Southampton City Council
TREASURY MANAGEMENT STRATEGY

2021/22 – 2024/25

Contents

	SECTION 1 - INTRODUCTION
1.1	**BACKGROUND**
1.1.1	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.
1.1.2	Overall responsibility for treasury management remains with the Council. No TM activity is without risk; the effective identification and management of risk are integral to the Council's treasury management objectives. 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. Our current policy is shown in Annex 1.
1.1.3	Investments held for service purposes or for commercial profit are considered in a different report, the Investment Strategy.
1.2	**EXTERNAL CONTEXT**
1.2.1	Annex 2 summarises the economic outlook and events in the context of which the Council operated its treasury function during 2020/21 and forecast movement in interest rates.
1.2.2	For the purpose of setting the budget, it has been assumed that new investments for 2021/22 will be short-term and at a rate of 0.01% (continued downward pressure on short-dated cash has brought net returns on money market funds to zero even after some managers have temporarily lowered their fees and the overnight plus the 1 and 2 week deposit rates on Debt Management Account Deposit Facility (DMADF) deposits have dropped below zero percent on occasion). New long-term loans taken over the period of the strategy will be borrowed at an average rate of 2.21%.
1.3	**LOCAL CONTEXT**
1.3.1	At 31 December 2020 the Council held £313M of debt (£247M borrowing plus £66M other long term liabilities) and £69M investments which is set out in further detail in Annex 3.
1.3.2	The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), which is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. The CFR is reduced by the application of resources such as capital receipts, grants or revenue funds.
1.3.3	While usable reserves and working capital are the underlying resources available for investment.
1.3.4	The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing. Table 1 shows that the Council has an increasing CFR due to the impact of the capital programme and a decreasing working balance surplus and will therefore need to borrow up to £314M

	over the forecast period (row 10). Annexe.4 shows the projected movement on CFR between years
1.3.5	Table 1: Balance Sheet Summary and Forecast

		31-Mar-20 Actual £M	31-Mar-21 Forecast £M	31-Mar-21 Forecast Movement in year £M	31-Mar-22 Forecast £M	31-Mar-23 Forecast £M	31-Mar-24 Forecast £M	31-Mar-25 Forecast £M
1	General Fund CFR	339.58	349.95	10.37	374.47	490.31	492.61	489.37
2	Housing CFR	169.13	177.49	8.36	198.94	231.33	287.63	317.76
3	**Total CFR**	**508.71**	**527.44**	**18.73**	**573.41**	**721.64**	**780.24**	**807.13**
4	Less Other Debt Liabilities*	(67.83)	(64.44)	3.39	(60.62)	(57.11)	(53.45)	(49.11)
5	**Loans CFR**	**440.88**	**463.00**	**22.12**	**512.79**	**664.53**	**726.79**	**758.02**
6	Less External Borrowing**	(277.23)	(231.59)	45.64	(222.84)	(216.84)	(210.84)	(204.84)
7	Internal (over) Borrowing	**163.65**	**231.41**	**67.76**	**289.95**	**447.69**	**515.95**	**553.18**
8	Less Usable Reserves	(174.55)	(178.40)	(3.85)	(128.87)	(123.89)	(123.89)	(72.97)
9	Less Working Capital Surplus	(58.01)	(58.01)	0.00	(58.01)	(58.01)	(58.01)	(58.01)
10	**New Borrowing or (Investments)**	**(68.91)**	**(5.01)**	**63.91**	**103.07**	**265.79**	**334.04**	**422.19**

** finance leases, PFI liabilities and transferred debt which form part of the Council's total debt*

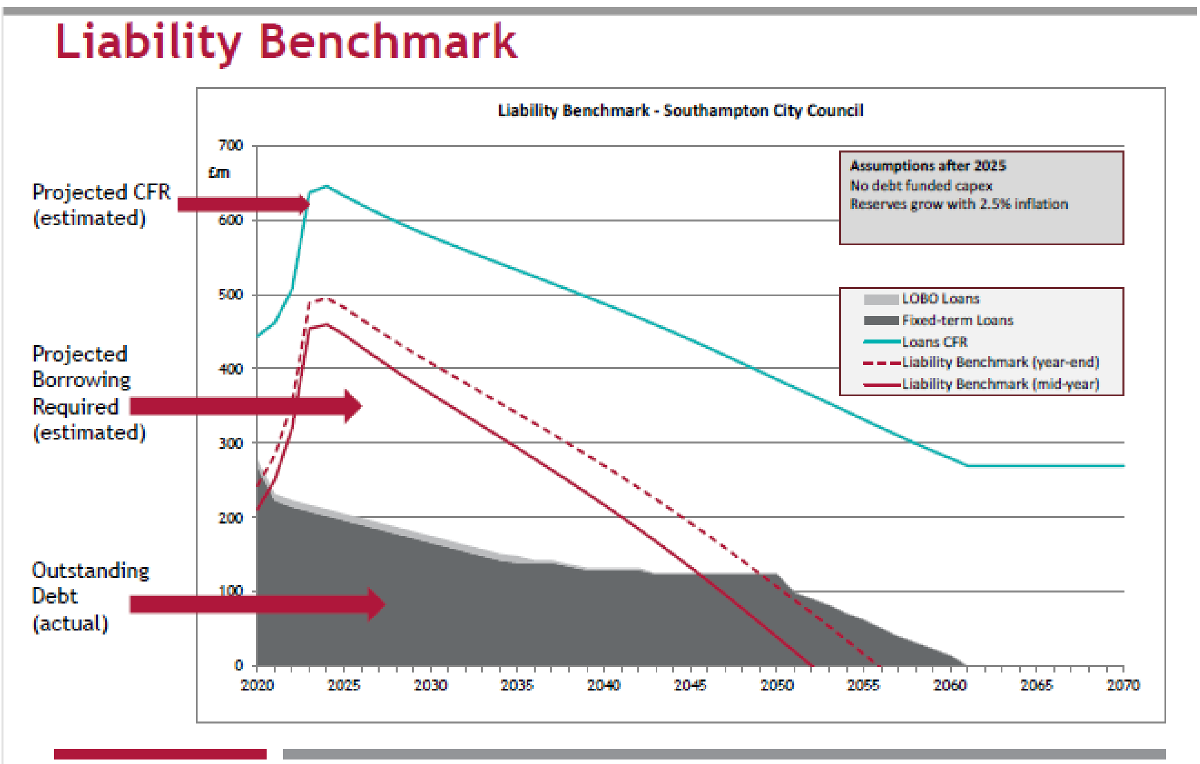
*** shows only loans to which the Council is committed and excludes optional refinancing*

1.3.6	Table 1 shows that the Council's CFR is rising over the next 4 years. This is due to increased investment, summarised below are the major projects expected to undertaken: • Building new homes (HRA) • Green City Charter investment • Bitterne Community Hub • School Expansion Programme • Highways and Integrated Transport Programme • Improving Outdoor Leisure Facilities • IT Strategy • Fleet Vehicles
1.3.7	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, as our committed borrowing (row 10) is significantly below our loans CFR (row 5).
1.4	**Liability Benchmark**
1.4.1	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 to further minimise credit risk.

1.4.2 Table 2: Liability benchmark

	31-Mar-20 Actual £M	31-Mar-21 Forecast £M	31-Mar-21 Forecast Movement in year £M	31-Mar-22 Forecast £M	31-Mar-23 Forecast £M	31-Mar-24 Forecast £M	31-Mar-25 Forecast £M
Loans CFR	**440.88**	**463.00**	**22.12**	**512.79**	**664.53**	**726.79**	**758.02**
Less Usable Reserves	(174.55)	(178.40)	(3.85)	(128.87)	(123.89)	(123.89)	(72.97)
Less Working Capital Surplus	(58.01)	(58.01)	0.00	(58.01)	(58.01)	(58.01)	(58.01)
Plus Minimum Investments	69.34	40.00	(29.34)	40.00	40.00	40.00	40.00
Liability Benchmark	**277.66**	**266.59**	**(11.07)**	**365.91**	**522.63**	**584.89**	**667.04**
Less Committed External Borrowing	(276.87)	(231.59)	45.28	(222.84)	(216.84)	(210.84)	(204.84)
Minimum Borrowing Need	**0.79**	**34.99**	**34.20**	**143.07**	**305.79**	**374.04**	**462.19**

1.4.3 The long term liability benchmark assumes minimum revenue provision based on the life of the asset and income, expenditure and reserves all increasing by inflation. This is shown in the chart below.

1.4.4 

1.4.5 This demonstrates that even with lower investment balances that there is still an underlying need for the council to borrow during 2021/22 as our actual committed debt at £222M will be below the benchmark of £366M.

SECTION 2 - BORROWING STRATEGY

2.0 The Council currently holds £247M of loans, a decrease of £31M since the 31 March 2020 despite an increased capital programme. This reflects the Council's policy of only borrowing when cash flows dictate or unless a particular good opportunity arises or to protect itself against an expected material increase in PWLB rates. The balance sheet forecast in Table 1 above shows that the Council expects the total

	loans CFR to increase by £22M in 2020/21 and by a further £50M in 2021/22 bringing our estimated loans CFR to £513M Committed borrowing at the end of 2021 is £232M, a decrease of £46M from the actual position at 31 March 2020, this decrease reflects maturities in year which have not yet been replaced. If the forecast capital programme for the year is achieved, then further borrowing of up to £103M will be required by 31 March 2022 as shown in Table 1.
2.1	**Objectives**
2.1.1	The Authority's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.
2.2	**Strategy**
2.2.1	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.
2.2.2	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 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 interest costs low, even if this causes additional cost in the short-term.
2.2.3	If it was cost effective the Council could also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing.
2.2.4	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. In addition, the Council may borrow further short-term loans to cover unexpected cash flow shortages.
2.3	**Sources of Borrowing**
2.3.1	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 HCC Pension Fund) • capital market bond investors

	• UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues
2.3.2	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
2.3.3	The Council has previously raised the majority of its long-term borrowing from the PWLB but will consider long-term loans from other sources including banks, pensions and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield (except for refinancing of existing debt; including internal financing) the Authority intends to avoid this activity in order to retain its access to PWLB loans and as a result has reviewed the capital programme and removed the £200M property investment fund scheme. Regeneration aims for investment remain acceptable, but all capital plans will be scrutinised by Government and will require the S151 officer to state they contain no ‘invest for yield’ proposals relying on borrowing.
2.3.4	**UK Municipal Bonds Agency plc (MBA)**
2.3.5	MBA 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. A report setting out in full the details, options and risks of the MBA was considered by full Council on 10 February 2016 and any initial proposal to borrow from the Agency will therefore need be the subject of a separate report to both Governance Committee and Full Council.
2.3.7	**Lender’s Option Borrower’s Option Loans (LOBOs)**
2.3.8	The Council holds £9M of LOBO loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. All of these LOBOS have options during 2021/22 and although the Council understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The Council will take the option to repay LOBO loans at no cost if it has the opportunity to do so.
2.4	**Short Term and Variable Rates**
2.4.1	Short term loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators.

	Financial derivatives may be used to manage this interest rate risk but in line with the CIPFA code, the Council would seek and consider external advice before entering into any agreement to ensure that it fully understands the implications.
2.5	**<u>Debt Rescheduling</u>**
2.5.1	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.
	SECTION 3 – TREASURY INVESTMENT STRATEGY
3.0	The Council invests its money for three broad purposes: • because it has surplus cash as a result of its day-to-day activities (known as **treasury management investments**), • to support local public services by lending to or buying shares in other organisations (**service investments**), and • to earn investment income (known as **commercial investments** where this is the main purpose).
3.1	**<u>Objectives</u>**
3.1.1	The CIPFA Code require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. Whilst a return is sought, the aim of Treasury activity is not primarily commercial in nature, it reflects addressing the cashflow needs of the council and the need for prudence and risk minimisation with public cash holdings. 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. 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, however it should be noted that a lower rate is an acceptable offset for higher credit and less risk, for example a covered bond.
3.2	**<u>Negative Interest Rates</u>**
3.2.1	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.
3.3	**<u>Strategy</u>**
3.3.1	As we have an increasing borrowing requirement our overall treasury strategy is to minimise both external borrowing and investments and to only borrow to the level of its net borrowing requirement. The reasons for this are to reduce credit risk, take

	pressure off the Council's lending list and also to avoid the cost of carry existing in the current interest rate environment. For longer term investments the Council aims to continue to diversify into more secure and/or higher yielding asset classes during 2021/22. The majority of cash used for cash flow purposes is invested in money market funds or with other Local Authorities.
3.4	**Business Model**
3.4.1	Under the new IFRS 9 standard, the accounting for certain investments depends on the Authority's "business model" for managing them. The Authority aims to achieve value from its 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.
3.5	**Approved Counterparties**
3.5.1	The Council may invest its surplus funds with any of the following counterparty types, subject to the cash limits (per counterparty) and time limits detailed below. This is the absolute limit and the working limit will be monitored against actual cash flows and movement on reserves together with advice from our financial advisors and will be adjusted each quarter as necessary in agreement with the CFO.
3.5.2	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	£10M	Unlimited
Secured investments *	5 years	£10M	Unlimited
Banks (unsecured) *	13 months	£5M	Unlimited
Building societies (unsecured) *	13 months	£5M	10%
Registered providers (unsecured) *	5 years	£10M	25%
Money market funds *	n/a	£10M per fund and no more than 0.50% of any investments fund in total for non-government funds	Unlimited
Strategic pooled funds	n/a	£30M	50%
Real estate investment trusts	n/a	£20M	25%
Other investments *	5 years	£1M	5%

**This is the absolute limit and the working limit will be monitored against actual cash flows and movement on reserves together with advice from our financial advisors and will be adjusted each quarter as necessary in agreement with the CFO.*

This table must be read in conjunction with the notes below

3.6	**<u>Investment Institutions</u>**
3.6.1	**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. 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 £1M per counterparty as part of a diversified pool e.g. via a peer-to-peer platform.
3.6.2	**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.
3.6.3	**Secured Investments:** Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they 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 highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.
3.6.4	**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 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.
3.6.5	**Corporates:** Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made either following an external credit assessment or to a maximum of £1M per company as part of a diversified pool in order to spread the risk widely.
3.6.6	**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.
3.6.7	**Money Market Funds:** Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small

	fee. Although no sector limit applies to money market funds, the Authority will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.
3.6.8	**Strategic Pooled Funds:** Bond, equity and property funds 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.
3.6.9	**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.
3.6.10	**Other investments:** This category covers treasury investments not listed above, for example unsecured corporate bonds and company loans. Non-bank companies cannot be bailed-in but can become insolvent placing the Authority's investment at risk.
3.6.11	**Operational bank accounts**: The Council may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be kept to a minimum. 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.
3.6.12	Given the stresses placed on the council's budget, all forms of investment will be carefully monitored during the year. The Chief Financial Officer (CFO), under delegated powers, will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements and Prudential Indicators. Decisions taken on the core investment portfolio will be reported quarterly to Cabinet.
3.7	<u>**Risk Assessment and Credit Ratings**</u>
3.7.1	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 rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") 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.
3.8	**Other Information on the Security of Investments**
3.8.1	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 Authority's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.
3.8.2	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 cause investment returns to fall but will protect the principal sum invested.
3.9	**Investment Limits**
3.9.1	The Council's revenue reserves and balances available to cover investment losses (excluding Schools, capital and HRA) are forecast to be £92M at 31st March 2021. In order that there is no immediate pressure on available reserves in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government and specified investments under advice, such as property funds) will be £10M. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors in Table 4 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.
3.9.2	Table 4 –Investment Limits

	Cash limit
Any group of pooled funds under the same management	25% per manager unless under specific advice as taken with CCLA
Negotiable instruments held in broker's nominee account	£50M per broker
Foreign countries	£10M per country

3.10	**Liquidity Management**
3.10.1	The Council undertakes high level cash flow forecasting 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. The Authority 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.
	SECTION 4 - TREASURY MANAGEMENT INDICATORS
4.0	The Council measures and manages its exposure to treasury management risks using the following indicators.
4.1	**Background**
4.1.1	The Authority typically receives its income (e.g. from taxes and grants) before it pays for its expenditure (e.g. through payroll and invoices). It also holds reserves for future expenditure and collects local taxes on behalf of other local authorities and central government. These activities, plus the timing of borrowing decisions, lead to a cash surplus which is invested in accordance with guidance from the Chartered Institute of Public Finance and Accountancy.
4.1.2	During the financial year the Council's investment balances have ranged between £61M and £114M and are currently £69M. Borrowing has ranged between £247M and £292M and is currently £247M.
4.2	**Security**
4.2.1	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. The average rating of our current portfolio is A+ which is above the target.

	Target
Portfolio average credit rating	A

4.3	**Liquidity**
4.3.1	The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments and has set a £10M minimum threshold on cash available in instant access accounts, if balances were to fall below this limit we would consider taking short term loans which are available without given prior notice and at competitive rates.

4.4	**<u>Interest Rate Exposure</u>**
4.4.1	This indicator is set to control the Council's exposure to interest rate risk. The upper limits are based on the one-year revenue impact of a 1% rise or fall in interest rates for existing variable rates on long term loans and assumed short term borrowing, offset by variable investments. The cost of an extra 1% per £1M is £10,000. We do not currently have any variable rate borrowing and any increase in short term borrowing rates should be offset by an increase in short term investment income. The limits are set at:

Interest rate risk indicator	£M
Upper limit on one-year revenue impact of a 1% **rise** in interest rates	1.5
Upper limit on one-year revenue impact of a 1% **fall** in interest rates	0.5

4.4.2	The main risk to the authority comes through the continued use of short term borrowing in place of fixed term long term debt for 2021/22. A 1% increase over the forecast rate would equate to £10,000 for each £1M borrowed, plus a possible ongoing impact on an increase in the long term rate.
4.4.3	The Authority has more exposure to an increase in interest rates than a reduction as our debt portfolio is higher than our investments. A fall in interest rates of 1% would see investment income fall by about £0.4M but this would be offset by reduction in debt charges.
4.5	**<u>Maturity Structure of Borrowing</u>**
4.5.1	This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing as set below.
4.5.2	

Refinancing rate risk indicator	Lower Limit %	Upper Limit %
Under 12 Months	0	50
12 months and within 24 months	0	50
24 months and within 5 years	0	50
5 years and within 10 years	0	55
10 years and within 20 years	0	60
20 years and within 30 years	0	65
30 years and above	0	75

4.5.3	Time periods start on the first day of each financial year and the maturity date of borrowing is the earliest date on which the lender can demand repayment. Although all LOBOs are now in their call options they are not expected to be called in the near future so are shown as uncertain, but as they only represent 3% of the total debt portfolio an early call would not pose a material risk in refinancing.
4.5.4	Details of our current level of debt and maturity is shown in Table 5 below. This shows that all debt is within existing levels.

4.5.5	Table 5 – Current Debt

Debt Maturity Profile	Lower Limit %	Upper Limit %	Actual Debt as at 30/09/2020 £M	Average Rate as at 30/09/2020 %	% of Debt	Compliance with set Limits?
Under 12 months	0	50	21.11	2.06%	9	Yes
12 months and within 24 months	0	50	5.75	2.69%	2	Yes
24 months and within 5 years	0	50	18.00	1.12%	7	Yes
5 years and within 10 years	0	55	30.00	1.12%	12	Yes
10 years and within 15 years	0	60	34.00	1.66%	14	Yes
15 years and within 20 years	0	60	5.00	4.60%	2	Yes
25 years and within 30 years	0	60	25.00	4.62%	10	Yes
30 years and within 35 years	0	60	36.70	3.54%	15	Yes
35 years and within 40 years	0	65	47.90	3.59%	19	Yes
40 years and within 45 years	0	75	14.25	3.70%	6	Yes
Uncertain*	0	5	9.00	4.86%	4	Yes
* Lobo's			**246.71**	**4.86%**	**100**	

4.6	**Principal Sums Invested for Periods Longer than a Year**
4.6.1	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 are shown below. Limits have been increased for future years to allow for the alternative investment strategy referred to in the main report if it were to be adopted.
4.6.2	

	Current £M	2021/22 £M	2022/23 £M	2023/24 £M	2024/25 £M
Limit on principal invested beyond year end	100	100	100	100	100

	SECTION 5 - RELATED MATTERS
5.0	There are a number of related matters that the CIPFA Code requires the Council to include in its Treasury Management Strategy.
5.1	**Monitoring, Reporting and Financial Implications**
5.1.1	The Chief Financial Officer will report to the Governance Committee on TM activity / performance as follows: (a) A mid-year review against the strategy approved for the year. (b) An outturn report on its treasury activity, no later than 30 September after the financial year end.
5.1.2	In addition, a quarterly update will be presented to Cabinet as part of Quarterly Revenue Financial Monitoring.
5.1.3	For the purpose of setting the budget, it has been assumed that new investments for 2021/22 will be short-term as mainly for cash flow purposes and at a rate of 0.01%

	(continued downward pressure on short-dated cash has brought net returns on money market funds to zero even after some managers have temporarily lowered their fees and the overnight plus the 1 and 2 week deposit rates on Debt Management Account Deposit Facility (DMADF) deposits have dropped below zero percent on occasion). Current Strategic investments are expected to generate £1.04M at an average yield of 3.68%
5.1.4	The forecast cost of financing the council's loan debt for 2021/22 is £17.41M of which £5.55M relates to the HRA. This is expected to rise to £27.65M (£8.30M HRA) by 2024/25 to accommodate the capital programme and refinancing of borrowing, however this will be subject to movement as the need for further borrowing becomes more certain. New long-term loans taken over the period of the strategy will be borrowed at an assumed average rate of 2.21%.
5.2	**Policy on Use of Financial Derivatives**
5.2.1	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).
5.2.2	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.
5.2.3	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.
5.2.4	In line with the CIPFA code, the Council would seek and consider external advice before entering into any agreement to ensure that it fully understands the implications.
5.3	**Markets in Financial Instruments Directive**
5.3.1	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 Authority's treasury management activities, the Chief Financial Officer believes this to be the most appropriate status.

5.4	**Housing Revenue Account Self-Financing and Limit on Indebtedness**
5.4.1	On 1st April 2012, the Council notionally split each of its existing long-term loans into General Fund and HRA pools. Since then new long-term loans borrowed are assigned 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.
5.4.2	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. This balance will be measured, and interest transferred between the General Fund and HRA at an agreed rate. Housing Legislation does not allow impairment losses to be charged to the HRA and consequently any credit related losses on the Council's investments will be borne by the General Fund alone. It is therefore appropriate that the General Fund is compensated for bearing this risk, and all interest transferred to the HRA should be adjusted downwards. The rate will be based on investments with the Debt Management Office. The rate of return on comparable investments with the government is lower and often referred to as the risk-free rate.
5.4.3	Following the Chancellor's announcement in the 2018 Autumn Budget, restrictions relating to HRA borrowing have been lifted. This means that the previous HRA debt cap of £199.6m has been removed, and there is now the emphasis for councils to plan their new build strategy and financing at a local level. The process for identifying priorities and sites for new build developments is now taking place and is expected to form the basis of a new delivery strategy incorporating affordability and prudence. As part of the new build strategy relevant Prudential Indicators will be agreed.
5.4.4	The HRA Business Plan supports a number of council strategies, including the Medium Term Financial Strategy, to ensure plans are affordable and budgets are aligned to the assumptions detailed in those strategies. The specific HRA Business Plan can be seen in the report being submitted to Council on 24 February 2021.
5.4.5	The HRA by default will underwrite any programmes that are unable to self-fund
5.5	**OTHER OPTIONS CONSIDERED**
5.5.1	The MHCLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Financial Officer, having consulted with relevant officers and members 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.

5.5.2

Options	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses will 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 will 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 will 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 will be less certain	