

Treasury Management & Investment Strategy 2020/21

Purpose

- 1.1 This report outlines the Council's Treasury Management Strategy for the financial year 2020/21 and the Treasury Management Indicators derived from this strategy. The report includes:
- Background and context
 - The Treasury Management Strategy
 - Treasury Management Indicators
 - Investment Strategy (Appendix 1)

Recommendations

- 2.1 To review the Treasury Management Strategy for 2020/21 outlined in paragraphs 4.26 to 4.64.
- 2.2 To note the Treasury Management Indicators for 2020/21 to 2022/23 in paragraph 4.65 to 4.70.
- 2.3 To review the Investment Strategy for 2020/21 outlined in the report attached at Appendix 1 at paragraphs 1.11 to 1.22.
- 2.4 To note the Investment Indicators for 2020/21 to 2022/23 outlined in the report attached at Appendix 1 in paragraph 1.23 to 1.30.
- 2.5 To consider the Investment approach for Commercial or Social Return outlined in the report attached at Appendix 1 in paragraphs 1.7 to 1.10

Reason

- 3.1 The Audit and Accounts Committee is responsible for providing scrutiny of the Treasury Management and Investment Strategy, before approval by cabinet on 12th

February 2020. This scrutiny is required as per the MHCLG Local Government Investment Guidance and the Finance and Accountancy's Treasury Management in the Public Services Code of Practice (the CIPFA Code)

Supporting information

4.1 Background

- 4.2 Treasury Management is the management of the Council's cash flows, borrowing and investments, and the associated risks. The Council has historically borrowed to finance capital expenditure but for a number of years have been an investor generating investment returns to support the Revenue Budget. This has also negated the need to borrow externally for a number of years, thereby saving on additional debt charges. 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.
- 4.3 The successful identification, monitoring and control of financial risk are central to the Council's treasury management where the priority is to protect capital rather than maximise return. The Treasury priorities are Security, Liquidity and Return in that order.
- 4.4 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) and the Prudential Property Investment guidance issued November 2019.
- 4.5 Investments held for service purposes or for commercial profit are considered in a different report, the Investment Strategy. The Investment Strategy can be found in Appendix 1.
- 4.6 The Treasury Management position is influenced by the Council's capital plans and their funding. These capital plans provide a guide to the borrowing need of the Council, requiring longer term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion debt previously drawn may be restructured to meet Council risk or cost objectives.

4.6 External Context

- 4.7 The information relating to the overall global position of the UK financial markets is provided by the Council's Treasury Management Advisors, Arlingclose. They provide a technical resource to support the Council with information including on-going market activity, inflation and interest forecasts. They also provide details on the creditworthiness of institutions that the Council invest money into.
- 4.8 **Economic background:**
- 4.9 The UK's Economic Forecasts are significantly influenced by the UK Government decision on exiting the European Union. Prior to agreement of the withdrawal bill the gilt market was factoring in high levels of uncertainty. At this stage the impact of BREXIT on economic activity is still to be fully incorporated into economic forecasts. However, there does seem to be a consensus that the current period of low inflation and interest rates will continue in the medium term. BREXIT therefore will continue to be a major influence on the Authority's treasury management strategy for 2020/21.
- 4.9 UK Consumer Price Inflation (CPI) for December registered 1.3% year on year, down from 1.5% in November. Core inflation, which excludes the more volatile components, fell to 1.4% from 1.7%. The most recent labour market data for the three months to August 2019 showed the unemployment rate ticked back up to 3.9% while the employment rate was 75.9%, just below recent record-breaking highs. The headline 3-month average annual growth rate for pay was 3.8% in August as wages continue to rise steadily. In real terms, after adjusting for inflation, pay growth increased 1.9%.
- 4.10 The Bank of England maintained Bank Rate to 0.75% in November following a 7-2 vote by the Monetary Policy Committee. 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.
- 4.11 **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 ring-fenced banks embedded in the market.
- 4.12 Looking forward, Brexit and the period of transition and/or a global recession remain the major risks facing banks and building societies in 2020/21 and a cautious and balanced approach to bank deposits remains advisable.

- 4.13 **Interest rate forecast:** The Authority'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 due to Brexit and the continuing global economic slowdown. The Bank of England stated in its December Monetary Policy Report that it is their intention to maintain Bank Rate at 0.75%. They have assumed an orderly transition to a deep free trade agreement between the United Kingdom and the European Union. UK GDP growth was projected to pick up from current below potential rates, supported by the reduction of Brexit-related uncertainties, an easing of fiscal policy and a modest recovery in global growth
- 4.14 Gilt yields have risen but remain at low levels and only some very modest upward movement from current levels are expected based on Arlingclose 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 likely.
- 4.15 A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix 2.
- 4.16 For the purpose of setting the budget, it has been assumed that new treasury management investments will secure interest rates of 0.60%, and that new long-term loans will be borrowed at an average rate of 2.68%.
- 4.17 **Local Context**
- 4.18 As at 31 December 2019, the total debt portfolio of the Council (including HRA debt) was £430.821m offset by investments of £71.340m resulting in an overall net debt position of £359.481m. This is set out in further detail at Appendix 3.
- 4.19 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 the CFR known as internal borrowing.
- 4.20 The table below sets out the estimated CFR from 1st April 2019 to 31st March 2023 from analysing the balance sheet and forecasts future changes.

Table : Balance Sheet Summary and Forecast

	31.3.19 Actual £m	31.3.20 Estimate £m	31.3.21 Forecast £m	31.3.22 Forecast £m	31.3.23 Forecast £m
General Fund CFR	400.3	439.2	508.6	560.2	563.9
HRA CFR	233.9	233.9	233.9	233.9	233.9
Total CFR	634.2	673.1	742.5	794.1	797.8
Less: Other debt liabilities	-91.2	-87.6	-83.4	-78.8	-74.7
Borrowing CFR	543.0	585.5	659.1	715.3	723.1
Less: External borrowing	-355.3	-343.7	-342.4	-341.5	-333.9
Internal (over) borrowing	187.7	241.8	316.7	373.8	389.2
Less: Usable reserves	-237.0	-187.9	-175.1	-163.9	-164.2
Less: Working capital	-16.2	-16.2	-16.2	-16.2	-16.2
Investments (or New borrowing)	65.5	-37.7	-125.4	-193.7	-208.8

- 4.21 The Council has an increasing CFR due to the capital programme. We are likely to take on new borrowing during 2020/21 (due to slippage in 2019/20) with an increased need in future years. The associated costs for this level of borrowing have been provided for in the Medium Term Financial Plan, as has the flexibility to fund the MRP cost of emerging priorities.
- 4.22 CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Council expects to comply with this recommendation during 2020/23.
- 4.23 **Liability benchmark:** To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest level of borrowing the Council would be required to have to enable cash and investment balances to be kept to a minimum level of £20m at each year-end to maintain sufficient liquidity but minimise credit risk. This assumes the same forecasts as in the table above.

4.24 Table : Liability benchmark

	31.3.19 Actual £m	31.3.20 Estimate £m	31.3.21 Forecast £m	31.3.22 Forecast £m	31.3.23 Forecast £m
Borrowing CFR	543.0	585.5	659.1	715.2	723.0
Less: Usable reserves	-237.0	-187.9	-175.1	-163.9	-164.2
Less: Working capital	-16.2	-16.2	-16.2	-16.2	-16.2
Plus: Minimum investments	20.0	20.0	20.0	20.0	20.0
Liability Benchmark	309.8	401.4	487.8	555.1	562.6

- 4.25 The benchmark assumes the following from 2019/20 to 2022/23:
- capital expenditure funded by borrowing of £197.951m
 - Minimum Revenue Provision on new capital expenditure based on the Council's MRP policy
 - decrease in reserves of £72.8m
 - existing loans of £22.455m being repaid
 - working capital remaining at current levels

4.26 Treasury Management Strategy - Borrowing Strategy

- 4.27 The Council currently holds £339.219m of loans, as part of its strategy for funding previous years' capital programmes. This is a decrease since the 31 March 2019, due to principal being repaid in year on annuity loans, £10.850m PWLB Loans maturing without replacement and repayment of Growth Points loans totalling £1.417m. A further 8.7m debt is due to be repaid by March 2023. The balance sheet forecast summary in table 4.20 above shows that the Council expects to borrow up to £125m in 2020/21. The Council may however borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £832m.
- 4.28 The Council's chief consideration when borrowing money will be to strike an appropriate balance in terms of risk between securing low interest costs and achieving cost certainty over the period which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.
- 4.29 Given the significant cuts to public expenditure and in particular to local government funding, the Authority'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 forgone investment income) and reduce overall treasury risk
- 4.30 The Council and our financial advisors will also monitor long term fixed rates. The cost of long term borrowing is projected to rise in future years. We will need to judge whether the "cost of carry" incurred by borrowing now is more or less than the increased cost of borrowing should we wait until future years.
- 4.31 The Council may arrange forward starting loans during 2020/21, where the interest rate is fixed in advance, but the cash is received later. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period. This could be utilised if the Council wish to hedge against interest rates going up without the cost of carry.
- 4.32 The Council may borrow short-term loans to cover net cash flows needs.

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

- Public Works Loan Board (PWLB) and any successor body
- Any other UK public sector body
- Any institution approved for investments (see below)
- Any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds (except our local Derbyshire CC Pension Fund)
- Capital market bond investors
- Special purpose companies created to enable local authority bond issues (Municipal Bonds Agency)

4.34 In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- Leasing
- Hire purchase
- Private Finance Initiative
- Sale and leaseback

4.35 The Council has previously raised the majority of its longer term borrowing from the PWLB. The Council continues to investigate other sources of financing and re-financing, both long and short term which may be available at more favourable rates and returns. This is now more likely as the government raised PWLB rates by 1% in October making other borrowing options more competitive.

4.36 **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.

4.37 **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. At present the penalty (premium) for repaying debt early is more than the interest rate saving we could achieve and therefore we do not anticipate rescheduling debt in the next three years.

4.38 **LOBOs:** (Lender's Option Borrower's Option loans)) are loans where the lender had the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost

- 4.39 **Municipal Bond 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.
- 4.40 **Capital Market/Bond Funding:** There are different structures that can be obtained through the capital markets such as deferred bonds, CPI linked bonds, fixed rate bonds. This borrowing option would be evaluated with the support of the Councils Treasury Advisors.
- 4.41 The following includes issues that will be considered prior to undertaking any external borrowing:
- affordability
 - maturity profile of existing debt
 - interest rate and refinancing risk
 - borrowing source
 - internal cash balances
 - borrowing need.
- 4.42 **Treasury Management Strategy - Investment Strategy**
- 4.43 At 31 December 2019, the Council held £71.337m of invested funds in counterparties and institutions. In the past 12 months, the Council's investment balance has ranged between £71m and £109m. It is expected that reduced level of investment will take place in the future due to the planned Capital Programme and moving from being an investor to a borrower again over the next three years.
- 4.44 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 interest return or yield. The Councils objective when investing money is to strike a balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income
- 4.45 **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.

- 4.46 **Strategy:** Given the increasing risk and very low returns from short-term unsecured bank investments, the Council will prioritise investing surplus cash in short- fixed term deposits with other Local Authorities, as they are not subject to bail-in, and there is an insignificant risk of insolvency. Short term money market funds are also used as these diversify risk and have instant access. There may be some use of (unsecured) bank deposits when a better investment solution is not available.
- 4.47 The council is looking to explore other investment opportunities during 2020/21. It may diversify into higher yielding asset classes, such as property funds or investment funds, but will ensure an appropriate balance between risk and reward is maintained. Such investments would be held for the longer term and changes in the value of the investment, both up and down, should be expected. These changes In value would not impact on the Income and Expenditure account due to a statutory override that is in place.
- 4.48 **Business models:** Under the new IFRS 9 standard, the accounting for certain investments depends on the Authority's "business model" for managing them. The Authority aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.
- 4.49 **Recommended Counterparties:** The Council may invest its surplus funds with any of the counterparty types in the table below, subject to the cash limits (per counterparty) and the time limits shown.

Table : 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	£5m 5 years	£10m 20 years	£10m 50 years	£5m 20 years	£5m 20 years
AA+	£5m 5 years	£10m 10 years	£10m 25 years	£5m 10 years	£5m 10 years
AA	£5m 4 years	£10m 5 years	£10m 15 years	£5m 5 years	£5m 10 years
AA-	£5m 3 years	£10m 4 years	£10m 10 years	£5m 4 years	£5m 10 years
A+	£5m 2 years	£10m 3 years	£5m 5 years	£5m 3 years	£5m 5 years
A	£5m 13 months	£10m 2 years	£5m 5 years	£5m 2 years	£5m 5 years
A-	£5m 6 months	£10m 13 months	£5m 5 years	£5m 13 months	£5m 5 years
None	£1m 6 months	n/a	£10m 25 years	£1m 5 years	£5m 5 years
Money Market Funds (MMF)	The lower of 0.5% of the fund size or £8m				
Other Pooled funds and Real Estate Investment Trusts	The lower of 0.5% of the fund size or £8m				
Bonds	The lower of 0.5% of bonds issued or £8m				

This table must be read in conjunction with the notes below

- 4.50 **Operational bank accounts:** The Council's operational bank account is currently provided by Lloyds Bank. The maximum balance held in the operational bank account will be £15m for ease of operation due to the inclusion of Derby Homes balances.

4.51 **Credit rating:** Investment limits are set by reference to the lowest published long-term credit rating from a selection of external credit ratings. 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. Types of investments are detailed in Appendix 4.

4.52 **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.

4.53 **Other Information on the Security of Investments:** The Council recognise that credit ratings should not be the sole determinant of the quality of an institution. Full regard will therefore be given to other available information on the credit quality of the organisations, in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. This service is provided by our treasury management advisors. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

4.54 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.

- 4.55 **Investment Limits:** The Council focus on security as its primary investment criteria as well as limiting investment in any particular counterparty or sector. This reduces the potential for investment losses. The Council assess the risk of losses within the Director of Financial Services Section 25 assessment into the adequacy of reserves reported elsewhere on the agenda. In order that no more than 10% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £8m. 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 – Investment Limits

Provider	Cash Limit
The Councils Banking Provider - Lloyds	£15m
Any single organisation, except the UK Central Government (excluding the operational bank)	£8m
UK Central Government	Unlimited
Any group of organisations under the same ownership	£8m per group
Any group of pooled funds under the same management	£17m per manager
Negotiable instruments held in a brokers nominee account	£17m per Broker
Foreign Countries	£8m per Country
Registered Providers and registered social landlords	£17m in total
Unsecured investments with Building societies	£8m in total
Loans to unrated companies	£8m in total
Money Market Funds (MMF)	50% of total
Real estate investment trusts	£17m in total
Bonds	£8m in total

It should be noted that although the table above shows the maximum amount that can be held in any counterparty or group to be agreed as part of the strategy, reduced limits may be adhered to in year based on the advice of our Treasury Advisors or as instructed by the Director of Financial Services.

- 4.56 **Liquidity management:** The Council uses a bespoke spreadsheet for its cash flow forecasting to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium term financial plan and longer term cash flow forecast.

4.57 **Treasury Management Strategy - Other Items**

The CIPFA Code requires the Council to include the following additional items in its Treasury Management Strategy.

4.58 **Policy on use of Financial Derivatives**

- 4.59 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.
- 4.60 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.
- 4.61 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.
- 4.62 **Policy on Apportioning Interest to the HRA** On 1st April 2012, the Council notionally split each of its existing long-term loans into General Fund and HRA pools. The allocation of loans to the HRA was below the HRA Capital Financing Requirement, meaning the HRA is under borrowed. This represents a loan from the general fund to the HRA. The rate of interest charged for the under borrowing is to be the average rate of interest of the general fund notional loans at the time of the split. The HRA currently receives interest on the average value of its reserves; the interest rate this is based on is to be the 1 month UK Government Treasury Bill interest rate to reflect a credit risk free return. Investments are credit risk free to the HRA because if any credit losses are made on investments, the credit loss cannot be charged to the HRA, they would be a general fund charge.
- 4.63 **Markets in Financial Instruments Directive:** The Authority has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Authority's treasury management activities, the Chief Financial Officer believes this to be the most appropriate status.

4.64 **Financial Implications**

The budget for investment income in 20/21 is £0.249m based on an average investment portfolio of £41.5m at an interest rate of 0.60%. The total budget for debt interest paid in 2020/21 is £17.013m based on an average debt portfolio of £396m and residual transferred debt. £10.537m of this debt interest is charged to the HRA based on the average HRA debt of £230.8m. If actual levels of investments, borrowing, and interest rates differ from those forecast, performance against budget will be different, the budget is monitored through out the year and variances are reported quarterly to Cabinet within the forecast quarterly outturn report.

4.65 **Treasury Management Indicators**

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

- 4.66 **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. Our score is less than the target set. This demonstrates that our weighted average credit score is better than the indicator and we have a low level of credit risk.

	Actual as at 9th December 2019	Target
Portfolio average credit score	1.15	3.00

- 4.67 **Liquidity:** The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available in a rolling one month period to meet unexpected payments each day, without additional borrowing.

Liquidity risk indicator	Target
Total cash available within one month	£20m

- 4.68 **Interest rate exposures:** This indicator is set to control the Authority'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	£195,000
Upper limit on one-year revenue impact of a 1% fall in interest rates	£550,000

- 4.69 **Maturity Structure of Borrowing:** This shows the amount of fixed rate borrowing maturing in each period, expressed as a percentage of total fixed rate borrowing. This indicator is designed to be a control over having large amounts of fixed rate debt falling to be replaced at the same time, exposing the Council to refinancing risk.

The upper and lower limits on the maturity structure of fixed rate borrowing will be:

Maturity structure of fixed rate borrowing	Forecast position for 31/03/2020 (%)	Lower Limit (%)	Upper Limit (%)
under 12 months	0.00	0	10
under 24 months	0.13	0	20
under 5 years	2.10	0	30
under 10 years	8.20	0	50
under 20 years	28.37	0	70
under 30 years	35.16	0	80
under 40 years	85.38	0	95
under 50 years	100	0	100

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. To minimise refinancing risk, future borrowing will be undertaken with an end date in a year where little other borrowing matures.

- 4.70 **Principal sums invested for periods longer than a year:** The purpose of this indicator is to control the Authority'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	2020/21	2021/22	2022/23
Limit on principal invested for longer than 364 days	£20m	£10m	£5m

4.71 **Capacity, Skills and Culture**

- 4.72 The training needs of the Council's Capital and Treasury Management team is assessed as part of the staff Great Performance Conversation (appraisal) process. Staffs periodically attend training courses, seminars and conferences provided by external advisors and CIPFA.
- 4.73 The CIPFA code requires the responsible officer to ensure that councillors with responsibility for treasury management to receive adequate training. Appropriate training is offered to all members of the Audit and Accounts Committee and is mandatory for the chair of this committee.

Public/stakeholder engagement

- 5.1 The Council carries out consultation on its spending proposals on an on-going basis. These spending proposals are reflected in the Treasury Management Strategy.

Other options

- 6.1 The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. We believe 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 in the table below

Table : Approved investment counterparties and limits

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

Financial and value for money issues

- 7.1 As outlined in the body of the report

Legal implications

- 8.1 The rules governing decisions on the capital programme are set out in the Local Government Act 2003 and in regulations and guidance issued under the Act, including the Prudential Code for Capital Finance in Local Authorities issued by CIPFA. This allows for additional unsupported borrowing provided that this is consistent with the Prudential Code, particularly in terms of affordability.

Other significant implications

- 9.1 As outlined in the body of the report.

This report has been approved by the following people:

Role	Name	Date of sign-off
Legal		
Finance	Toni Nash, Head of Finance	
Service Director(s)	Simon Riley, Director of Financial Services	
Report sponsor	Paul Simpson, Strategic Director of Corporate Resources	
Other(s)		

1.1 The Council can invest its money for three broad purposes:

- 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),
- To support local public services by lending to or buying shares in other organisations (service investments),
- To earn investment income (known as commercial investments) where this is the main purpose.

1.2 This investment strategy meets the requirements of statutory guidance issued by the government in January 2018, and focuses on the second and third of these categories.

1.3 Treasury Management Investments

1.4 The Authority 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 commitments. 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.

1.5 The return on investments support the priorities and objectives of the Council

1.6 Full details of the Authority's policies and its plan for 2020/21 for treasury management investments are covered by the main body of this report.

1.7 Investing for Commercial or Social Return

1.8 In order to support frontline services such as central Government funding changes over time, Councils have to consider how best they deploy their resources, knowledge and borrowing capacity to replace lost income. The drivers, characteristics, available credit and risks associated with such transactions will differ from one scheme to another as well as from general treasury activity. Schemes, for instance, may take into account non-financial 'social' returns alongside financial gain.

1.9 The Council recognises that investment in other financial assets and property primarily for financial return, taken for non treasury management purposes, requires careful investment management. Such activity could include loans supporting services outcomes, investment in subsidiaries, and investment property portfolios

1.10 The Council will ensure that all the Council's investments are covered in the financial strategy or commercial plan (when developed and adopted), and will set out, where relevant, the organisations risk appetite and specific policies and arrangements for non treasury instruments. It recognises that the risk appetite for these activities may differ from mainstream Treasury Management Activity. However, common across both 'commercial' transactions and treasury instruments is the need for holistic council-wide planning, robust due diligence and oversight

1.11 Service Investments: Loans

1.12 The Council lends money to local businesses and organisations to support local public services and stimulate local economic growth.

1.13 The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to limit this risk, and ensure that total exposure to service loans remains proportionate to the size of the Authority, upper limits on the outstanding loans to each category of borrower can be seen in the table below.

1.14 Table : Loans for service purposes

Borrower	Balance Owing 31/03/19 £m	Loss Allowance 31/03/19 £m	Net Figure in Accounts 31/03/19 £m	Approved Limit 2020/21 £m
DEGF	1.602	0.920	0.681	7.262
Old Bell	0.177	0.002	0.175	
Cricket Club	1.870	0.029	1.841	
TOTAL	3.649	0.951	2.697	

1.15 Accounting standards require the Council to set aside loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Authority's statement of accounts are shown net of this loss allowance. The loss allowance reflects the expectation that future cash flows might not take place because the borrower could default on their obligations. Credit risk plays a crucial part in assessing losses. Where risk has increased significantly since an instrument was initially recognised, losses are assessed on a lifetime basis. Where risk has not increased significantly or remains low, losses are assessed on the basis of 12-month expected losses. However, the Authority makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments.

1.16 The Council assesses the risk of loss before entering into, and whilst holding a service loan. This is done through a robust assessment of and approval process for initial loan applications, due diligence and continued monitoring. For contracts over £0.100m the Council have procured an independent specialist to provide due diligence on its behalf. An organisations credit rating is highlighted as part of the loan approval process and the companies risk rating is taken into account when the interest rate is set. Risk is monitored using a variety of tools including company accounts, companies house, management information, cashflow forecasts and track record.

1.17 Financial Guarantees

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

1.19 The Council continues to underwrite the pension liability relating to Derby Homes membership of the Local Government Pension Scheme. In the event of Derby Homes ceasing to trade this liability would transfer to the council. The value of the Derby Homes reported pension deficit was £32.882m as at 31st March 2019

1.20 Capacity, Skills and Culture

1.21 The training needs of the Council's Capital and Treasury Management team is assessed as part of the staff Great Performance Conversation (appraisal) process. These staff periodically attend training courses, seminars and conferences provided by external advisors and CIPFA.

1.22 The CIPFA code requires the responsible S151 officer (Director of Financial Services) to ensure that councillors with responsibility for treasury management receive adequate training. Appropriate training is offered to all members of the Audit and Accounts Committee and is mandatory for the chair of this committee.

1.23 Investment Indicators

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

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

1.26 **Table : Total Risk Exposure**

Total investment exposure	31.03.2019 Actual £m	31.03.2020 Forecast £m	31.03.2021 Forecast £m
Treasury management investments	67.878	58.349	25.000
Service investments: Loans	3.649	3.431	3.062
TOTAL EXPOSURE	71.527	61.780	28.062

This indicator will be refreshed on adoption of the Commercial Property Investment Strategy (CIPS) during 2020/21.

- 1.27 **How investments are funded:** Government guidance is that these indicators should include how investments are funded. Since the Authority 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 Authority's investments are funded by usable reserves and income received in advance of expenditure. Service loans, for example, are funded through a mix of grant, capital receipts and borrowing.

1.28 **Table: Investments funded by borrowing.**

Investments funded by borrowing	31.03.2019 Actual £m	31.03.2020 Forecast £m	31.03.2021 Forecast £m
Service investments: Loans	2.047	2.011	1.685
TOTAL FUNDED BY BORROWING	2.047	2.011	1.685

This indicator will be refreshed on adoption of the Commercial Property Investment Strategy (CIPS) during 2020/21

- 1.29 **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

1.30 Table : Investment Rate of Return

Investments net rate of return	2018/19 Actual %	2019/20 Forecast %	2020/21 Forecast %
Treasury management investments	0.66	0.60	0.60
Service investments: Loans	3.53	0.13	1.81
ALL INVESTMENTS	0.77	0.58	0.69

This indicator will be refreshed on adoption of the Commercial Property Investment Strategy (CIPS) during 2020/21

Appendix 2

Arlingclose Economic & Interest Rate Forecast January 2020

Underlying assumptions:

- The global economy has entered a period of weaker growth in response to political issues. The UK economy continues to experience slower growth due to both Brexit uncertainty and the downturn in global activity. In response, global and UK interest rate expectations are low.
- Some improvement in global economic data and a more positive outlook for US/China trade negotiations has prompted worst case economic scenarios to be pared back
- The new Conservative UK government will progress with achieving Brexit on 31 st January 2020. The more stable political environment will prompt a partial return in business and household confidence in the short term, but the subsequent limited Brexit transitional period, which the government is seeking to enforce, will create additional economic uncertainty.
- UK economic growth stalled in Q4 2019. Inflation is running below target at 1.5%. The inflationary consequences of the relatively tight labour market have yet to manifest, while slower global growth should reduce the prospect of externally driven pressure, although escalating geopolitical turmoil could continue to push up oil prices
- The first few months of 2020 will indicate whether the economy benefits from restored confidence. The government will undertake substantial fiscal easing in 2020 21 which should help support growth in the event of a downturn in private sector activity.
- The weak outlook for the UK economy and current low inflation have placed pressure on the MPC to loosen monetary policy. Two MPC members vote for an immediate cut in the last two MPC meetings of 2019. The evolution of the economic data and political moves over the next few months will inform policy, but upside risks to Bank Rate are very limited.
- Central bank actions and escalating geopolitical risks will produce volatility in financial markets including bond markets.

Forecast:

- We have maintained our Bank Rate forecast at 0.75 for the foreseeable future. Substantial risks to this forecast remain, arising primarily from the government's policy around Brexit and the transitional period.
- 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%

Appendix 3

Current Debt and Investment Portfolio Position 31 December 2019

	£m
External Borrowing:	
- Fixed Rate PWLB	292.211
- Fixed Rate Market	20.000
- Other Local Authorities	25.000
- SALIX Energy Efficiency	1.275
- University of Derby	0.733
Other Long-term Liabilities:	
- PFI Financing	90.801
- Finance Leases	0.396
- Transferred Debt from other Local Authorities	0.405
Total Gross External Debt	430.821
Treasury Investments:	
- Money Market Funds	(28.601)
- Local Authority Fixed Term Deposits	(40.000)
- Unsecured Banks	(2.739)
Total Treasury Investments	(71.340)
Total Net External Debt	359.481

Definitions of Types of Permitted Investments

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 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 £1m 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, 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 any of the previously outlined 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: 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 through 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. 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 Authority maintaining operational continuity.

Glossary of Treasury Management Terms	
Term	Description
Bail-in	Investors take a loss on their investment to rescue a failing bank. It is alternative to a bail- out of a failing bank, where the loss is made good by the governments and taxpayers.
Bank Rate	The official interest rate set by the Bank of England's Monetary Policy Committee and what is generally termed at the "base rate".
Call Accounts	A call account is a bank account for investment funds it has no fixed deposit period, provides instant access to funds and allows unlimited withdrawals and deposits.
Capital Expenditure	Expenditure on the acquisition, creation or enhancement of capital assets.
Capital Financing Requirement (CFR)	The Council's underlying need to borrow for capital purposes representing the cumulative capital expenditure of the local authority that has not yet been financed.
Credit Default Swap	A financial instrument for swapping the risk of debt default; the buyer effectively pays an insurance premium against the risk of default.
Credit Ratings	A formal opinion issued by a registered rating agency of a counterparty's (or a country's) future ability to meet its financial liabilities; these are opinions only and not guarantees.
Financial Derivative	A financial contract whose value is based on, or "derived" from, a traditional security (such as a stock or a bond), an asset (such as a commodity), or a market index.
Gilts	Gilts are a UK government liability in sterling, issued by HM Treasury and listed on the London Stock Exchange. Being issued by the UK government, they are deemed to be very secure as the investor expects to receive the full face value of the bond to be repaid on maturity.
London Interbank Bid Rate (LIBID)	The London interbank market is a wholesale money market in London where banks exchange monies. The bid rate is the rate London banks are willing to pay for deposits and other banks' unsecured funds from other banks in the London interbank market.
Money Market Fund (MMF)	Pooled funds which invest in a range of short term assets providing high credit quality and high liquidity.
Monetary Policy	The Monetary Policy Committee (MPC) is a committee of the Bank of England who decides what monetary policy action to take. The

Committee (MPC)	MPC sets and announces policy eight times a year.
Minimum Revenue Provision (MRP)	An annual provision that the Council is statutorily required to charge to the Revenue Account to finance capital expenditure funded by unsupported borrowing that has not yet been financed.
Public Works Loan Board (PWLB)	The Public Works Loan Board (PWLB) is a statutory body operating within the United Kingdom Debt Management Office, an Executive Agency of HM Treasury. PWLB's function is to lend money from the National Loans Fund to local authorities, and to collect the repayments.