APPENDIX B

TREASURY MANAGEMENT STRATEGY STATEMENT 2021-22

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 30 September 2020 the council held £809m of borrowing and £188m 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 to £1.5bn 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 2020 the council borrowed £81m from the Public Works Loans Board (PWLB), as part of HM Treasury. The loans were taken with fixed rates with maturities between 8 and 49 years at an average interest rate of 1.58%.

13. 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. By doing so, the Authority is able to reduce net borrowing costs and reduce overall treasury risk.

14. Drawing of long term borrowing has therefore been supplemented by 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 2020 was £177m. This policy has continued during 2020-21.

15. Officers regularly monitor current and forecast interest rates to determine the benefits of internal/short-term borrowing against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly.

16. During the first half of 2020-21 the council borrowed £7m from the Mayor of London's Energy Efficiency Fund (MEEF). The MEEF gets funding from the European Regional Development Fund and other partner banks to fund developments within London councils and other public sector bodies that will result in reduction in carbon emissions. The rates are therefore more favourable than comparable PWLB rates.

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 borrowing during the second half of 2020-21, with further borrowing required during 2021-22.

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 to ensure the lowest available rates are achieved.

20. All short term borrowing during 2019-20 was via other local authorities. During the first half of 2020-21, £82m of short term debt matured and was repaid. A further £51.5m in new short term debt from other local authorities was drawn. Borrowing from other local authorities is typically at lower rates than from other sources for short duration debt. However the recent increase in PWLB rates has had a significant impact on the local authority to local authority lending market.

16. The council's outstanding debt portfolio, used to fund historical capital expenditure, stood at £810m as at 31 March 2020.

17. All long term outstanding debt was borrowed from the Public Works Loans Board (PWLB), part of HM Treasury, at fixed rates of interest. During the first half of 2020-21, £2.5m of long term debt principal matured and was repaid to PWLB.

18. In July 2020 the council borrowed £7m from the Mayor of London's Energy Efficiency Fund (MEEF). The MEEF gets funding from the European Regional Development Fund and other partner banks to fund developments within London councils and other public sector bodies that will result in reduction in carbon emissions. The rates are therefore more favourable than comparable PWLB rates.

19. The weighted average rate of interest for the council's debt portfolio was 3.9% as at 31 March 2020. This reflects the largely historical nature of the debt, the majority of which was drawn prior to 2008.

Investment Position and Activity

20. The council holds sizable investment balances, representing income received in advance of expenditure plus balances and reserves held. Investments as at 30 September 2020 were £188m (£148m at 30 September 2019).

21. 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.

22. 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

23. 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.

24. 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.

25. The distribution of council investments across counterparties by rating and maturity as at 31 March 2020 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**

26. The Authority's treasury management adviser Arlingclose is forecasting that Bank of England Bank Rate will remain at 0.1% until at least the end of 2023. The risks to this forecast are judged to be to the downside as the BoE and UK government continue to react to the coronavirus pandemic and the Brexit transition period ends. The BoE extended its asset purchase programme to £895 billion in November while keeping Bank Rate on hold. However, further interest rate cuts to zero, or possibly negative, cannot yet be ruled out but this is not part of the Arlingclose central forecast.

27. The annualised rate of return for council treasury management assets for the first six months of the financial year was 0.5%. The reduction in market yield led to an increase in the value for existing longer dated assets within the portfolio, but will lead to a reduction in future yields as existing assets mature or are realised.

28. 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 first half of the financial year the benchmark index annualised return was 0.50% indicating an outperformance of 0.1%.

29. 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.

30. 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.

31. 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.

32. The 2020-21 investment strategy, agreed by Council Assembly in February 2020, 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.