration.

**Climate change:** The Authority's investment decisions consider long-term climate risks to support a low carbon economy in line with its declaration of a Climate Emergency in 2019. The Authority's aim is to make the county of Monmouthshire zero carbon by 2030 and will revise the Corporate Plan, Well-being Plan, Local Development Plan and other relevant plans and policies in support of this. It will call on the Welsh Government and the UK Government to provide the necessary powers, resources and technical support to successfully meet the 2030 target.

**Specified investments:** The WG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement unless the counterparty is a local authority,
- 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".

The Authority defines "high credit quality" organisations and securities as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of [A-] or higher.

**Loans:** The WG Guidance defines a loan as a written or oral agreement where the authority temporarily transfers cash to a third party, joint venture, subsidiary or associate who agrees a return according to the terms and conditions of receiving the loan, except where the third party is another local authority.

A local authority may choose to make loans & other investments in local enterprises, local charities, wholly owned companies and joint ventures where relevant to Council functions and to promote local economic growth.

The Authority uses an allowed ‘expected credit loss’ model for loans and receivables as set out in *International Financial Reporting Standard 9 Financial Instruments* as adopted by proper practices to measure the credit risk of its loan portfolio. Appropriate consideration is given to state aid rules and competition law. The Authority has appropriate credit control arrangements to recover overdue repayments in place.

**Non-specified investments:** Any financial investment not meeting the definition of a specified investment or a loan is classed as non-specified. Given the wide definition of a loan, this category only applies to units in pooled funds and shares in companies.

**Non-financial investments:** This category covers non-financial assets held primarily or partially to generate a profit, primarily investment property. Security is determined by comparing each asset’s purchase price to its fair value using the model in International Accounting Standard 40: Investment Property as adapted by proper practices. The Authority’s current Investment Property portfolio is divided into long held Investment Properties such as County Farms and the three more recently acquired commercial Investment Properties which support economic regeneration.

The total of the Authorities usable reserves forecast at 31<sup>st</sup> March 2021 is £21.8m. This represents 62% of the value of the Authorities Commercial Investment Properties acquired to date. Due to the due diligence process undertaken before Commercial Investments are entered into and the forecast income over the lifetime of the assets, these investments are considered to be prudent by the Authority.

**Liquidity:** The Authority’s liquidity management has been detailed in the main Treasury report with regard to treasury activities. Before supporting local entities or placing a commercial investment the impact on liquidity is fully addressed, most commonly by taking out loans of an appropriate maturity to ensure funds are available for the life of the activity. £40,000 of seed funding was placed with SRS Ltd in 2011/12 with the intention of it remaining there for the long term to support that entity.

Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice and can take a considerable period to sell in certain market conditions. To ensure that the invested funds can be accessed when they are needed, for example to repay capital borrowed, the Authority will follow its Investment strategy for Commercial assets which ensures that any borrowed capital will be repaid with annual income earned from the investment or that an exit strategy identified during the due diligence will be followed.

**Yield (net profit):** The Authority utilises its profit generating investment activity to achieve a balanced revenue budget. Table 1 below details the proportion of treasury & property rental income to the net revenue budget and therefore its contribution to meeting the costs of delivery of the Authorities primary functions. Any Authority wide shortfall, including shortfalls resulting from lower than budgeted returns from Investments, will be addressed as part of that process to bring the Authority’s outturn position back to a balanced position.

*Table 1: Proportionality of Investments*

	<b>2020/21 Forecast</b>	<b>2021/22 Budget</b>	<b>2022/23 Budget</b>	<b>2023/24 Budget</b>
Net Revenue Budget	155.1	161.5	168.9	177.6

Investment income	3.3	3.3	3.3	3.3
Proportion	2.1%	2.1%	2.0%	1.9%

**Investment advisers:** The Authority has appointed Arlingclose Limited as treasury management advisers and has used Alder King as advisers for the last 2 Commercial investment Property Acquisitions. The quality of these services is controlled by the Internal Estates team and also the Investment Committee appointed to oversee the Commercial Investments.

**Borrowing in advance of need:** Welsh Government guidance is that local authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed. The Authority, after having regard to the provisions in this guidance has entered into its commercial investments utilising Local Authority investment powers, which allow for the prudent management of its financial affairs where carried out reasonably and in accordance with an authority's primary function to serve the public. Returns from commercial investments help to ensure there are sufficient funds to continue to provide public services and promote economic regeneration.

**Capacity and skills:** The Section 151 officer is responsible for ensuring that those elected members and statutory officers involved in the investment decision making process have appropriate capacity, skills and information to enable them to:

1. take informed decisions as to whether to enter into a specific investment;
2. assess individual investments in the context of the strategic objectives and risk profile of the local authority; and
3. understand how the quantum of these decisions have changed the overall risk exposure of the local authority.

The Audit Committee has a delegated responsibility to scrutinise the treasury management activity of the Authority, which ensures that elected members have the necessary opportunity to assess whether officers are operating within the boundaries of both the prudential framework and the internal boundaries approved within the TMSS. The Audit Committee is provided with training by the Authority's Treasury Management advisers periodically and have been presented with a questionnaire to assess further training requirements

**Commercial deals:** The investment committee is responsible for ensuring that those tasked with negotiating commercial deals have the appropriate skills and access to information to allow them to operate with regard to the principles of the prudential framework and regulatory regime within which the Authority operates.

**Prudential Indicators**

Capital Expenditure £m	2020/21 Forecast	2021/22 Budget	2022/23 Budget	2023/24 Budget	2024/25 Budget
Capital Fund Services	61.2	25.0	24.3	9.0	9.2

Capital Financing £m	2020/21 Forecast	2021/22 Budget	2022/23 Budget	2023/24 Budget	2024/25 Budget
External Sources (Grants & S106 Contributions)	25.9	15.6	2.4	2.4	2.5
Own Resources (Capital receipt and reserves)	5.1	2.9	2.9	1.2	1.2
Borrowing & other Debt	30.2	6.5	19.0	5.4	5.5
<b>Total</b>	<b>61.2</b>	<b>25.0</b>	<b>24.3</b>	<b>9.0</b>	<b>9.2</b>

Gross Debt Forecast compared to CFR £m	2020/21 Forecast	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Debt (Inc. PFI, leases, right of use assets)	176.5	168.5	175.4	172.3	164.3
Capital Financing Requirement (Total)	189.4	213.9	226.3	225.2	224.0

<b>Authorised &amp; Operational Borrowing Limits</b>	2020/21 Forecast	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Authorised limit - borrowing	247.0	246.5	259.8	258.7	257.5
Operational boundary - PFI, leases & right of use assets	4.4	4.4	4.4	4.4	4.4
<b>Authorised Limit - total external debt</b>	<b>251.5</b>	<b>250.9</b>	<b>264.2</b>	<b>263.1</b>	<b>261.9</b>
Operational Boundary - borrowing	216.8	216.3	229.6	228.5	227.3
Operational Boundary - PFI, leases & right of use assets	2.9	2.9	2.9	2.9	2.9
<b>Operational Boundary - total external debt</b>	<b>219.8</b>	<b>219.2</b>	<b>232.5</b>	<b>231.4</b>	<b>230.2</b>

Proportion of Financing Costs to net revenue stream	2020/21 Forecast	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Interest £m	4.0	3.5	3.7	3.8	3.6
MRP £m	6.1	6.4	6.6	6.5	6.7
<b>Total Financing costs £m</b>	<b>10.1</b>	<b>9.9</b>	<b>10.3</b>	<b>10.3</b>	<b>10.3</b>
Net Revenue Stream (£m)	155.1	161.5	168.9	177.6	185.0
<b>Proportion of net revenue stream %</b>	<b>6.54%</b>	<b>6.15%</b>	<b>6.08%</b>	<b>5.80%</b>	<b>5.58%</b>