Report to Audit and Governance Committee

Date: 25th January 2022

Title: Treasury Management Strategy 2022/23

Relevant councillor(s): Cllr John Chilver, Cabinet Member for Finance, Resources, Property and Assets and Cllr Timothy Butcher, Deputy Cabinet Member for Finance, Resources, Property and Assets

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Recommendations: The Audit and Governance Committee are asked to recommend the Council's Treasury Management Strategy Statement (TMSS) for 2022/23 to Council to agree at its meeting on 23rd February 2022.

The Audit and Governance Committee are asked to recommend the operational boundary for external borrowing, the authorised limit for external borrowing, the maturity structure of borrowing and the upper limit for principal sums invested for longer than 365 days to Council to agree at its meeting on 23rd February 2022.

Executive summary

1.1 The Council is required to approve a treasury management strategy statement before the start of each financial year. The table below is a summary of the Council's treasury position on 31st March 2021 and 31st December 2021.

31st March 2021 £m	%	Treasury Portfolio	31st December 2021 £m	%
Treasury Investments				
0.00	0%	Banks & Building Societies	10.00	5%
68.85	48%	Local Authorities (invested less than 364 days)	103.00	50%
29.17	20%	Money Market Funds	62.36	30%
15.35	11%	UK Government	0.00	0%
10.00	7%	Local Authorities (invested longer than 364 days)	10.00	5%
20.00	14%	Property Fund	20.00	10%
143.37	**100%**	**Total Treasury Investments**	**205.36**	**100%**
External Borrowing				
-286.46	91%	PWLB[1]	-280.59	90%
-30.00	9%	LOBOs[2]	-30.00	10%
-316.46	**100%**	**Total External Borrowing**	**-310.59**	**100%**
Net treasury investments / (Borrowing)				
-173.09		**Net Treasury Investments /(Borrowing)**	**-105.23**	

[1] PWLB Public Works Loans Board. The PWLB is a statutory body, part of HM Treasury; its purpose is to lend money to local authorities. The Council's main 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.

[2] LOBOs Lender Option Borrower Option. LOBOs are long term borrowing instruments which include an option for the lender to periodically revise the interest rate. If the lender decides to revise the interest rate, the borrower then has the option to pay the revised interest rate or repay the loan.

1.2 The Council continues to pursue a strategy of keeping borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep external financing costs low. The Council will continue the strategy of internal borrowing while it makes sense to continue to do so. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs and to potentially take advantage of possible increasing interest rates over the forthcoming year. Liquid cash was diversified over several counterparties and Money Market Funds to manage both credit and liquidity risks.

1.3 The Council's main 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 Council is actively reviewing opportunities for borrowing at low rates if borrowing is required to finance items within the capital programme. The continuation of the Council's strategy of using surplus cash instead of external borrowing, keeping external financing costs low. The Medium Term Financial Planning process for 2022/23 and future years has taken a zero based approach to treasury management budgets.

1.4 Following a competitive tendering process, Link Treasury Services Limited (Link) were appointed as the Council's treasury advisor with effect from 1 August 2021. Link provided a training session for members of the Audit & Governance Committee in September and they advised the Council in developing the Treasury Management Strategy Statement (TMSS) for 2022/23, including investment counterparties and borrowing requirements. Changes to the TMSS includes introducing the definition of specified and non-specified investments. Specified investments are those with a high level of credit quality and subject to a maturity limit of one year or have less than a year left to run to maturity if originally they were classified as being non-specified investments solely due to the maturity period exceeding one year. Non-specified investments are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use. The maximum exposure non-specified treasury management investments is £100m.

1.5 The Council has also determined that it will only use approved counterparties from the UK and from countries with a minimum sovereign credit rating of AA- from Fitch (or equivalent), previously the minimum sovereign credit rating was AA. The cash limit for AA+, AA and AA- sovereign rated foreign countries is £10m per country – Canada, Finland and the U.S.A. are AA+, Abu Dhabi (UAE), and France are AA, Belgium, Hong Kong, Qatar and the United Kingdom are AA-. The cash limit for AAA sovereign rated countries is £20m per country – Australia, Denmark, Germany, Luxembourg, Netherlands, Norway, Singapore, Sweden and Switzerland are AAA. These lists will be added to, or deducted from, by officers should ratings change in accordance with this policy. In addition, no more than £50m will be placed with any non-UK country at any time, limits in place above will apply to a group of companies and sector limits will be monitored regularly for appropriateness. Also, lending limits for each counterparty will be set through applying a matrix table applying the creditworthiness service provided by the Link Group which employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies. Ultra-short dated bond funds have also been added to the counterparty list.

Content of report

1.6 In line with the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice for Treasury Management and the Council's Financial Procedures (part of the constitution), this Council is required to submit a treasury management strategy statement for the following financial year to the Audit and Governance Committee to consider on 25th January 2022, prior to the Council agreeing the strategy at its meeting on 23rd February 2022. The draft Treasury Management Strategy Statement for 2022/23 is attached as Appendix 1 to this report. The strategy for 2022/23 covers the current treasury position, treasury indicators which limit the treasury risk and activities of the Council, prospects for interest rates, the borrowing strategy, policy on borrowing in advance of need, debt rescheduling, the investment strategy, creditworthiness policy and the policy on use of external service providers.

1.7 The Code of Practice defines Treasury Management as: The management of the organisation's investments 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. Treasury management is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code).

1.8 The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity and the Council's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The Council is asked to approve the following limits to borrowing activity:

The operational boundary. This is the limit beyond which external debt is not normally expected to exceed.

Operational boundary £m	**2021/22 Estimate**	**2022/23 Estimate**	**2023/24 Estimate**	**2024/25 Estimate**
Debt	395	410	410	410
Other long-term liabilities	7.5	7.5	7.5	7.5
Total	**402.5**	**417.5**	**417.5**	**417.5**

1.9 **The authorised limit for external debt.** This is a key prudential indicator and represents a control on the maximum level of borrowing. This represents a legal limit beyond which external debt is prohibited, and this limit needs to be approved by full

Council. If there is a possibility that the Council is likely to exceed the agreed authorised limit, then full Council approval would be required in advance. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

Authorised limit £m	**2021/22 Estimate**	**2022/23 Estimate**	**2023/24 Estimate**	**2024/25 Estimate**
Debt	495	510	510	510
Other long-term liabilities	10	10	10	10
Total	**505**	**520**	**520**	**520**

1.10 **Maturity structure of borrowing.** These gross limits are set to reduce the Council's exposure to large, fixed rate sums falling due for refinancing, and are required for upper and lower limits.

Maturity structure of borrowing 2022/23		
	Lower	**Upper**
Under 12 months	0%	15%
12 months to 2 years	0%	17%
2 years to 5 years	0%	22%
5 years to 10 years	0%	34%
10 years to 20 years	0%	33%
20 years to 30 years	0%	33%
30 years to 40 years	0%	30%
40 years to 50 years	0%	30%

1.11 This Council has defined the list of types of investment instruments that the treasury management team are authorised to use. Specified investments are those with a high level of credit quality and subject to a maturity limit of one year or have less than a year left to run to maturity if originally they were classified as being non-specified investments solely due to the maturity period exceeding one year. Non-specified investments are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use. The maximum exposure to non-specified treasury management investments is £100m.

1.12 The Council has determined that it will only use approved counterparties from the UK and from countries with a minimum sovereign credit rating of AA- from Fitch (or equivalent). The cash limit for AA+, AA and AA- sovereign rated foreign countries is £10m per country – Canada, Finland and the U.S.A. are AA+, Abu Dhabi (UAE), and France are AA, Belgium, Hong Kong, Qatar and the United Kingdom are AA-. The cash limit for AAA sovereign rated countries is £20m per country – Australia, Denmark, Germany, Luxembourg, Netherlands, Norway, Singapore, Sweden and Switzerland are AAA. These lists will be added to, or deducted from, by officers should ratings change in accordance with this policy.

1.13 In addition, no more than £40m will be placed with any non-UK country at any time, limits in place above will apply to a group of companies and sector limits will be monitored regularly for appropriateness.

1.14 The Council's investment strategy sets out the approach for choosing investment counterparties. They are based on a system of credit ratings provided by the three main credit rating agencies and supplemented by additional market data (such as rating outlooks, credit default swaps and bank share prices) provided by our treasury advisors.

1.15 Both the CIPFA Code and government guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum 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.

1.16 Lending limits for each counterparty will be set through applying the matrix table overleaf. This Council will apply the creditworthiness service provided by the Link Group. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard & Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- "watches" and "outlooks" from credit rating agencies;
- CDS spreads that may give early warning of changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

	Colour (and long-term rating	**Counterparty**	**Transaction**	**Time**

	where applicable)	Limit £m	limit £m	limit
Banks *	yellow	£20m	£10m	5yrs
Banks	purple	£20m	£10m	2 yrs
Banks	orange	£20m	£10m	1 yr
Banks – part nationalised	blue	£20m	£10m	1 yr
Banks	red	£10m	£5m	6 mths
Banks and Building Societies	green	£10m	£5m	100 days
Banks and Building Societies	No colour	Not to be used	-	-
Limit 3 category – Council's banker (where "No Colour")	-	Minimal balances	Minimal balances	1 day
Debt Management Agency Deposit Facility (UK Government)	UK sovereign rating	Unlimited	£100m	6 months
Local authorities (sector limit £75m)	n/a	£10m	£10m	5 yrs
Housing associations (sector limit £25m)	Colour bands	£5m	£5m	As per colour band
	Fund rating**	**Counterparty Limit**		**Time Limit**
Money Market Funds CNAV[1]	AAA	£30m		liquid
Money Market Funds LVNAV[2]	AAA	£30m		liquid
Money Market Funds VNAV[3]	AAA	£30m		liquid
Ultra-Short Dated Bond Funds with a credit score of 1.25	Dark pink / AAA	£30m		liquid
Ultra-Short Dated Bond Funds with a credit score of 1.50	Light pink / AAA	£30m		liquid

CNAV[1] – Constant Net Asset Value
LVNAV[2] – Low Volatility Net Asset Value
VNAV[3] – Variable Net Asset Value

1.17 The Council will invest with other local authorities. However, where a local authority has issued a section 114 notice or has been granted permissions to use capital to help with their revenue budgets the investment can only placed with the prior approval of the Service Director – Corporate Finance and Section 151 Officer in consultation with the Cabinet Member for Finance, Resources, Property and Assets. If a local authority that the Council has invested in subsequently issues a section 114 or is given a capitalisation directive, then this will be reported to the Audit and Governance Committee at the earliest opportunity.

1.18 The Council is asked to approve the following treasury indicator and limit for the total principal funds invested for greater than 365 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment and are based on the availability of funds after each year-end.

Upper limit for principal sums invested for longer than 365 days			
£m	**2022/23**	**2023/24**	**2024/25**
Principal sums invested for longer than 365 days	£25m	£25m	£25m
Current investments as at 31st December 2021 in excess of 1 year maturing in each year	£0m	£10m	£0m

1.19 CIPFA published revised Treasury Management Code and Prudential Code on 20th December 2021 and has stated that formal adoption is not required until the 2023/24 financial year. This Council has to have regard to these codes of practice when it prepares the Treasury Management Strategy Statement and Annual Investment Strategy, and also related reports during the financial year.

1.20 The revised codes will have the following implications:

- a requirement for the Council to adopt a new debt liability benchmark treasury indicator to support the financing risk management of the capital financing requirement;
- clarify what CIPFA expects a local authority to borrow for and what they do not view as appropriate. This will include the requirement to set a proportionate approach to commercial and service capital investment;
- create new Investment Practices to manage risks associated with non-treasury investment (similar to the current Treasury Management Practices(TMPs));
- ensure that any long term treasury investment is supported by a business model;

- a requirement to effectively manage liquidity and longer term cash flow requirements;
- amendment to TMP1 to address ESG policy within the treasury management risk framework;
- amendment to the knowledge and skills register for individuals involved in the treasury management function - to be proportionate to the size and complexity of the treasury management conducted by each council;
- a new requirement to clarify reporting requirements for service and commercial investment, (especially where supported by borrowing/leverage).

1.21 In addition, all investments and investment income must be attributed to one of the following three purposes: -

- **Treasury management** Arising from the organisation's cash flows or treasury risk management activity, this type of investment represents balances which are only held until the cash is required for use. Treasury investments may also arise from other treasury risk management activity which seeks to prudently manage the risks, costs or income relating to existing or forecast debt or treasury investments.
- **Service delivery** Investments held primarily and directly for the delivery of public services including housing, regeneration and local infrastructure. Returns on this category of investment which are funded by borrowing are permitted only in cases where the income is "either related to the financial viability of the project in question or otherwise incidental to the primary purpose".
- **Commercial return** Investments held primarily for financial return with no treasury management or direct service provision purpose. Risks on such investments should be proportionate to a council's financial capacity – i.e., that 'plausible losses' could be absorbed in budgets or reserves without unmanageable detriment to local services. An authority must not arrange new borrowing from the PWLB to invest primarily for financial return, there is no requirement to sell existing commercial acquisitions.

1.22 As this Treasury Management Strategy Statement and Annual Investment Strategy deals solely with treasury management investments, the categories of service delivery and commercial investments will be dealt with as part of the Capital Strategy report.

1.23 Members will be updated on how all these changes will impact our current approach and any changes required will be formally adopted within the 2023/24 TMSS report. The changes represent good practice and we don't envisage any issues implementing the changes.

Legal and financial implications

1.24 The publication of an annual strategy, a mid-year treasury report and an annual treasury management report conforms to best practice as required by the Code of Practice CIPFA Treasury Management in the Public Services.

Corporate implications

1.25 There are none.