APPENDIX B

Treasury Management Strategy Statement 2022/23

Summary of the Report

1. This Treasury Management Strategy Statement (TMSS) sets out the treasury management issues in accordance with proper practice.

2. The Council uses treasury management advisors to help its decision making, keeping officers up to date with economic developments and providing training and support. Arlingclose Limited has been the Council's appointed advisor since December 2012.

3. The ongoing impact on the UK from coronavirus together with higher inflation, the likelihood of higher interest rates and the country's trade position post-Brexit will be major influences on the Authority's treasury management strategy for 2022/23.

4. As a steward of public finance, the Council will continue to take all practical steps to protect its investment portfolio. In this respect emphasis remains in this order of priority:

   - **Security:** which includes the following:
     - Reducing risk in order to protect the return of capital sums, particularly in relation to the Council's investments;
     - Where balances are expected to be invested for more than one year attempting as far as possible, within the parameters of this document, a total return equal to or higher than the prevailing rate of inflation.

   - **Liquidity:** availability of cash when needed (adequate but not excessive liquidity).

   - **Yield:** a return commensurate with the level of risk.

5. Harlow Council has embarked on a number of major projects which will deplete surplus cash held. It is anticipated that during 2022/23 the Council will need to undertake external borrowing.

Introduction

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

7. 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.

8. Investments held for service purposes or for commercial profit are considered in a different report, the 'Investment Strategy' (Appendix D).

9. **Interest rate forecast:** The Council's treasury management adviser Arlingclose is forecasting that Bank Rate will rise in calendar Q2 2022 to subdue inflationary pressures and the perceived desire by the BoE (Bank of England) to move away from emergency levels of interest rates.

10. For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 0.4%, and that new long-term loans will be borrowed at an average rate of 3%.

Local Context

11. On 31 December 2021, the Council held £211.837m of borrowing and £33.714m of investments.

12. 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.

13. The Council has an increasing CFR due to the capital programme, but minimal investments and will therefore be required to borrow up to £22.6m over the forecast period to 2025.

14. 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 2022/23.

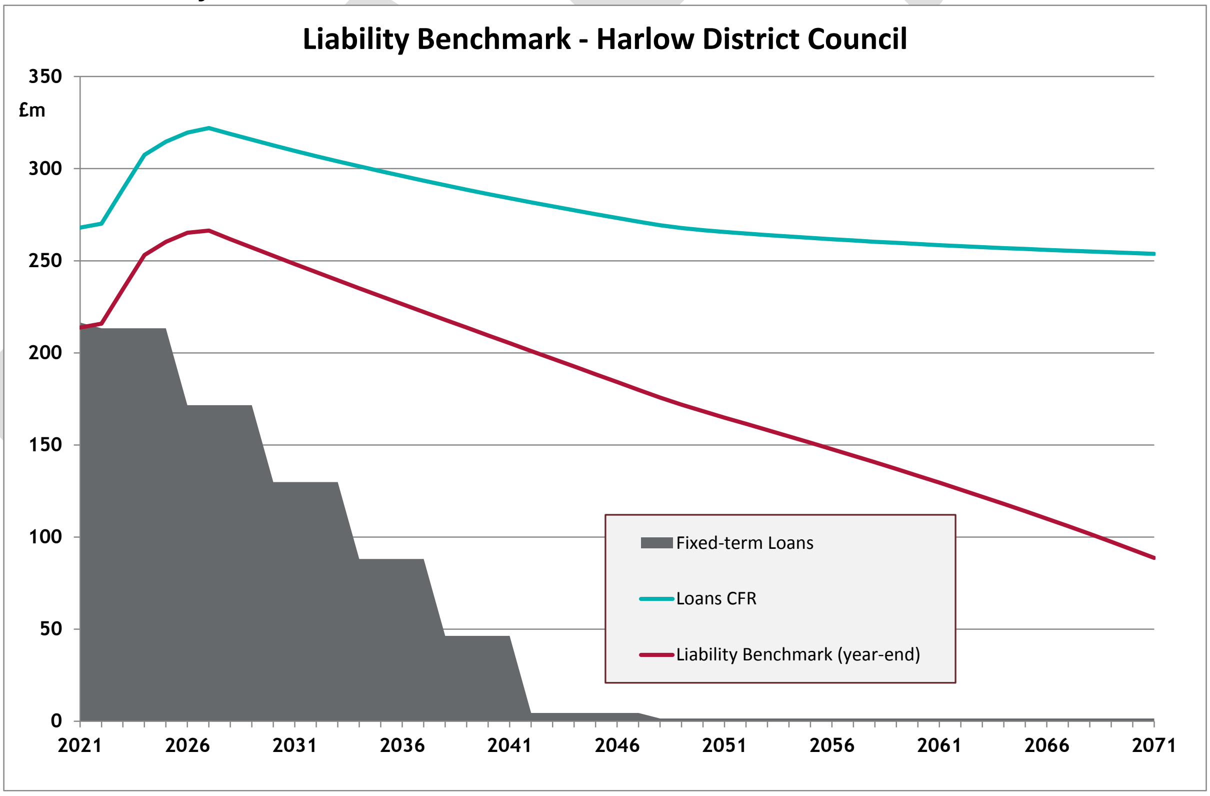
15. **Liability benchmark:** To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes that cash and investment balances are kept to a minimum level of £10m at each year-end to maintain sufficient liquidity but minimise credit risk.

Table 1: Liability Benchmark

	Actual 31/03/2021 £,000	Estimate 31/03/2022 £,000	Estimate 31/03/2023 £,000	Estimate 31/03/2024 £,000	Estimate 31/03/2025 £,000
Total CFR	268,025	270,153	288,977	307,497	314,611
Less: Balance Sheet Resources	64,352	64,352	64,352	64,352	64,352
Net Loans Requirement	203,673	205,801	224,625	243,145	250259,
Plus: Liquidity Allowance	10,000	10,000	10,000	10,000	10,000
Liability Benchmark	213,673	215,801	234,625	253,145	260,259

Following on from the medium-term forecasts in table 1 above, the long-term liability benchmark assumes no capital expenditure funded by borrowing and expenditure and reserves increasing by inflation of 2.5% a year. This is shown in the chart below:

Chart 1: Liability Benchmark



This chart shows if current loans are not replaced on maturity the borrowing will be well below the liability benchmark in the long term. This means that further loans will need to be borrowed to ensure minimum cash balances are available to the council.

Borrowing Strategy

16. The Council currently holds £211.837m of loans, being the same as the previous year, as part of its strategy for funding previous years' capital programmes but mainly for the requirement to finance the Government's self financing changes for housing in 2021. The 2022/23 capital programme indicates that the Council expects to borrow up to £19.4m in 2022/23. The Council may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £320 million.

17. **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.

18. **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 remains likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead. Where longer-term loans are utilised, they will be considered in the context of ensuring interest rates will be adequately balanced by income streams associated with the capital investment being financed.

19. 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/ 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 2022/23 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

20. The Council has previously raised all of its long-term borrowing from the PWLB. PWLB loans are no longer available to Councils planning to buy investment assets primarily for yield. The Council intends to avoid this activity in order to retain its access to PWLB loans.

21. 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. Forward starting loans are not available from the PWLB so would have to be borrowed from a private sector provider or potentially from the newly created 'UK Infrastructure Bank'. These types of loans may only be available through a bidding process for certain types of infrastructure or may not be at rates competitive to the PWLB.

22. In addition, the Council may borrow short-term loans to cover unplanned cash flow shortages, although this eventuality is highly unlikely to occur because the spread of investments provides for sufficient cash liquidity to meet forecast cash flows.

23. **Sources of borrowing:** The approved sources of long-term and short-term borrowing are:
- HM Treasury's PWLB lending facility (formerly the Public Works Loans Board)
- any institution approved for investments (see below)
- any other UK public sector body
- any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds (except Essex County Council Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues.

24. **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 debt liabilities:
- Leasing
- Hire purchase
- Private Finance Initiative
- Sale and leaseback

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

26. **Short-term and variable rate loans**: These loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below. Financial derivatives may be used to manage this interest rate risk (see section below).

27. **Debt rescheduling:** The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk. Due to the current interest rate environment there is usually a high premium cost association with repaying a loan early: for example repaying a £42m PWLB loan due for repayment in 2030 with interest paid at 3.2% would lead to a premium of approximately £9m needing to be paid.

<u>Treasury Investment Strategy</u>

28. 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 investment balance has ranged between £11.2m and £40.9m. The expenditure profile of the Council is linked closely to its capital investment plans and is expected to impact on the level of available resources for investment reducing to lower levels in 2022/23.

29. **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.

30. **Negative interest rates:** In the event that the Bank of England sets the Bank Rate at or below zero security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

31. **Strategy:** Given the increasing risk and very low returns from short-term unsecured bank investments, the Council will retain diversification into more secure and/or higher yielding asset classes during 2022/23 where cash is identified as available for longer-term investment. This diversification will represent a continuation of the current strategy.

32. **Approved counterparties:** The Council may invest its surplus funds with any of the counterparty types in table 3 below, subject to the cash limits (per counterparty) and the time limits shown.

33. With reduce cash surpluses anticipated to be available, the cash limits assume an investment portfolio between £10m and £20m.

34. Harlow Council's typical day-to-day investments are with local authorities for up to one year.

Table 3: Approved investment counterparties and 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	£1m 5 years	£2m 20 years	£2m 50 years	£1m 20 years	£1m 20 years
AA+	£1m 5 years	£2m 10 years	£2m 25 years	£1m 10 years	£1m 10 years
AA	£1m 4 years	£2m 5 years	£2m 15 years	£1m 5 years	£1m 10 years
AA-	£1m 3 years	£2m 4 years	£2m 10 years	£1m 4 years	£1m 10 years
A+	£1m 2 years	£2m 3 years	£1m 5 years	£1m 3 years	£1m 5 years
A	£1m 13 months	£2m 2 years	£1m 5 years	£1m 2 years	£1m 5 years
A-	£1m 6 months	£2m 13 months	£1m 5 years	£1m 13 months	£1m 5 years
None	£0.5m 6 months	n/a	**£2m** **25 years**	£50,000 5 years	£1m 5 years
Pooled funds and real estate investment trusts		£4m per fund or trust			

This table must be read in conjunction with the notes below

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

36. **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. See below for arrangements relating to operational bank accounts.

37. **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.

38. **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 zero risk. Investments with the UK Central Government may, in principle, be made in unlimited amounts for up to 50 years, although tying up the Council's cashflow for such an extensive period is particularly unlikely and an unforeseen occurrence.

39. **Local Authorities:** The Council's day-to-day investment transactions have moved more towards investments with other local authorities rather than banks. Councils have a legal duty to pass a balanced budget, have revenue raising powers, and a lender of last resort in the form of the Public Works Loan Board. In unusual circumstances, the lender is able to recoup the principal sum lent under the Local Government Act 2003, sections 6 and 13. In spite of continued reductions in central government funding, making the setting of budgets and budget monitoring even more challenging, the risk of default remains very low. Where a Council issues a notice under Section 114(3) of the Local Government Finance Act 1988 – as is currently the case with Slough Borough Council – then section 115(6) of the Act prevents local authority lending. There is concern in the local government community about some authorities that have engaged in excessive levels of commercial activity, in particular in light of the pressure the pandemic has put on the economy. This Council will exercise a degree of caution and will not lend where it feels the risk is too great. The Council may consider using an investment platform (iDealTrade) which contains quantitative information about borrowers.

40. **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.

41. **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.

42. **Pooled funds:** Shares or units in diversified investment vehicles consisting of 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.

43. 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.

44. **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 £4m (except in exceptional circumstances to avoid negative returns and as previously agreed over the Christmas period, defined as 20 December to 4 January inclusive, when the limit will be £6m). 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.

45. **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.

46. 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.

47. **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.

48. 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.

49. **Investment limits**: The maximum that will be lent to any one organisation (other than the UK Government) will be £4m. 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.

50. The cash limits assume an investment portfolio between £10m and £20m.

Table 4: Investment limits

	Cash limit
Any single organisation*, except the UK Central Government	£2m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£2m per group
Any group of pooled funds under the same management	£5m per manager
Negotiable instruments held in a broker's nominee account	£5m per broker
Foreign countries	£2m per country
Registered providers and registered social landlords	£5m in total
Unsecured investments with building societies	£2m in total
Loans to unrated corporates	£2m in total
Money market funds	£20m in total
Real estate investment trusts	£5m in total

* ‘Single organisation’ in this context does not mean a single money market fund or other pooled fund as these are inherently diversified and spread investments across a number of organisations.

51. **Liquidity management:** The Council uses a purpose-built cash flow forecasting spreadsheet 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

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

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

Interest rate risk indicator	**Limit**
Upper limit on one-year revenue impact of a 1% rise in interest rates	£400,000
Upper limit on one-year revenue impact of a 1% fall in interest rates	£400,000

54. The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced new market rates.

55. **Maturity structure of borrowing:** This indicator is set to control the Council’s exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing will be:

Refinancing rate risk indicator	**Upper limit**	**Lower limit**
Under 12 months	25%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

56. 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.

57. **Principal sums invested for periods longer than a year:** The purpose of this indicator is to control the Council’s exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

Price risk indicator	**2021/22**	**2022/23**	**2023/24**
Limit on principal invested beyond year end	£5m	£5m	£5m

Related Matters

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

59. **Policy on apportioning interest to the Housing Revenue Account:** On 1 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.

60. **Policy on the use of 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).

61. 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.

62. 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.

63. 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.

64. **Markets in Financial Instruments Directive**: The Council has opted up to professional client status with its providers of financial services, including

advisers, brokers and fund managers, allowing it access to a smaller 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 Deputy to the Chief Executive and Head of Finance & Property Services believes this to be the most appropriate status.

Financial Implications

65. The budget for investment income in 2022/23 is £84,000, based on an average investment portfolio of £21 million at an interest rate of 0.4%. The budget for debt interest paid is £7.191 million, based on an average debt portfolio of £217.9 million at an average interest rate of 3.31%. If actual levels of investments and borrowing, or actual interest rates, differ from those forecast, performance against budget will be correspondingly different.

Other Options Considered

66. The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Deputy to the Chief Executive and Head of Finance & Property, having consulted the Portfolio Holder (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