APPENDIX B

TREASURY MANAGEMENT STRATEGY STATEMENT 2020-21

Introduction

1. Treasury management is the management of the authority's cash flows, borrowing and investments. The council is exposed to financial risks from treasury management activity including possible losses associated with council investment and potential for increased borrowing costs arising from market movements. The identification, monitoring and control of financial risks are a crucial part of the financial management and governance arrangements of the council.

2. Treasury risk management is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) 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.

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

4. Under financial delegation, the strategic director of finance and governance is responsible for all executive and operational decisions on treasury management. This treasury management strategy, together with supporting prudential indicators and policies will ensure that these responsibilities can be carried out effectively.

Net Borrowing Position

5. As at 31 December 2019 the council held £757m of borrowing and £148m of investments.

6. 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, known as internal borrowing.

7. The Council has an increasing CFR due to its ambitious capital programme. Based on current forecasts there is an estimated need to borrow up £1bn by 31 March 2025.

Borrowing strategy and debt management activity and position

8. The council's debt management strategy since 2011-12 has been to pursue a policy of internal borrowing, which is the use of existing reserves and balances to temporarily fund capital expenditure rather than the use of external borrowing.

9. The use of internal borrowing allows the council to minimise unnecessary external borrowing costs by only borrowing when needed for liquidity, or to benefit from advantageous borrowing rates. Borrowing in advance of need from a cashflow perspective creates a 'cost of carry' which is the difference between

the short term investment income earned through holding cash balances compared against longer term external debt financing costs

10. During the period from 2011-12 to 2017-18 the rate of return on short term investments was consistently much lower compared to longer term borrowing. The savings for the council from deferring external borrowing in this way equate to circa £20m

11. Efficient use of existing council resources to fund capital expenditure through internal borrowing also reduces the council's counterparty risk inherent in the investment of cash balances.

12. During the financial year to 31 March 2019 the council borrowed £117m from the Public Works Loans Board (PWLB), as part of HM Treasury, in 13 separate loans, with maturity terms ranging from 35 to 49 years at an average interest rate of 2.49%.

13. The £117m borrowed in long term debt was lower than the £150m originally forecast at the beginning of 2018-19. The re-profiling of capital expenditure into future years allowed the council to defer external borrowing. This had the impact of reducing the interest cost associated with debt financing to the revenue budget.

14. Drawing of long term borrowing has been supplemented by a continuation of short term borrowing from other local authorities to reduce the overall debt interest expense for the council. The level of short term borrowing from other local authorities as at 31 March 2019 was £120m.

15. This approach to short term borrowing has continued during 2019-20 with the balance of short term borrowing from local authorities at £175m as at 31 December 2019, although the balance as at 31 March 2020 is expected to reduce to £130m. The weighted average rate of interest on existing short term borrowing is 0.9%, significantly less than long term rates of borrowing.

16. Officers regularly monitor current and forecast interest rates to determine the appropriateness of the internal and short term borrowing approach, so that the reduction in current borrowing costs from use of internal balances is not offset by higher borrowing costs in the future.

17. Future borrowing requirements arising from the approved capital programme, the extent of internal borrowing and the need to refinance scheduled debt repayments, together with potential for interest rate rises, indicate the need for long-term borrowing during the second half of 2019-20, with further borrowing required during 2020-21.

18. All historical long term debt for the council has been drawn from the PWLB. However future borrowing could come from a variety of different sources. In October 2019, a percentage point increase in the rate of borrowing from the PWLB was announced, with immediate effect. The council has already built a higher assumed rate of interest into budgets, given that the PWLB rate was expected to rise in the medium term.

19. The council could borrow through other financial institutions and banks, or directly from other local authorities. Alternative sources of borrowing to the PWLB will be considered Any borrowing decision will be made in consideration of capital and cashflow forecasts, market conditions, interest rate expectations

and with respect to associated risks. The council will also utilise the advice of its external treasury advisor Arlingclose.

20. The council's outstanding debt portfolio, used to fund historical capital expenditure, stood at £677m as at 31 March 2019 with £364m attributable to the HRA and £313m to the general fund.

21. All long term outstanding debt was borrowed from the PWLB, part of HM Treasury, at fixed rates of interest. During the first half of 2019-20, £2.5m of long term debt principal matured and was repaid to PWLB.

22. The weighted average rate of interest for the council's debt portfolio is 3.9% as at 31 December 2019 a reduction from 4.2% as at 31 March 2019.

Investment Position and Activity

23. The council holds sizable investment balances, representing income received in advance of expenditure plus balances and reserves held. Investments as at 31 December 2019 were £148m (£108m at 31 December 2018).

24. Council resources that are not immediately required for current expenditure are invested in money market instruments in accordance with the MHCLG Guidance on Local Authority Investments and the approved investment strategy. The MHCLG guidance gives priority to security and liquidity and the council's aim is to achieve a yield commensurate with these principles.

25. Council investments are managed both in-house and delegated to two fund managers: Alliance Bernstein and Aberdeen Standard (formerly Aberdeen Asset Management). The focus for in-house investment is to meet variable near term cash liquidity requirements, principally using money market funds and other highly secure, liquid financial instruments

26. Any surplus cash resources not required in the short term to fund council activities is placed with the council's two external fund managers. The fund managers invest for a longer term in UK government gilts, supranational bank bonds, certificates of deposits issued by major banks/ building societies and other financial instruments.

27. The use of fund managers has the advantage of diversification of investment risk, coupled with the services of professional fund managers, which over the longer-term, provides enhanced returns within the council's risk appetite. Although investments can be redeemed from the fund managers at short notice, the intention is to hold them for the medium term. Their performance and suitability in meeting the council's investment objectives are regularly monitored.

28. The distribution of council investments across counterparties by rating and maturity as at 31 December 2019 is set out in the table below:

	A		AA		AAA		Total
Investment Maturity	**£m**	**%**	**£m**	**%**	**£m**	**%**	**£m**
Up to 1 Year	18.9	13%	39.0	26%	51.3	35%	109.2
1 - 2 Years	1.5	1%	2.0	1%	5.1	3%	8.6
2 - 5 Years	0.0	0%	7.1	5%	22.6	15%	29.7
Total	**20.4**	**14%**	**48.1**	**33%**	**79.0**	**54%**	**147.5**

16. The global economic environment during the first half of this year was marked by a continuation of declining trade volumes and political uncertainty, especially surrounding trade relations between US and China.

17. Concern regarding political uncertainty and a possible global recession led to additional monetary easing from central banks. This accelerated already declining yields across all major economies. The German 10 year Bund dropped further into negative territory reaching -0.57% at the end of Q2 and the yield for 10 year US Treasury collapsed from 3.25% in November 2018 to 1.66% as at the end of September 2019.

18. The annualised rate of return for council treasury management assets for the first nine months of the financial year was 1.0%. To analyse the treasury management portfolio, the council measures the return against a composite investment benchmark of three month LIBID and one to three year gilt index. For the equivalent period the benchmark index annualised return was 0.65% indicating an outperformance of 0.35%.

19. The rate of investment return generated by the treasury management portfolio is a consequence of the council's prudent, low risk approach to treasury management investing. This is in line with the requirements of the statutory guidance for local government treasury investment issued by MHCLG.

20. The priorities for treasury management investment are, in order of priority, security, liquidity and yield. The objective therefore is to ensure that funds are available to meet council liabilities as they fall due.

21. It is important that the treasury management strategy is suitably flexible such that the council can take advantage of market opportunities and maintain appropriate asset diversification within the portfolio to best support the council's revenue budget, whilst retaining the overriding objectives of security and liquidity.

22. The 2019-20 investment strategy, agreed by Council Assembly in February 2019, had allowed for enhanced flexibility in the implementation of the investment strategy for the council such that there is no requirement to change it further at this time.