EASTSUFFOLK
COUNCIL

AUDIT & GOVERNANCE COMMITTEE

Monday 6th January 2020

TREASURY MANAGEMENT STRATEGY STATEMENT FOR 2020/21 & TREASURY MANAGEMENT INVESTMENT STRATEGY FOR 2020/21

EXECUTIVE SUMMARY

1. This report sets out the Council's Treasury Management Strategy for 2020/21 and the Treasury Management Investment Strategy for 2020/21 and covers:
   - the current treasury position;
   - treasury indicators which limit the treasury risk and activities of the Council;
   - prospects for interest rates;
   - the borrowing strategy; and
   - the investment strategy
2. The report recommends that the Treasury Management Strategy for 2020/21 and the Treasury Management Investment Strategy for 2020/21 be reviewed and commented upon and recommended for approval.

Is the report Open or Exempt?	Open

Wards Affected:	All Wards across East Suffolk

Cabinet Member:	Councillor Steve Gallant Leader of the Council and Cabinet Member with responsibility for Resources Councillor Maurice Cook Assistant Cabinet Member with responsibility for Resources

Supporting Officer:	Simon Taylor Chief Finance Officer and Section 151 Officer 01394 444570 simon.taylor@eastsuffolk.gov.uk

1 INTRODUCTION

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

2 TREASURY MANAGEMENT STRATEGY STATEMENT FOR 2020/21

2.1 The strategy for 2020/21 set out in Appendix A covers:

Treasury management issues:

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy; and
- the investment strategy.

3 HOW DOES THIS RELATE TO EAST SUFFOLK BUSINESS PLAN?

3.1 The Treasury Management Strategy Statement is a CIPFA requirement; the report does not link directly to the Vision of the Business Plan, but through ensuring good governance arrangements and security of the Council's investment income this will help to achieve financial self-reliance and the planned actions set out in the Business Plan.

4 FINANCIAL AND GOVERNANCE IMPLICATIONS

4.1 Security of the Council's cash is the over-riding consideration in setting the Treasury Management Strategy Statement. The Council is constantly receiving advice from its external Treasury Advisors, Arlingclose, with regard to the creditworthiness of financial institutions in order to inform investment decisions.

4.2 The Council's banking provider is Lloyds Bank Plc.

5 REASON FOR RECOMMENDATION

5.1 The Local Government Act 2003 requires the Council to set out its Treasury Management Strategy and Investment Strategy in advance of each financial year. These strategies set out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

RECOMMENDATIONS

1. That the Audit & Governance Committee reviews, comments upon, and recommends the Treasury Management Strategy Statement and the Treasury Management Investment Strategy for 2020/21 to Cabinet and Full Council for approval.

APPENDICES	
Appendix A	Treasury Management Strategy Statement 2020/21
Appendix B	Treasury Management Investment Strategy 2020/21

BACKGROUND PAPERS – none

Treasury Management Strategy Statement 2020/21

Introduction

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.

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.

Investments held for service purposes or for commercial profit are considered in the Investment Strategy.

External Context

Economic background: The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Councils treasury management strategy for 2020/21.

UK Consumer Price Inflation (CPI) for October registered 1.5% year on year, a 0.2% reduction from the previous month. Core inflation, which excludes the more volatile components, rose to 1.7% from 1.5% in August and has remained steady at this rate through September and October. The most recent labour market data for the three months to September 2019 showed the unemployment rate ticked back up to 3.8% while the employment rate was 76%, just below recent record-breaking highs. The headline three-month average annual growth rate for pay was 3.8% in September as wages continue to rise steadily. In real terms, after adjusting for inflation, pay growth increased 1.8%.

Gross Domestic Product (GDP) growth rose by 0.3% in the third quarter of 2019 from -0.2% in the previous three months with the annual rate falling further below its trend rate to 1.0% from 1.2%. Services and construction added positively to growth, by 0.6% and 0.4% respectively, while production was flat and agriculture recorded a fall of 0.2%. Looking ahead, the Bank of England's Monetary Policy Report (formerly the Quarterly Inflation Report) forecasts economic growth to pick up during 2020 as Brexit-related uncertainties dissipate and provide a boost to business investment helping GDP reach 1.6% in Q4 2020, 1.8% in Q4 2021 and 2.1% in Q4 2022.

The Bank of England maintained Bank Rate at 0.75% in November following a 7-2 vote by the Monetary Policy Committee (MPC). Despite keeping rates on hold, MPC members did confirm that if Brexit uncertainty drags on or global growth fails to recover, they are prepared to cut interest rates as required. Moreover, the downward revisions to some of the growth projections in the Monetary Policy Report suggest the Committee may now be less convinced of the need to increase rates even if there is a Brexit deal.

Growth in Europe remains soft, driven by a weakening German economy which saw GDP fall -0.1% in Q2 and is expected to slip into a technical recession in Q3. Euro zone inflation was 0.8% year on year in September, well below the European Central Bank's (ECB) target of 'below, but close to 2%' and leading to the central bank holding its main interest rate at 0% while cutting the deposit facility rate to -0.5%. In addition to maintaining interest rates at ultra-low levels, the ECB announced it would recommence its quantitative easing programme from November.

In the US, the Federal Reserve began easing monetary policy again in 2019 as a pre-emptive strike against slowing global and US economic growth on the back on of the ongoing trade war with China.

At its last meeting the Federal Reserve cut rates to the range of 1.50-1.75% and financial markets expect further loosening of monetary policy in 2020. US GDP growth slowed to 1.9% annualised in Q3 from 2.0% in Q2.

Credit outlook: Credit conditions for larger UK banks have remained relatively benign over the past year. The UK's departure from the European Union was delayed three times in 2019 and while there remains some concern over a global economic slowdown, this has yet to manifest in any credit issues for banks. Meanwhile, the post financial crisis banking reform is now largely complete, with the new ringfenced banks embedded in the market.

Metro Bank and TSB Bank hit the news headlines in 2019 both suffering adverse publicity and falling customer numbers.

Looking forward, the potential for a "no-deal" Brexit and/or a global recession remain the major risks facing banks and building societies in 2020/21 and a cautious approach to bank deposits remains advisable.

Interest rate forecast: The Council's treasury management adviser, Arlingclose, is forecasting that Bank Rate will remain at 0.75% until the end of 2022. The risks to this forecast are deemed to be significantly weighted to the downside, particularly given the need for greater clarity on the post Brexit transition period and the continuing global economic slowdown. The Bank of England, having previously indicated interest rates may need to rise if a Brexit agreement was reached, stated in its November Monetary Policy Report and its Bank Rate decision (7-2 vote to hold rates) that the MPC now believe this is less likely.

Gilt yields have risen but remain at low levels and only some very modest upward movement from current levels are expected based on Arlingclose's interest rate projections. The central case is for 10-year and 20-year gilt yields to rise to around 1.00% and 1.40% respectively over the time horizon, with broadly balanced risks to both the upside and downside. However, short-term volatility arising from both economic and political events over the period is a near certainty.

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

For the purpose of setting the budget, it has been assumed that new treasury management investments will be made at an average rate of 0.80%, and that new long-term loans will be borrowed at an average rate of 2.77%.

Local Context

On 30th November 2019, the Council held £77.41m of borrowing and £120.82m of investments. This is set out in further detail at Appendix B. 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.

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. The Council expects to comply with this recommendation during 2020/21 and in the subsequent years.

Borrowing Strategy

The Council currently holds £77.41 million of loans, a decrease of £10.16 million on the previous year which is due to £10 million of variable rate loans being due for redemption. The Council may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £153 million.

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.

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.

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 2020/21 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

Alternatively, the Council may arrange forward starting loans during 2020/21, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period. In addition, the Council may borrow short-term loans to cover unplanned cash flow shortages.

The Council has previously raised all of its long-term borrowing from the PWLB but, as a consequence of the recent increase in PWLB borrowing by councils to invest in commercial property, the government increased PWLB rates by 1% in October 2019, making it now a relatively expensive option. The Council will now look to borrow any 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.

Sources of borrowing: The approved sources of long-term and short-term borrowing are:

- Public Works Loan Board (PWLB) and any successor body;
- 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 local Pension Fund);
- capital market bond investors;
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues; and
- include any other counterparty you intend to borrow from.

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; and
- sale and leaseback.

The Council has previously raised all of its long-term borrowing from the PWLB but it continues to investigate other sources of finance, such as local authority loans and bank loans that may be available at more favourable rates.

Municipal Bonds Agency: UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to full Council.

LOBOs: The Council does not hold any LOBO's (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost.

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.

Debt rescheduling: The PWLB allows Council's 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.

Investment Strategy

The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council's (Suffolk Coastal and Waveney District Councils) investment balance has ranged between £85.78 million and £132.78 million, and similar levels are expected to be maintained in the forthcoming year.

Objectives: The CIPFA Code requires 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. 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.

Negative interest rates: If the UK enters into a recession in 2020/21, there is a small chance that the Bank of England could 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. This situation already exists in many other European countries. 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.

Strategy: Given the increasing risk and very low returns from short-term unsecured bank investments, the Council aims to diversify into more secure and/or higher yielding asset classes during 2020/21. This is especially the case for the estimated £30m that is available for longer-term investment. The majority of the Council's surplus cash is currently invested in either short-term unsecured bank deposits or Local Authority deposits. This diversification will represent a substantial change in strategy over the coming year.

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.

Approved counterparties: The Council may invest its surplus funds with any of the counterparty types in table 1 below, subject to the cash limits (per counterparty) and the time limits shown. These limits exclude any interest payments which will be paid to the Council periodically.

Table 1: Approved investment counterparties and principal limits

Credit rating	Banks unsecured	Banks Secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£20m 5 years	£25m 20 years	£30m 50 years	£20m 20 years	£20m 20 years
AA+	£20m 5 years	£25m 10 years	£30m 25 years	£20m 10 years	£20m 10 years
AA	£20m 4 years	£25m 5 years	£30m 15 years	£20m 5 years	£20m 10 years
AA-	£20m 3 years	£25m 4 years	£30m 10 years	£20m 4 years	£20m 10 years
A+	£20m 2 years	£25m 3 years	£30m 5 years	£20m 3 years	£20m 5 years
A	£20m 13 months	£25m 2 years	£30m 5 years	£20m 2 years	£20m 5 years
A-	£20m 6 months	£25m 13 months	£20m 5 years	£20m 13 months	£20m 5 years
None	£4m 6 months	n/a	£10m 25 years	£10m 5 years	£20m 5 years
Pooled funds and real estate investment trusts	£10m per fund				

This table must be read in conjunction with the notes below.

Credit rating: Investment limits are set by reference to the lowest published long-term credit rating from a selection of rating agencies. 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.

Banks 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.

Banks secured: 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 higher 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.

Government: Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency although they are not a zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

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 £50,000 per company as part of a diversified pool in order to spread the risk widely.

Registered providers: 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 tightly 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.

Pooled funds: Shares or units in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

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.

Real estate investment trusts (REIT): 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. Investments in REIT shares cannot be withdrawn but can be sold on the stock market to another investor.

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 below £15m 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.

Risk assessment and credit ratings: Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as “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.

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.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, 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 a reduction in the level of investment income earned but will protect the principal sum invested.

Investment limits: In order that investment balances are not put at too higher risk the maximum that will be lent to any one organisation (other than the UK Government) will be £25 million. 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 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 2: Investment limits

	Cash limit
Any single organisation, except the UK Central Government	£25m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£25m per group
Any group of pooled funds under the same management	£10m per manager
Negotiable instruments held in a broker’s nominee account	£10m per broker
Foreign countries	£4m per country
Registered providers & Registered Social Landlords	£10m in total
Unsecured investments with building societies	£15m in total
Loans to unrated corporates	£2m in total
Money Market Funds	50% of total investments

Liquidity management: The Council uses purpose-built cash flow forecasting software 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.

Treasury Management Indicators

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

Security: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit score of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk. The lower the score the lower the risk is.

	2019/20 Q3	**Target**
Portfolio average credit score	4.9	4

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.

	Target
Total cash available within 3 months	£15.00m

Interest rate exposures: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed will be:

	2020/21	**2021/22**	**2022/23**
Upper limit on fixed interest rate exposure	100%	100%	100%
Upper limit on variable interest rate exposure	50%	50%	50%

Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate.

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 fixed rate borrowing will be:

	Upper	**Lower**
Under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	75%	0%
5 years and within 10 years	75%	0%
10 years and within 20 year	75%	0%
20 years and above	100%	0%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Principal sums invested for periods longer than one 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:

	2020/21	2021/22	2022/23	2023/24
Limit on principal invested beyond year end	£20.0m	£20.0m	£20.0m	£20.0m

Operational Boundary for External Debt: The operational boundary is based on the Council's estimate of most likely (i.e. prudent but not worst case) scenario for external debt. It links directly to the Council's estimates of capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring. Other long-term liabilities comprise finance lease, Private Finance Initiative and other liabilities that are not borrowing but form part of the Council's debt.

Operational Boundary	2020/2021 Limit £m	2021/22 Limit £m	2022/23 Limit £m	2023/24 Limit £m
Borrowing	153.00	153.00	153.00	153.00
Total Debt	153.00	153.00	153.00	153.00

Authorised Limit for External Debt: The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Council can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Authorised Limit	2020/21 Limit £m	2021/22 Limit £m	2022/23 Limit £m	2023/24 Limit £m
Borrowing	155.00	155.00	155.00	155.00
Total Debt	155.00	155.00	155.00	155.00

<u>Related Matters</u>

The CIPFA Code requires the Council to include the following in its treasury management strategy.

Financial Derivatives: Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

In line with the CIPFA Code, the Council will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.

Housing Revenue Account: On 1st April 2012, the Council notionally split each of its existing long-term loans into General Fund and HRA pools. In the future, new long-term loans borrowed will be assigned in their entirety to one pool or the other. Interest payable and other costs/income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged/credited to the respective revenue account. Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. This balance will be measured each month and interest transferred between the General Fund and HRA at the Council's average interest rate on investments, adjusted for credit risk.

Markets in Financial Instruments Directive: The Council has opted up to professional client with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but with the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the Chief Finance Officer believes this to be the most appropriate status.

Financial Implications

The budget for investment income in 2020/21 is £0.80 million, based on an average investment portfolio of £100 million at an average interest rate of 0.80%. The budget for debt interest paid in 2020/21 is £2.61 million, based on an average debt portfolio of £77.41 million at an average interest rate of 3.25%. If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different.

Other Options Considered

The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Finance Officer, having consulted the Cabinet Member for Resources, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
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

Annex A – Arlingclose Economic & Interest Rate Forecast December 2019

Underlying assumptions:

- The global economy is entering a period of slower growth in response to political issues, primarily the trade policy stance of the US. The UK economy has displayed a marked slowdown in growth due to both Brexit uncertainty and the downturn in global activity. In response, global and UK interest rate expectations have eased.
- Some positivity on the trade negotiations between China and the US has prompted worst case economic scenarios to be pared back. However, information is limited, and upbeat expectations have been wrong before.
- Brexit has been delayed until 31st January 2020. Following the General Election, the Conservative position in parliament has been strengthened, which eliminates the chance of Brexit being further frustrated. A key concern is the limited transitionary period following a January 2020 exit date, which will maintain and create additional uncertainty.
- UK economic growth has stalled despite Q3 2019 GDP of 0.3%. Monthly figures indicate growth waned as the quarter progressed and survey data suggest falling household and business confidence. Both main political parties have promised substantial fiscal easing, which should help support growth.
- While the potential for divergent paths for UK monetary policy remain the weaker external environment severely limits potential upside movement in Bank Rate, while the slowing UK economy will place pressure on the MPC to loosen monetary policy. Indeed, two MPC members voted for an immediate cut in November 2019.
- Inflation is running below target at 1.7%. While the tight labour market risks medium-term domestically-driven inflationary pressure, slower global growth should reduce the prospect of externally driven pressure, although political turmoil could push up oil prices.
- Central bank actions and geopolitical risks will continue to produce significant volatility in financial markets, including bond markets.

Forecast:

- Although we have maintained our Bank Rate forecast at 0.75% for the foreseeable future, there are substantial risks to this forecast, dependant on whether the UK leaves the EU with a deal and the evolution of the global economy.
- Arlingclose judges that the risks are weighted to the downside.
- Gilt yields have risen but remain low due to the soft UK and global economic outlooks. US monetary policy and UK government spending will be key influences alongside UK monetary policy.
- We expect gilt yields to remain at relatively low levels for the foreseeable future and judge the risks to be broadly balanced.

	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.21**
Arlingclose Central Case	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**
Downside risk	-0.50	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	**-0.73**
3-month money market rate														
Upside risk	0.10	0.10	0.25	0.25	0.25	0.25	0.25	0.25	0.30	0.30	0.30	0.30	0.30	**0.25**
Arlingclose Central Case	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**
Downside risk	-0.50	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	**-0.73**
1yr money market rate														
Upside risk	0.10	0.20	0.20	0.20	0.20	0.20	0.20	0.25	0.30	0.30	0.30	0.30	0.30	**0.23**
Arlingclose Central Case	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**
Downside risk	-0.30	-0.50	-0.55	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	**-0.60**
5yr gilt yield														
Upside risk	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.45	0.45	0.45	**0.37**
Arlingclose Central Case	**0.50**	**0.50**	**0.50**	**0.55**	**0.60**	**0.60**	**0.60**	**0.60**	**0.60**	**0.60**	**0.60**	**0.60**	**0.60**	**0.57**
Downside risk	-0.35	-0.50	-0.50	-0.55	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	**-0.56**
10yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	**0.37**
Arlingclose Central Case	**0.75**	**0.75**	**0.80**	**0.80**	**0.85**	**0.85**	**0.90**	**0.90**	**0.95**	**0.95**	**1.00**	**1.00**	**1.00**	**0.88**
Downside risk	-0.40	-0.40	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	**-0.45**
20yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	**0.37**
Arlingclose Central Case	**1.20**	**1.20**	**1.25**	**1.25**	**1.25**	**1.30**	**1.30**	**1.30**	**1.35**	**1.35**	**1.35**	**1.40**	**1.40**	**1.30**
Downside risk	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	**-0.45**
50yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	**0.37**
Arlingclose Central Case	**1.20**	**1.20**	**1.25**	**1.25**	**1.25**	**1.30**	**1.30**	**1.30**	**1.35**	**1.35**	**1.35**	**1.40**	**1.40**	**1.30**
Downside risk	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	**-0.45**

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 1.80%

PWLB Local Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

Annex B – Existing Investment & Debt Portfolio Position

	Nov-19 **Actual Portfolio** **£m**
External borrowing:	
Public Works Loan Board	**77.41**
Local authorities	**0**
Other loans	**0**
Total external borrowing	**77.41**
Other long-term liabilities:	
Leases	6.47
Total other long-term liabilities	
Total gross external debt	**83.88**
Treasury investments:	
Banks & building societies (unsecured)	10.96
Government (incl. local authorities)	93.00
Money Market Funds	2.00
Other pooled funds	14.86
Total treasury investments	**120.82**
Net debt	-36.94

Annex C – Summary of Existing Investment & Debt Portfolio Position

Type of Loan	Start Date	Maturity	Principal	Interest Rate	
Maturity Loans					
Fixed	30/11/1995	30/09/2024	2,000,000	8.38%	GF/HRA
Fixed	19/12/1996	31/03/2022	1,000,000	7.88%	GF/HRA
Fixed	10/08/2007	31/03/2055	3,000,000	4.55%	GF/HRA
Fixed	28/03/2012	28/03/2039	10,000,000	3.47%	HRA
Fixed	28/03/2012	28/03/2036	10,000,000	3.42%	HRA
Fixed	28/03/2012	28/03/2027	10,000,000	3.01%	HRA
Fixed	28/03/2012	28/03/2041	10,000,000	3.49%	HRA
Fixed	28/03/2012	28/03/2032	10,000,000	3.30%	HRA
Fixed	28/03/2012	28/03/2042	8,000,000	3.50%	HRA
Variable	28/03/2012	28/03/2022	10,286,000	0.92%	HRA
Equal Instalments of Principle (EIP)					
Fixed	15/05/2015	15/11/2035	3,120,000	3.69%	GF/HRA
Annuity					
Fixed	10/09/1968	26/08/2028	7,433	7.62%	GF/HRA
		Total	**77,413,433**		

Counterparty	Type of Investment	Principle		Start Date	Maturity	Interest Rate
Bank 1	Instant Access	4,960,000	n/a	n/a	n/a	
Bank 2	Instant Access	3,000,000	n/a	n/a	n/a	0.40%
Bank 3	32 Day Notice	500,000	n/a	21/05/2019	n/a	0.75%
Bank 4	95 Day Notice	2,500,000		21/05/2019		0.95%
		10,960,000				
Central Government	Fixed Term	5,000,000	<1 month	13/11/2019	02/12/2019	0.50%
Local Authority 1	Fixed Term	2,000,000	1 Year	03/12/2018	03/12/2019	1.01%
Local Authority 2	Fixed Term	2,000,000	6 months	03/06/2019	03/12/2019	0.85%
Local Authority 2	Fixed Term	3,000,000	6 months	07/06/2019	06/12/2019	0.85%
Local Authority 3	Fixed Term	10,000,000	1 Year	10/12/2018	10/12/2019	1.10%
Local Authority 2	Fixed Term	1,000,000	6 months	10/06/2019	10/12/2019	0.80%
Local Authority 2	Fixed Term	1,000,000	6 months	04/07/2019	03/01/2020	0.80%
Central Government	Fixed Term	3,000,000	<2 months	13/11/2019	06/01/2020	0.50%
Local Authority 1	Fixed Term	2,000,000	1 Year	04/01/2019	06/01/2020	1.01%
Local Authority 4	Fixed Term	3,000,000	6 months	19/08/2019	19/02/2020	0.80%
Local Authority 5	Fixed Term	2,000,000	278 days	29/05/2019	02/03/2020	0.92%
Local Authority 1	Fixed Term	4,000,000	1 Year	05/03/2019	05/03/2020	0.98%
Local Authority 6	Fixed Term	5,000,000	6 months	20/09/2019	20/03/2020	0.80%
Local Authority 7	Fixed Term	5,000,000	9 months	20/08/2019	20/05/2020	0.89%
Local Authority 2	Fixed Term	2,000,000	6 months	22/11/2019	22/05/2020	0.85%
Local Authority 8	Fixed Term	5,000,000	6 months	22/11/2019	22/05/2020	0.85%
Local Authority 2	Fixed Term	3,000,000	6 months	28/11/2019	28/05/2020	0.85%
Local Authority 9	Fixed Term	3,000,000	1 Year	25/06/2019	25/06/2020	0.95%
Local Authority 10	Fixed Term	5,000,000	6 months	08/07/2019	08/07/2020	0.95%
Local Authority 10	Fixed Term	5,000,000	1 Year	19/07/2019	20/07/2020	0.95%
Local Authority 11	Fixed Term	4,000,000	1 Year	31/07/2019	29/07/2020	0.95%
Local Authority 2	Fixed Term	3,000,000	1 Year	28/08/2019	26/08/2020	0.90%
Local Authority 12	Fixed Term	5,000,000	9 months	29/11/2019	01/09/2020	0.80%
Local Authority 13	Fixed Term	2,000,000	1 Year	25/09/2019	23/09/2020	0.90%
Local Authority 14	Fixed Term	5,000,000	2 Years	31/10/2018	30/10/2020	1.35%
Local Authority 15	Fixed Term	3,000,000	1 Year	01/11/2019	30/10/2020	0.83%
		93,000,000				
MMF 1	Instant Access	2,000,000	n/a	n/a	n/a	0.77%
		2,000,000				
Pooled Fund 1	Notice Long Term	9,856,000		29/11/2017		4.49%
Pooled Fund 2	Notice Long Term	5,000,000		17/10/2019		3.36%
		14,856,000				
	Total	**120,816,000**				

Investment Strategy Report 2020/21

East Suffolk Council

Introduction

The Council invests its money for two broad purposes:

- because it has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure (known as treasury management investments), and
- to earn investment income (known as commercial investments where this is the main purpose).

Treasury Management Investments

The Council typically receives its income in cash (e.g. from taxes and grants) before it pays for its expenditure in cash (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. The balance of treasury management investments is expected to fluctuate between £97 million and £140 million during the 2020/21 financial year.

Contribution: The contribution that these investments make to the objectives of the Council is to support effective treasury management activities.

Further details: Full details of the Council's policies and its plan for 2020/21 for treasury management investments are covered in a separate document, the treasury management strategy.

Commercial Investments: Property

Contribution: The Council invests in local commercial property with the intention of making a profit that will be spent on local public services.

Table 1: Property held for investment purposes in £ millions

Property	Actual	31.3.2019 actual	
	Purchase cost £000	Gains or (losses) £000	Value in accounts £000
Commercial shop	166	-22	144
Commercial shop	1,433	-603	830
Commercial shop	2,358	-450	1,908
TOTAL	**3,957**	**-1,075**	**2,882**

Security: In accordance with government guidance, the Council considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs.

The fair value of the Council's investment property portfolio is no longer sufficient to provide security against loss. However, the Council fully expects the fair value to increase following significant works to the adjoining car park, with the fair value expected to increase to that nearing the original purchase price.

Risk assessment: The Council assesses the risk of loss before entering into and whilst holding property investments by assessing the viability of the cost of financing the investment against the return on investment in terms of receivable income. Investments that are subject to short leases are unlikely to be considered due to the high risk of potential voids.

Liquidity: Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice and can take a considerable period to sell in certain market conditions. To ensure that the invested funds can be accessed when they are needed, for example to repay capital borrowed; the Council ensures that borrowing is on an equal instalment basis and that revenue budgets cover the cost of the loan repayment.

Loan Commitments and Financial Guarantees

Although not strictly counted as investments, since no money has exchanged hands yet, loan commitments and financial guarantees carry similar risks to the Council and are included here for completeness.

The Council does not have any current financial guarantees and all loans are through the Public Works Loan Board (PWLB).

Capacity, Skills and Culture

Elected members and statutory officers: It is important that the members and officers involved in the Treasury Management function have appropriate capacity, skills and information to enable them to take informed decisions on specific investments, to assess the risk and strategic objectives and to ensure that the Council's risk exposure is managed. Periodically the Council's external Treasury advisors, Arlingclose will hold member training sessions which will provide members with a raft of technical advice specifically designed for the Council's environment. Additionally, Officers have a wide range of information available to them from various sources such as the Charted Institute of Public Finance and Accountancy (CIPFA), Arlingclose and Room 151. Officers will also attend a number of courses/seminars throughout the year and have periodical strategic meetings with the Council's treasury advisors.

Commercial deals: Officers negotiating commercial deals are aware of the core principles of the prudential framework and of the regulatory regime within which local Authorities operate and have access to a number of external bodies who can provide specific advice and direction.

Corporate governance: All of the Council's procedures provide a corporate governance arrangement that ensure accountability and for decision making on investment activities and ensure that the Council's Chief Finance Officer/Section 151 Officer is fully briefed on the Council's investment position at any one time.

Investment Indicators

The Council has set the following quantitative indicators to allow elected members and the public to assess the Council's total risk exposure as a result of its investment decisions.

Total risk exposure: The first indicator shows the Council's total exposure to potential investment losses. This includes amounts the Council is contractually committed to lend but have yet to be drawn down and guarantees the Council has issued over third party loans.

Table 2: Total investment exposure in £millions

Total investment exposure	**31.03.2019 Actual £000**	**31.03.2020 Forecast £000**	**31.03.2021 Forecast £000**
Treasury management investments	113.28	102.00	110.00
Commercial investments: Property	2.88	2.88	2.88
TOTAL INVESTMENTS	**116.16**	**104.88**	**112.88**
Guarantees issued on loans	87.57	77.41	77.25
TOTAL EXPOSURE	**-28.59**	**-27.47**	**-35.63**

How investments are funded: Government guidance is that these indicators should include how investments are funded. Since the Council does not normally associate particular assets with particular liabilities, this guidance is difficult to comply with. However, the following investments could be described as being funded by borrowing. The remainder of the Council's investments are funded by usable reserves and income received in advance of expenditure.

Table 3: Investments funded by borrowing in £millions

Investments funded by borrowing	**31.03.2019 Actual £000**	**31.03.2020 Forecast £000**	**31.03.2021 Forecast £000**
Commercial investments: Property	3.36	3.20	3.04

Rate of return received: This indicator shows the investment income received less the associated costs, including the cost of borrowing where appropriate, as a proportion of the sum initially invested. Note that due to the complex local government accounting framework, not all recorded gains and losses affect the revenue account in the year they are incurred.

Table 4: Investment rate of return (net of all costs)

Investments net rate of return	**2018/19 Actual**	**2019/20 Forecast**	**2020/2021 Forecast**
Treasury management investments	0.89%	0.89%	0.85%
Treasury management property investments	4.21%	4.39%	4.40%
Commercial investments: Property	5.0%	1.2%	1.2%
ALL INVESTMENTS	**10.10%**	**6.48%**	**6.08%**