



## North East Derbyshire District Council

### Treasury Management Strategy 2022/23 – 2025/26

#### 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 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 Council's prudent financial management.
- 1.2 Treasury risk management at the Council is conducted within the framework of the *Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition* (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year. This report fulfils the Council's legal obligation under the *Local Government Act 2003* to have regard to the CIPFA code.
- 1.3 Investments held for service purposes or for commercial profit are considered in a different report, the Investment Strategy.

#### External Context

- 1.4 **Economic background:** The ongoing impact on the UK from coronavirus, together with higher inflation, higher interest rates, and the country's trade position post-Brexit, will be major influences on the Council's treasury management strategy for 2022/23.
- 1.5 The Bank of England (BoE) increased Bank Rate at 0.25% in December 2021 while maintaining its Quantitative Easing programme at £895 billion. The Monetary Policy Committee (MPC) voted 8-1 in favour of raising rates, and unanimously to maintain the asset purchase programme. Within the announcement the MPC noted that the pace of the global recovery was broadly in line with its November Monetary Policy Report. Prior to the emergence of the Omicron coronavirus variant, the Bank also considered the UK economy to be evolving in line with expectations, however the increased uncertainty and risk to activity the new variant presents, the Bank revised down its estimates for Q4 GDP growth to 0.6% from 1.0%. Inflation was projected to

be higher than previously forecast, with CPI likely to remain above 5% throughout the winter and peak at 6% in April 2022. The labour market was generally performing better than previously forecast and the BoE now expects the unemployment rate to fall to 4% compared to 4.5% forecast previously, but notes that Omicron could weaken the demand for labour.

- 1.6 UK CPI for November 2021 registered 5.1% year on year, up from 4.2% in the previous month. Core inflation, which excludes the more volatile components, rose to 4.0% year on year from 3.4%. The most recent labour market data for the three months to October 2021 showed the unemployment rate fell to 4.2% while the employment rate rose to 75.5%.
- 1.7 In October 2021, the headline 3-month average annual growth rate for wages were 4.9% for total pay and 4.3% for regular pay. In real terms, after adjusting for inflation, total pay growth was up 1.7% while regular pay was up 1.0%. The change in pay growth has been affected by a change in composition of employee jobs, where there has been a fall in the number and proportion of lower paid jobs.
- 1.8 Gross Domestic Product (GDP) grew by 1.3% in the third calendar quarter of 2021 according to the initial, compared to a gain of 5.5% quarter on quarter in the previous quarter, with the annual rate slowing to 6.6% from 23.6%. The Q3 gain was modestly below the consensus forecast of a 1.5% quarter on quarter rise. During the quarter activity measures were boosted by sectors that reopened following pandemic restrictions, suggesting that wider spending was flat. Looking ahead, while monthly GDP reading suggest there had been some increase in momentum in the latter part of Q3, Q4 growth is expected to be soft.
- 1.9 GDP Growth in the euro zone increased by 2.2% in calendar Q3 2021 following a gain of 2.1% in the second quarter and a decline of -0.3% in the first. Headline inflation has been strong, with CPI registering 4.9% year-on-year in November, the fifth successive month of inflation. Core CPI inflation was 2.6% year on year in November, the fourth month of successive increases from July's 0.7% year on year. At these levels, inflation is above the European Central Bank's target of 'below, but close to 2%', putting some pressure on its long-term stance of holding its main interest rate of 0%.
- 1.10 The US economy expanded at an annualised rate of 2.1% in Q3 2021, slowing sharply from gains of 6.7% and 6.3% in the previous two quarters. In its December 2021 interest rate announcement, the Federal Reserve continue to maintain the Fed Funds rate at between 0% and 0.25% but outlined its plan to reduce its asset purchase programme earlier than previously stated and signalled they are in favour of tightening interest rates at a faster pace in 2022, with three 0.25% movements now expected.
- 1.11 **Credit outlook:** Since the start of 2021, relatively benign credit conditions have led to credit default swap (CDS) prices for the larger UK banks to remain low and had steadily edged down throughout the year up until mid-November when the

emergence of Omicron has caused them to rise modestly. However, the generally improved economic outlook during 2021 helped bank profitability and reduced the level of impairments many had made as provisions for bad loans. However, the relatively recent removal of coronavirus-related business support measures by the government means the full impact on bank balance sheets may not be known for some time.

- 1.12 The improved economic picture during 2021 led the credit rating agencies to reflect this in their assessment of the outlook for the UK sovereign as well as several financial institutions, revising them from negative to stable and even making a handful of rating upgrades.
- 1.13 Looking ahead, while there is still the chance of bank losses from bad loans as government and central bank support is removed, the institutions on the Council's counterparty list are well-capitalised and general credit conditions across the sector are expected to remain benign. Duration limits for counterparties on the Council's lending list are under regular review and will continue to reflect economic conditions and the credit outlook.
- 1.14 **Interest rate forecast:** The Council's treasury management adviser Arlingclose is forecasting that Bank Rate will continue to rise in calendar Q1 2022 to subdue inflationary pressures and the perceived desire by the BoE to move away from emergency levels of interest rates.
- 1.15 Investors continue to price in multiple rises in Bank Rate over the next forecast horizon, and Arlingclose believes that although interest rates will rise, the increases will not be to the extent predicted by financial markets. In the near-term, the risks around Arlingclose's central case are to the upside while over the medium-term the risks become more balanced.
- 1.16 Yields are expected to remain broadly at current levels over the medium-term, with the 5, 10 and 20 year gilt yields expected to average around 0.65%, 0.90%, and 1.15% respectively. The risks around for short and medium-term yields are initially to the upside but shifts lower later, while for long-term yields the risk is to the upside. However, as ever there will almost certainly be short-term volatility due to economic and political uncertainty and events.
- 1.17 A more detailed economic and interest rate forecast provided by Arlingclose is attached at **Appendix A**.
- 1.18 For the purpose of setting the budget, it has been assumed that new treasury management investments will be made at an average rate of 0.01%, and that new long-term loans will be borrowed at an average rate of 2%.

### Local Context

1.19 On 30<sup>th</sup> November 2021, the Council held £147.1m of borrowing and £34.0m 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** below.

**Table 1: Balance sheet summary and forecast**

	<b>31/3/21 Actual £m</b>	<b>31/3/22 Estimate £m</b>	<b>31/3/23 Forecast £m</b>	<b>31/3/24 Forecast £m</b>	<b>31/3/25 Forecast £m</b>	<b>31/3/26 Forecast £m</b>
General Fund CFR	13.4	17.0	18.3	16.8	13.7	10.6
HRA CFR	169.8	173.4	175.2	177.0	178.8	180.6
<b>Total CFR</b>	<b>183.2</b>	<b>190.4</b>	<b>193.5</b>	<b>193.8</b>	<b>192.5</b>	<b>191.2</b>
Less: Other debt liabilities *	0	0	0.3	0.2	0.1	0.1
<b>Loans CFR</b>	<b>183.2</b>	<b>190.4</b>	<b>193.8</b>	<b>194.0</b>	<b>192.6</b>	<b>191.3</b>
Less: External borrowing **	(149.2)	(147.0)	(147.2)	(145.0)	(140.8)	(139.8)
Internal borrowing	34.0	43.4	46.6	49.0	51.8	51.5
Less: Balance sheet reserves	(70.0)	(67.4)	(58.3)	(59.0)	(61.8)	(61.5)
<b>Investments</b>	<b>36.0</b>	<b>24.0</b>	<b>11.7</b>	<b>10.0</b>	<b>10.0</b>	<b>10.0</b>

\* leases that form part of the Council's total debt.

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

1.20 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 Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

1.21 The Council has an increasing CFR due to commitments within the capital programme and also loans for Northwood Group Ltd and Rykneld Homes Ltd. The forecast level of reserves means that the majority of borrowing throughout this period is likely to be from internal resources.

1.22 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 2022/23.

- 1.23 **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**

	<b>31/3/20 Actual £m</b>	<b>31/3/21 Estimate £m</b>	<b>31/3/22 Forecast £m</b>	<b>31/3/23 Forecast £m</b>	<b>31/3/24 Forecast £m</b>	<b>31/3/25 Forecast £m</b>
<b>CFR</b>	<b>183.2</b>	<b>190.4</b>	<b>193.8</b>	<b>194.0</b>	<b>192.6</b>	<b>191.2</b>
Less: Balance sheet reserves	(70.0)	(67.4)	(58.3)	(59.0)	(61.8)	(61.5)
<b>Net loans requirement</b>	<b>113.2</b>	<b>123.0</b>	<b>135.5</b>	<b>135.0</b>	<b>130.8</b>	<b>129.7</b>
Plus: Liquidity allowance	10.0	10.0	10.0	10.0	10.0	10.0
<b>Liability Benchmark</b>	<b>123.2</b>	<b>133.0</b>	<b>145.5</b>	<b>145.0</b>	<b>140.8</b>	<b>139.7</b>

### **Borrowing Strategy**

- 1.24 The Council currently holds £149.2m of loans, a decrease of £0.3m on the previous year, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in **Table 1** shows that the Council does not expect to need to borrow in 2022/23. The Council may however, borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £203.8m.
- 1.25 **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.
- 1.26 **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, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.
- 1.27 By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal

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 2022/23 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

- 1.28 The Council has previously raised all 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 Council intends to avoid this activity in order to retain its access to PWLB loans.
- 1.29 Alternatively, the Council 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.
- 1.30 In addition, the Council may borrow short-term loans to cover unplanned cash flow shortages.
- 1.31 **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 Derbyshire County Council Pension Fund)
  - capital market bond investors
  - UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues
- 1.32 **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
- 1.33 **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 Council.

- 1.34 **LOBOs:** The Council doesn't hold or intend to hold any LOBO (Lender's Option Borrower's Option) loans.
- 1.35 **Short-term and variable rate loans:** These loans leave the Council 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. Financial derivatives may be used to manage this interest rate risk (see section below).
- 1.36 **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.

### **Treasury Investment Strategy**

- 1.37 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 £33.0m and £48.0m, and similar levels are expected to be maintained in the forthcoming year.
- 1.38 **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.
- 1.39 Where balances are expected to be invested for more than one year, the Council 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.
- 1.40 **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.

- 1.41 **Strategy:** Given the increasing risk and very low returns from short-term unsecured bank investments, the Council aims to further diversify into more secure and/or higher yielding asset classes during 2022/23. The majority of the Council's surplus cash is currently invested in short-term unsecured bank deposits, local authorities, registered providers and money market funds. This diversification will represent a continuation of the strategy currently adopted.
- 1.42 **Business models:** Under the new IFRS 9 standard, the accounting for certain investments depends on the Council's "business model" for managing them. The Council aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.
- 1.43 **Approved counterparties:** The Council may invest its surplus funds with any of the counterparty types in **Table 3** below, subject to the cash limits (per counterparty) and the time limits shown.

**Table 3: Approved investment counterparties and limits**

Sector	Time limit	Counterparty limit	Sector limit
The UK Government	50 years	Unlimited	n/a
Local authorities & other government entities	25 years	£5m	Unlimited
Secured investments *	25 years	£5m	Unlimited
Banks (unsecured) *	13 months	£5m	Unlimited
Building societies (unsecured) *	13 months	£5m	£20m
Registered providers (unsecured) *	5 years	£5m	£20m
Money market funds *	n/a	£5m	Unlimited
Strategic pooled funds	n/a	£5m	£20m
Real estate investment trusts	n/a	£5m	£20m
Other investments *	5 years	£5m	£20m

- 1.44 \* **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.

- 1.45 For entities without published credit ratings, investments may be made either (a) where external advice indicates the entity to be of similar credit quality; or (b) to a maximum of £5m per counterparty as part of a diversified pool e.g. via a peer-to-peer platform.
- 1.46 **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.
- 1.47 **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.
- 1.48 **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.
- 1.49 **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.
- 1.50 **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.

- 1.51 **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 Council 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 Council's investment objectives will be monitored regularly.
- 1.52 **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.
- 1.53 **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.
- 1.54 **Operational bank accounts:** The Council may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept at £5m per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.
- 1.55 **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. 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.
- 1.56 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.

- 1.57 **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, 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.
- 1.58 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 may cause investment returns to fall, but will protect the principal sum invested.
- 1.59 **Investment limits:** The Council's revenue reserves available to cover investment losses are forecast to be £23.3 million on 31st March 2022. In order that no more than 21.5% 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 £5 million. A group of entities under the same ownership will be treated as a single organisation for limit purposes.
- 1.60 Credit risk exposures arising from non-treasury investments, financial derivatives and balances greater than £5 million in operational bank accounts count against the relevant investment limits.
- 1.61 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**

	<b>Cash limit</b>
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	£5m per country

- 1.62 **Liquidity management:** The Council uses its own cash flow forecasting techniques to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium-term financial plan and cash flow forecast.
- 1.63 The Council will spread its liquid cash over a number of 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.

### **Treasury Management Indicators**

- 1.64 The Council measures and manages its exposures to treasury management risks using the following indicators:
- 1.65 **Security:** The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

<b>Credit risk indicator</b>	
Portfolio average credit rating	<b>Target &lt;3.0</b>
Current portfolio average credit rating on investments	<b>Actual 1.45</b>

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

<b>Liquidity risk indicator</b>	<b>Amount available</b>
Total cash available within 3 months	£32m

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

Interest rate risk indicator	Limit each year
Upper limit on one-year revenue impact of a 1% <u>rise</u> in interest rates	£1.5m
Upper limit on one-year revenue impact of a 1% <u>fall</u> in interest rates	(£1.5m)

- 1.68 The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at new market rates.
- 1.69 **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:

Refinancing rate risk indicator	Upper limit	Lower limit
Under 12 months	20%	0%
12 months and within 24 months	20%	0%
24 months and within 5 years	40%	0%
5 years and within 10 years	40%	0%
10 years and above	90%	0%

- 1.70 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.
- 1.71 **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:

Price risk indicator	2022/23	2023/24	2024/25
Limit on principal invested beyond year end	£20m	£20m	£20m

### **Related Matters**

- 1.72 The CIPFA Code requires the Council to include the following in its treasury management strategy.
- 1.73 **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).

- 1.74 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.
- 1.75 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.
- 1.76 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.
- 1.77 **Markets in Financial Instruments Directive:** The Council 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 Council's treasury management activities, the Chief Financial Officer believes this to be the most appropriate status.
- 1.78 **Financial Implications:** The General Fund budget for investment income in 2022/23 is £0.003m with the HRA budget for investment income in 2022/23 being £0.007m, based on an average investment portfolio of £22.0m at an average interest rate of 0.04%. The General Fund budget for debt interest paid in 2022/23 is £0.459m with the HRA budget for debt interest paid in 2022/23 being £4.729m, based on an average debt portfolio of £147.0m at an average interest rate of 3.53%. If actual levels of investments and borrowing, or actual interest rates, differ from those forecast, performance against budget will be correspondingly different.

#### **Other Options Considered**

- 1.79 The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Financial Officer, having consulted the Cabinet Member for Finance, 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.

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

## **Appendix A**

### **Economic & Interest Rate Forecast (Arlingclose October 2021)**

#### **Underlying assumptions:**

- The global recovery from the pandemic has entered a more challenging phase. The resurgence in demand has led to the expected rise in inflationary pressure, but disrupted factors of supply are amplifying the effects, increasing the likelihood of lower growth rates ahead. The advent of the Omicron variant of coronavirus is affecting activity and is also a reminder of the potential downside risks.
- Despite relatively buoyant activity survey data, official GDP data indicates that growth was weakening into Q4 2021. Other data, however, suggested continued momentum, particularly for November. Retail sales volumes rose 1.4%, PMIs increased, and the labour market continued to strengthen. The end of furlough did not appear to have had a significant impact on unemployment. Wage growth is elevated.
- The CPI inflation rate rose to 5.1% for November and will rise higher in the near term. While the transitory factors affecting inflation are expected to unwind over time, policymakers' concern is persistent medium term price pressure.
- These factors prompted the MPC to raise Bank Rate to 0.25% at the December meeting. Short term interest rate expectations remain elevated.
- The outlook, however, appears weaker. Household spending faces pressures from a combination of higher prices and tax rises. In the immediate term, the Omicron variant has already affected growth – Q4 and Q1 activity could be weak at best.
- Longer-term government bond yields remain relatively low despite the more hawkish signals from the BoE and the Federal Reserve. Investors are concerned that significant policy tightening in the near term will slow growth and prompt the need for looser policy later. Geo-political and coronavirus risks are also driving safe haven buying. The result is a much flatter yield curve, as short-term yields rise even as long-term yields fall.
- The rise in Bank Rate despite the Omicron variant signals that the MPC will act to bring inflation down whatever the environment. It has also made clear its intentions to tighten policy further. While the economic outlook will be challenging, the signals from policymakers suggest their preference is to tighten policy unless data indicates a more severe slowdown.



- While Q2 UK GDP expanded more quickly than initially thought, the ‘pingdemic’ and more latterly supply disruption will leave Q3 GDP broadly stagnant. The outlook also appears weaker. Household spending, the driver of the recovery to date, is under pressure from a combination of retail energy price rises, the end of government support programmes and soon, tax rises. Government spending, the other driver of recovery, will slow considerably as the economy is taken off life support
- Inflation rose to 3.2% in August. A combination of factors will drive this to over 4% in the near term. While the transitory factors affecting inflation, including the low base effect of 2020, are expected to unwind over time, the MPC has recently communicated fears that these transitory factors will feed longer-term inflation expectations that require tighter monetary policy to control. This has driven interest rate expectations substantially higher
- The supply imbalances are apparent in the labour market. While wage growth is currently elevated due to compositional and base factors, stories abound of higher wages for certain sectors, driving inflation expectations. It is uncertain whether a broad-based increased in wages is possible given the pressures on businesses.
- Government bond yields increased sharply following the September FOMC and MPC minutes, in which both central banks communicated a lower tolerance for higher inflation than previously thought. The MPC in particular has doubled-down on these signals in spite of softer economic data. Bond investors expect higher near-term interest rates but are also clearly uncertain about central bank policy.
- The MPC appears to be playing both sides, but has made clear its intentions to tighten policy, possibly driven by a desire to move away from emergency levels. While the economic outlook will be challenging, the signals from policymakers suggest Bank Rate will rise unless data indicates a more severe slowdown.

**Forecast:**

- The MPC will want to build on the strong message it delivered this month by tightening policy despite Omicron uncertainty.
- Arlingclose therefore expects Bank Rate to rise to 0.50% in Q1 2022, but then remain there. Risks to the forecast are initially weighted to the upside, but becoming more balanced over time. The Arlingclose central forecast remains below the market forward curve.

- Gilt yields will remain broadly flat from current levels. Yields have fallen sharply at the longer end of the yield curve, but expectations of a rise in Bank Rate have maintained short term gilt yields at higher levels.
- Easing expectations for Bank Rate over time could prompt the yield curve to steepen, as investors build in higher inflation expectations.
- The risks around the gilt yield forecasts vary. The risk for short and medium term yields is initially on the upside but shifts lower later. The risk for long-term yields is weighted to the upside.

	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
<b>Official Bank Rate</b>													
Upside risk	0.00	0.00	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk	0.00	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
<b>3-month money market rate</b>													
Upside risk	0.05	0.05	0.25	0.35	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.25	0.55	0.55	0.60	0.60	0.60	0.60	0.65	0.65	0.65	0.65	0.65	0.65
Downside risk	0.00	-0.25	-0.25	-0.30	-0.30	-0.30	-0.30	-0.35	-0.35	-0.35	-0.35	-0.35	-0.35
<b>5yr gilt yield</b>													
Upside risk	0.00	0.35	0.45	0.55	0.55	0.55	0.55	0.55	0.55	0.50	0.50	0.45	0.45
Arlingclose Central Case	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.65	0.70	0.75	0.75
Downside risk	-0.10	-0.20	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.30	-0.35	-0.40	-0.40
<b>10yr gilt yield</b>													
Upside risk	0.10	0.25	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.55	0.55	0.55
Arlingclose Central Case	0.80	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.90	0.90	0.95	0.95
Downside risk	-0.10	-0.25	-0.30	-0.35	-0.35	-0.35	-0.35	-0.35	-0.35	-0.40	-0.40	-0.40	-0.40
<b>20yr gilt yield</b>													
Upside risk	0.30	0.40	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	1.00	1.05	1.10	1.10	1.10	1.10	1.15	1.15	1.15	1.20	1.20	1.20	1.20
Downside risk	-0.15	-0.30	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45
<b>50yr gilt yield</b>													
Upside risk	0.25	0.30	0.40	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.70	0.75	0.80	0.85	0.90	0.95	1.00	1.05	1.05	1.10	1.10	1.15	1.15
Downside risk	-0.15	-0.30	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45

**PWLB Standard Rate (Maturity Loans) = Gilt yield + 1.00%**  
**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**

	<b>30/11/21 Actual Portfolio £m</b>	<b>30/11/21 Average Rate %</b>
<b>External borrowing:</b>		
Public Works Loan Board	147	3.53
<b>Total external borrowing</b>	<b>147</b>	<b>3.53</b>
<b>Total other long-term liabilities:</b>	<b>0</b>	<b>0</b>
<b>Total gross external debt</b>	<b>147</b>	<b>3.53</b>
<b>Treasury investments:</b>		
The UK Government	0	0.00
Local authorities	5	0.15
Banks (unsecured)	0	0.00
Money Market Funds	29	0.01
<b>Total treasury investments</b>	<b>34</b>	<b>0.03</b>
<b>Net debt</b>	<b>113</b>	