AUDIT COMMITTEE – 29 JANUARY 2021

TREASURY MANAGEMENT STRATEGY REPORT 2021/22

1. INTRODUCTION

1.1. Treasury management is the management of the Council's cash flows, borrowing and investments, and the associated risks. The Council has borrowed and invested 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 Council's prudent financial management.

1.2. Treasury risk management at the Council is conducted within the framework of the CIPFA Code which requires the Council to approve a Treasury Management Strategy Statement (TMSS) before the start of each financial year. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

1.3. Investments held for service purposes or for commercial profit are considered in a different report, the Investment Strategy.

2. POLICIES AND APPROVALS REQUIRED

2.1. Treasury Management Strategy Statement

The Treasury Management Strategy Statement sets out how the Council's treasury service will support the capital expenditure and financing decisions taken over the three year period from 2021/22 to 2023/24. The day to day treasury management function and the limitations on activity through treasury indicators are also set out in the statement.

This report has been prepared prior to the adoption of the Capital Programme for 2021/22 and subsequent years. Therefore, the target indicators may be subject to minor variation. These indicators are targets only and minor adjustments will not be reported.

Any adjustments to the treasury management limits will be reported.

2.2. Treasury Management Investment Strategy

Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in Public Services: Code of Practice 2017 Edition (the CIPFA Code). This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

The Treasury Management investment strategy sets out the Council's criteria for choosing investment counterparties and limiting exposure to the risk of loss.

This strategy is shown in Annex A in Section 5.

The above policies and parameters provide an approved framework within which officers undertake the day to day treasury activities.

This strategy aims to strike a balance between allowing for current investment levels to continue, whilst also considering the Council's intention to directly invest in both commercial and residential property.

3. ENVIRONMENTAL IMPLICATIONS

3.1. There are no environment implications arising from this report.

4. CRIME AND DISORDER IMPLICATIONS

4.1. There are no crime and disorder implications arising from this report.

5. RECOMMENDATIONS

The Audit Committee is recommended to request Council to approve the key element of this report:

5.1. The Treasury Management Strategy 2021/22 to 2023/24 including the Annual Treasury Management Investment Strategy for 2021/22 (and the remainder for 2020/21) and the Treasury Indicators contained within Annex A.

5.2. That authority is delegated to the Section 151 Officer, who in turn delegates to Hampshire County Council's Director of Corporate Resources, as agreed in the Service Level Agreement, to manage all Council investments (other than the high yield investment portfolio) and borrowing according Treasury Management Strategy Statement as appropriate.

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2. EXTERNAL CONTEXT

2.1. The following paragraphs explain the economic and financial background against which the TMSS is being set.

2.2. Economic background

The impact of the coronavirus pandemic and the UK's exit from the European Union will continue to be a major influence on the Council's treasury management strategy for 2021/22.

The Bank of England's (BoE) Monetary Policy Committee (MPC) met in December 2020 and voted unanimously to hold Bank Rate at 0.10% and to maintain its Quantitative Easing asset purchase programme at £895m. The MPC identified that the successful trialling of some Covid-19 vaccines was likely to reduce the downside risks to the economic outlook, but that economic activity had been affected by the increase in Covid-19 cases and reimposition of restrictions resulting in an unusually uncertain outlook for the economy, an outlook that will have been further affected by the subsequent national lockdown in January 2021.

Gross Domestic Product (GDP) grew by 16.0% in Quarter 3 after suffering a fall of 18.8% in the previous quarter, reflecting the easing of restrictions throughout the summer of 2020, although this had already slowed to 1.1% in September and 0.4% in October, leaving it 8% below its level in Quarter 4 of 2019.

UK Consumer Price Inflation (CPI) for November 2020 registered 0.3% year on year, down from 0.7% in the previous month and well below the BoE's target of 2%.

The most recent labour market data for the three months to October 2020 showed the unemployment rate was 4.9%, up 0.7% on the previous quarter. The government's employment support schemes may limit near term rises in unemployment, but the BoE predicts a substantial further increase is still likely. The employment rate fell to 72.5% in October and the 3-month average annual growth rate for wages was 2.1% for regular pay in real terms.

2.3. Credit outlook

After spiking in late March 2020 due to the onset of the global pandemic, credit default swap (CDS) prices for the larger UK banks have steadily fallen back to almost pre-pandemic levels. Bank profitability in 2020 is likely to be significantly lower than in previous years as a result of significant provisions for potential losses resulting from the pandemic.

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, there remains the potential risk for bank losses to be greater than expected when government and central bank support starts to be removed and Arlingclose therefore advises a cautious approach to bank deposits in 2021/22.

2.4. Interest rate forecast

The Council's treasury management adviser, Arlingclose, is forecasting that BoE Bank Rate will remain at 0.1% until at least the end of 2023. Downside risks remain, however, and may be heightened in the short term as the UK reacts to the escalation in coronavirus infection rates and the end of the Brexit transition period, therefore further cuts to 0% or even into negative territory cannot be completely ruled out.

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

3. BALANCE SHEET SUMMARY AND FORECAST

3.1. On 31 December 2020, the Council held £131.1m of borrowing and £78.2m of 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.

Table 1: Balance Sheet Summary and Forecast	31/03/20 Actual £m	31/03/21 Estimate £m	31/03/22 Forecast £m	31/03/23 Forecast £m	31/03/24 Forecast £m
General Fund CFR	7.8	10.9	21.8	32.9	33.6
Housing Revenue Account CFR	1.9	5.4	10.4	22.0	33.4
HRA Settlement	130.4	126.3	122.2	118.1	114.0
Total CFR	**140.1**	**142.6**	**154.4**	**173.0**	**181.0**
Less: External borrowing *	(131.2)	(126.9)	(122.6)	(118.3)	(114.0)
Internal (over) borrowing	**8.9**	**15.7**	**31.8**	**54.7**	**67.0**
Less: GF Usable reserves	(30.3)	(30.8)	(21.8)	(19.3)	(19.6)
Less: HRA Usable reserves	(17.4)	(16.8)	(14.3)	(12.6)	(11.0)
Less: Working capital	(17.7)	(17.7)	(17.7)	(17.7)	(17.7)
Resources for investments	**(65.4)**	**(65.3)**	**(53.8)**	**(49.6)**	**(48.3)**
New borrowing (or investments)	**(56.5)**	**(49.6)**	**(22.0)**	**5.1**	**18.7**

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

3.2. 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.

3.3. The General Fund CFR is showing an increase over the period as the Council looks to roll out its commercial and residential investment strategies. The HRA CFR is also increasing as the Council looks to deliver the accelerated housing programme as per the Housing Strategy to 2026. Table 1 demonstrates that the Council will be internally borrowed beyond the resources available for investment, at this point, an external borrowing position potentially sets in. At the appropriate time, the Council will consult with its treasury advisors on how best to service its borrowing requirements, including the possibility of renewing maturing loans on the HRA.

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

4. BORROWING STRATEGY

4.1. The Council currently holds £131.1m of loans, a decrease of £4.4m on the previous year, predominantly as a result of the HRA refinancing in 2012. The balance sheet forecast in Table 1 shows that the Council does not expect to need to borrow in 2021/22. The Council may however borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £206.3m.

4.2. Objectives

The Council'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 Council's long-term plans change is a secondary objective.

4.3. Strategy

Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, if the Council does need to borrow, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

By internally borrowing, the Council 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. Arlingclose will assist the Council with this 'cost of carry' and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2021/22 with a view to keeping future costs low, even if this causes additional cost in the short-term.

The Council has previously raised all of its long-term borrowing from the Public Works Loan Board (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 Council intends to avoid this activity in order to retain its access to PWLB loans.

Alternatively, the Council may also arrange forward starting loans during 2021/22, 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 Council may borrow short-term loans (normally for up to one month) to cover unplanned cash flow shortages.

4.4. 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 Hampshire Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

4.5. 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

4.6. Short-term and variable rate loans

These loans leave the Council exposed to the risk of short-term interest rate rises, which is monitored through the indicator on interest rate exposure in the treasury management indicators below.

4.7. 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 Council 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.

5. TREASURY INVESTMENT STRATEGY

5.1. The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council's treasury investment balance has ranged between £57.5m and £126.4m, and balances are expected to reduce over the forthcoming year due to internal borrowing in relation to the capital programme.

5.2. Objectives

The CIPFA Code requires the Council 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 Council'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.

5.3. 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, and in some instances negative interest rates are already being seen. 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.

5.4. Strategy

Given the increasing risk and very low returns from short-term unsecured bank investments, the Council aims to continue hold investments that provide diversification through greater security and/or higher yielding asset classes. This is especially the case for the estimated funds that are available for longer-term investment.

At 31 December 2020 approximately 62% of the Council's surplus cash was invested so that it is not subject to bail-in risk, as it was invested in local authorities, pooled property, equity and multi-asset funds, registered providers, secured bank bonds and with the Debt Management Office. Of the 38% of cash that was subject to bail-in risk, 69% was held in overnight money market funds and cash plus funds which are subject to a reduced risk of bail-in, and 10% was held in very short term notice accounts providing a comparatively favourable rate of interest in exchange for a short notice period within the 35-day maximum recommended by Arlingclose. The remaining 21% of cash subject to bail-in risk was held in overnight bank call accounts for liquidity purposes.

Further detail is provided at Appendix B and this diversification represents a continuation of the strategy adopted in 2015/16.

Under the new IFRS 9 standard, the accounting for certain investments depends on the 'business model' for managing them. The Council aims to achieve value from its internally managed treasury investments through 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.

The Council also invests in pooled property, equity and multi-asset funds, which allow diversification into asset classes other than cash without the need to own and manage the underlying investments. The funds operate on a variable net asset value (VNAV) basis and offer diversification of investment risk, coupled with the services of a professional fund manager; they also offer the potential for enhanced returns over the longer term but are likely to be more volatile in the short-term. All of the Council's pooled fund investments are in the funds' distributing share classes which pay out the income generated.

Table 2 shows the market value of the Council's investments in pooled funds held at 31 December 2020, with valuations continuing to be impacted by the ongoing volatility in markets as a result of the coronavirus pandemic.

Table 2: High yield investments capital value	Principal invested £m	Market value 31/12/2020 £m	Capital yield in 2020 %
Pooled Property Funds	7.6	7.2	(4.9)
Pooled Equity Funds	3.0	2.9	(4.4)
Pooled Multi Asset Funds	3.0	3.0	(1.6)
Total	**13.6**	**13.1**	**(4.0)**

Money can usually be redeemed from pooled funds at short notice however these investments must be viewed as long-term investments from core balances not required for immediate liquidity requirements. This ensures that even in times of market volatility, the Council will not be a forced seller and will not crystalise capital losses.

Changes to International Financial Reporting Standards mean that even if investments are not sold, unrealised capital gains and losses on these investments need to be reflected in the revenue account on an annual basis. There is, however, currently a statutory override in place for local authorities that exempts them from complying with this requirement for the next 3 years meaning that any changes in value continue to be accounted for through an unusable reserve.

The Council's long-term investments in pooled funds are expected to bring benefits to the revenue budget through higher yields than can be achieved on cash investments. As shown in Table 3, without the allocation to pooled funds the weighted average return of the Council's cash investments would have been 0.29%. By investing in pooled funds, the weighted average return at 31 December 2020 was

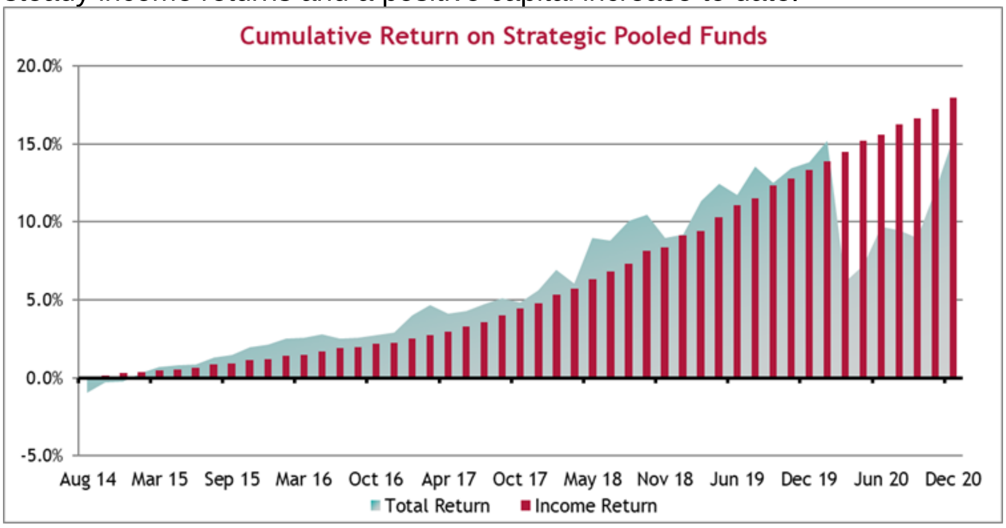
0.91%, meaning the allocation to higher yielding investments has added 0.62% to the average interest rate earned by the remainder of the portfolio.

This benefit to the revenue budget is demonstrated in Table 3, using cash balances and average returns at 31 December 2020. It should be noted however that this is a snapshot at a particular point in time and balances and returns do not remain constant over the course of a year. The actual returns will form part of the outturn report at the conclusion of the financial year.

Table 3: Estimated annual income returns	Cash balance at 31/12/2020 £m	Weighted average return %	Estimated annual income return £m
Short-term and long-term cash investments	64.6	0.29	0.19
Investments targeting higher yields	13.6	3.26	0.44
Total	**78.2**	**0.91**	**0.63**

The performance of these investments and their suitability in meeting the Council's objectives are monitored regularly and discussed with Arlingclose.

The cumulative total return from the Council's investments in pooled equity, property and multi-asset funds since purchase is shown in the graph below. This highlights that despite volatility in the capital value of the funds over 2020, these pooled funds have delivered strong and steady income returns and a positive capital increase to date.



5.5. Investment limits

The maximum that will be lent to any one organisation (other than the UK Government) will be £10 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 as shown in Table 4.

Table 4: Investment limits	Cash limit
Any single organisation, except the UK Central Government	£10m each
UK Central Government	Unlimited
Any group of pooled funds under the same management	£25m per manager

5.6. Approved counterparties

The Council may invest its surplus funds with any of the counterparty types in Table 5, subject to the limits shown.

Table 5: Sector and counterparty limits			
Sector	**Time limit**	**Counterparty limit**	**Sector limit**
The UK Government	30 years	Unlimited	n/a
Local authorities & other government entities	25 years	£10m	Unlimited
Secured investments *	25 years	£10m	Unlimited
Banks (unsecured) *	13 months	£5m	Unlimited
Building societies (unsecured) *	13 months	£5m	£10m
Registered providers	5 years	£5m	£10m
Money market funds *	n/a	£10m	Unlimited
Strategic pooled funds	n/a	£10m	£50m
Real estate investment trusts	n/a	£5m	£10m
Other investments *	5 years	£5m	£10m

This table must be read in conjunction with the notes below

5.7. * 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 known factors including external advice will be taken into account.

For entities without published credit ratings, investments may be made where external advice indicates the entity to be of similar credit quality.

5.8. Government

Loans, 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 30 years.

5.9. 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.

5.10. 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.

5.11. Registered providers (unsecured)

Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and 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.

5.12. 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 Council will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

5.13. Strategic pooled funds

Shares or units in diversified investment vehicles consisting of bond, equity and property investments. These funds offer enhanced returns over the longer term but are more volatile in the short term and allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. This sector also includes cash plus funds which are also a type of pooled fund, but are used for short-term funds, with a lower risk appetite. Because strategic pooled funds have no defined maturity date, but are available for withdrawal after a notice period; their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.

5.14. Real estate investment trusts (REITs)

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.

5.15. 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 Council's investment at risk.

5.16. Operational bank accounts

The Council may incur operational exposures, for example though current accounts, 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 low. The Council's operational bank account is with Lloyds and aims to keep the overnight balances held in current accounts as positive, and as close to £0 as possible. 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 Council maintaining operational continuity.

5.17. Risk assessment and credit ratings

Credit ratings are obtained and monitored by the Council'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 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.

5.18. Other information on the security of investments

The Council 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 and reports in the quality financial press and analysis and advice from the Council'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 Council 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 Council's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will likely lead to investment returns falling but will protect the principal sum invested.

5.19. Liquidity management

The Council has due regard for its future cash flows when determining the maximum period for which funds may prudently be committed. Historic cash flows are analysed in addition to significant future cash movements, such as payroll, grant income and council tax precept. Limits on long-term investments are set by reference to the Council's medium term financial position (summarised in Table 1) and forecast short-term balances.

The Council will spread its liquid cash over at least four providers (e.g. bank accounts and money market funds) to ensure that access to cash is maintained in the event of operational difficulties at any one provider, except in cases of extreme market stress whereby the Council will be able to invest all of its liquid cash in one provider only, being the Debt Management Office.

6. TREASURY MANAGEMENT INDICATORS

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

6.2. Interest rate exposures

The following indicator shows the sensitivity of the Council's current investments and borrowing to a change in interest rates. Fixed rate investments maturing during the year are assumed to be variable for the remainder of the year.

Table 6: Interest rate risk indicator	31 December 2020 £m	Impact of +/-1% interest rate change £m
Sums subject to variable interest rates		
Investment	78.2	+/-0.8
Borrowing	(0.0)	+/-0.0

6.3. Maturity structure of borrowing

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

Table 7: Refinancing rate risk indicator	Upper	Lower
Under 12 months	25%	0%
12 months and within 24 months	25%	0%
24 months and within 5 years	25%	0%
5 years and within 10 years	25%	0%
10 years and above	100%	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.

6.4. Principal sums invested for periods longer than a year

The purpose of this indicator is to control the Council'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:

Table 8: Price risk indicator	2021/22	2022/23	2023/24
Limit on principal invested beyond a year	£40m	£30m	£25m

7. RELATED MATTERS

7.1. The CIPFA Code requires the Council to include the following in its TMSS.

7.2. 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 Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, 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 Council will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.

7.3. Housing Revenue Account

On 1st April 2012, the Council 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 average % Local Authority 7 day rate.

7.4. Markets in Financial Instruments Directive

The Council has opted up to professional client status with its providers of financial services, including advisers, 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 Council's treasury management activities, the s151 Officer believes this is the most appropriate status.

7.5. Financial Implications

The budget for investment income in 2021/22 is £0.515m, based on an average investment portfolio of £69m at an interest rate of 0.75%. The budget for debt interest paid in 2021/22 is £4.162m, based on an average debt portfolio of £124m at an average interest rate of 3.36%. If actual levels of investments and borrowing, or actual interest rates, differ from those forecast, performance against budget will be correspondingly different.

Where investment income exceeds budget, e.g. from higher risk investments including pooled funds, or debt interest paid falls below budget, e.g. from cheap short-term borrowing, then up to 50% of the revenue savings will be transferred to a treasury management reserve to cover the risk of capital losses or higher interest rates payable in future years.

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.
- 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 – Existing Investment & Debt Portfolio Position

Investment Position (Treasury Investments)	30/09/2020 Balance £m	Movement £m	31/12/2020 Balance £m	31/12/2020 Rate %	31/12/2020 WAM* years
Short term Investments					
Banks and Building Societies:					
- Unsecured	2.9	0.5	9.4	0.06	0.0
Money Market Funds	37.9	(19.2)	18.7	0.01	0.0
Local Authorities	15.0	(0.5)	14.5	0.45	0.2
Debt Management Office	-	13.0	13.0	0.01	0.1
Registered Providers	4.0	-	4.0	1.93	0.2
Cash Plus Funds	2.0	-	2.0	1.23	0.0
	67.8	**(6.2)**	**61.6**	**0.28**	**0.1**
Long term investments					
Banks and Building Societies:					
- Secured	3.0	-	3.0	0.47	2.1
	3.0	**-**	**3.0**	**0.47**	**2.1**
High yield investments					
Pooled Property Funds**	7.6	-	7.6	3.88	N/A
Pooled Equity Funds**	3.0	-	3.0	4.11	N/A
Pooled Multi-Asset Funds**	3.0	-	3.0	3.68	N/A
	13.6	**-**	**13.6**	**3.26**	**N/A**
TOTAL INVESTMENTS	**84.4**	**(6.2)**	**78.2**	**0.91**	**0.2**

* Weighted average maturity

** The rates provided for pooled fund investments are reflective of the average dividend return over the last 12 months.

Treasury Management Position	31/12/2020 Balance £m	31/12/2020 Rate %
External Borrowing		
PWLB	(131.1)	(3.25)
Investments		
Total Investments	78.2	0.91
Net Debt	**(52.9)**	