Council Cabinet
16 February 2022

Derby City Council

Report sponsor: Simon Riley, Strategic Director of Corporate Resources
Report author: Toni Nash, Head of Finance, Corporate Resources

ITEM 14

Treasury Management and Investment Strategy 2022/23

Purpose

1.1 This report outlines and seeks approval of the Council's Treasury Management Strategy for the Financial Year 2022/23 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 3).

Recommendations

2.1 To approve and recommend:

a) The Treasury Management Strategy for 2022/23 outlined in section 4
b) The Treasury Management Indicators for 2022/23 to 2024/25 outlined in section 4.61
c) The Current debt and Investment Portfolio Position outlined in Appendix 1
d) The Definitions of Types of Permitted Investments outlined in Appendix 2
e) The Investment Strategy for 2022/23 outlined in the report in section 4.36 and attached Appendix 3
f) The Investment approach for Commercial or Social Return Appendix 3, section 1.7
g) The Investment Indicators for 2022/23 to 2024/25 outlined in Appendix 3, section 1.24.

2.2 **To delegate:**

- Authority to the Strategic Director of Corporate Resources to amend investment levels following appropriate advice from the Council's treasury advisors as detailed in section 4.48.

Reason

3.1 Under the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) the Council is required to approve a treasury management strategy before the start of each financial year. This report also fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

Supporting information

4.1 **Background**
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 and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates.

4.2 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. Consistent with the spirit of the CIPFA's Code, the Treasury Team priorities are Security, Liquidity and Return in that order when making investment-related outcomes.

4.3 Financial activity invariably exposes the Council to risk. A non-exhaustive list of treasury-related risks would include:

- Liquidity management risk
- Market risk
- Interest rate risk
- Credit risk
- Settlement risk
- Exchange rate risk
- Operational risk.

These risks can occur by a significant event, or a series of events, such as:

- Political uncertainty or unrest
- Natural disasters as exhibited by the current COVID-19 pandemic
- Changes in government policy
- Changes to general market sentiments.

4.4 Treasury-related risks can potentially create volatility within the financial market. The value of asset prices can swiftly go down leading to a loss of funds initially, investment and borrowing costs are examples of changes which the Council are exposed to when there is a sudden movement in the market. Accordingly, a robust risk management framework must be in place to eliminate or minimise risk exposure and its impact. The Council's risk-based approach is operated 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 3.

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 the Council's refinancing risk or cost objectives.

4.7 **External Context**
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 intelligence, inflation and interest forecasts. They also provide details on the creditworthiness of institutions that the Council invest money into.

4.8 **Economic background**
The ongoing impact on the UK from coronavirus, together with higher inflation, 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.

4.9 The Bank of England (BoE) increased the Bank Rate to 0.25% in December 2021. The UK CPI for November 2021 registered 5.1% year on year, up from 4.2% in the previous month. Core inflation, which excludes the more volatile components, rose to 4.0% year-on-year from 3.4%.

4.10 **Interest rate forecast**
The Authority's treasury management adviser Arlingclose is forecasting that Bank Rate will continue to rise in calendar Quarter 1 2022 to subdue inflationary pressures and the perceived desire by the BoE to move away from emergency levels of interest rates.

4.11 For the purpose of setting the budget, is has been assumed that new treasury management investments will secure an average rate of return of 0.06%, and that new long term loans will be borrowed at an average rate of 1.72%.

4.12 **Local Context**
As at 31st December 2021, the total debt portfolio of the Council (including HRA debt) was £422.385m offset by investments of £69.558m resulting in an overall net debt position of £352.827m. This is set out in further detail at Appendix 1.

4.13 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 is known as internal borrowing.

4.14 The table below sets out the estimated CFR from 1st April 2020 to 31st March 2025 from analysing the balance sheet and forecasts future changes.

Table 1: Balance Sheet Summary and Forecast

	31/3/21 Actual £m	31/3/22 Estimate £m	31/3/23 Forecast £m	31/3/24 Forecast £m	31/3/25 Forecast £m
General Fund CFR	481.5	526.5	570.2	628.2	666
HRA CFR	214.8	214.8	214.8	214.8	214.8
Total CFR	**696.3**	**741.3**	**785**	**843**	**870.8**
Less: Other debt liabilities	(85.3)	(80.5)	(76.1)	(71.2)	(66.1)
Borrowing CFR	**611**	**660.8**	**708.9**	**771.8**	**804.7**
Less: External borrowing	(347.7)	(336.9)	(329.4)	(325.5)	(325)
Internal (over) borrowing	**263.3**	**323.9**	**379.5**	**446.3**	**479.7**
Less: Usable reserves	(190)	(175.8)	(162.3)	(159.5)	(160.6)
Less: Working capital	(63.4)	(44.4)	(44.4)	(44.4)	(44.4)
Investments (or New borrowing)	**9.9**	**103.7**	**(172.8)**	**(242.4)**	**(274.7)**

* Usable Reserves include revenue reserves, capital reserves and capital receipts

4.15 The Council has been able to defer external borrowing for capital purposes since 2008, utilising internal financing sources and cash balances. This is of benefit to the MTFP as the council has not incurred borrowing costs.

4.16 The Council has an increasing CFR due to the capital programme and is forecasting to take on new borrowing during 2022/23 with an increased need in future years. The associated costs for this level of borrowing have been included in the MTFP, as has the flexibility to fund the MRP cost of emerging priorities.

4.17 CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Council's external borrowing and other debt liabilities should be lower than its highest forecast CFR over the next three years. Table 1 above shows that the Council expects to comply with this recommendation during 2021/22 through to 2024/25.

4.18 **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 during 2020/21 and £15m 2021/22 onwards to maintain sufficient liquidity but minimise credit risk.

4.19 **Table 2: Liability benchmark**

	31/3/21 Actual £m	31/3/22 Estimate £m	31/3/23 Forecast £m	31/3/24 Forecast £m	31/3/25 Forecast £m
Borrowing CFR	611	660.8	708.9	771.8	804.7
Less: Usable reserves	(190)	(175.8)	(162.3)	(159.5)	(160.6)
Less: Working capital	(63.4)	(44.4)	(44.4)	(44.4)	(44.4)
Plus: Minimum investments	20	15	15	15	15
Liability Benchmark	**377.6**	**455.6**	**517.2**	**582.9**	**614.7**

4.20 The benchmark assumes the following from 2021/22 to 2024/25:

- Capital Expenditure funded by borrowing of £211.7m as detailed in the Capital section within this report and Quarter 3 monitoring included on this meeting's agenda
- Minimum Revenue Provision on new capital expenditure based on the Council's MRP policy
- Decrease in reserves of £29.4m
- Existing loans of £22.7m being repaid
- Working capital reducing by £19.0m
- Decrease in minimum investments of £5m.

4.21 Treasury Management Strategy - Borrowing Strategy

4.22 The Council currently holds £336.9m of loans as part of its strategy for funding previous years' capital programmes. This is a decrease since the 31st March 2021, resulting from £10m of short-term borrowing from other Local Authorities being at the end of March 2021 and repaid during April and to in-year principal repayments on annuity loans. A further £21.605m debt is due to be repaid by March 2024. The balance sheet forecast summary in table 1 in section 4.14, shows that the Council has a need to borrow up to £172.7m in 2022/23. The Council may however borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £850.6m (prudential indicators are detailed in Appendix 16 of the Medium Term Financial report also included on this meetings agenda) and is in accordance with the prudential code and borrowing guidelines.

4.23 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.

4.24 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 borrowing 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.

4.25 The Council and our financial advisors will also monitor long-term fixed rates. The cost of long-term borrowing is projected to rise modestly 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. Decisions on when to undertake borrowing in line with this strategy is delegated to the Strategic Director of Corporate Resources.

4.26 The Council has previously raised the majority of its long-term borrowing from the PWLB but will consider long-term loans from other sources including banks, pensions and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Authority intends to avoid this activity in order to retain its access to PWLB loans.

4.27 The Council may arrange forward starting loans during 2022/23, 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.

4.28 The Council may borrow short-term loans to cover net cash flow needs.

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

- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
- 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)
- The UK Infrastructure Bank where borrowing applications if they match their core objectives (i.e. Tackling climate change and supporting regional and local economic development - regeneration).

4.30 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.

4.31 **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.

4.32 **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.

4.33 **Municipal Bond 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 Full Council.

4.34 **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 Council's Treasury Advisors.

4.35 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
- Purpose in line with approval process.

4.36 **Treasury Management Strategy - Treasury Investment Strategy**
At 31st December 2021, the Council held £69.558m of invested funds in counterparties and institutions. In the past 12 months, the Council's treasury investment balance has ranged between £63m and £103m. It is expected that reduced level of investment will take place in the future due to the planned Capital Programme and potentially moving from being an investor to a borrower again over the next three years.

4.37 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 Council's 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. Where balances are expected to be invested for more than one year, the Authority 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.

4.38 **Negative interest rates:** The COVID-19 pandemic increased the possibility that the Bank of England would set its Bank Rate at or below zero, which would likely feed through to negative interest rates on all low risk, short-term investment options. At present this has not happened although the Council have seen negative interest rates from the Debt Management Office on short term investments. Since investments cannot pay negative income, negative rates have been applied by reducing the value of investments. 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.

4.39 **Strategy:** Given the increasing risk and very low returns from short-term unsecured bank investments, the Council has been prioritising investment outcomes with in short, fixed term deposits with other Local Authorities and the DMO as they are not subject to bail-in, and there is an insignificant risk of insolvency. Short-term money market funds have also been used to diversify risk and have instant access and includes some use of (unsecured) bank deposits when better investment opportunities were unavailable.

4.40 In response to the very low returns from short-term unsecured bank investments, the Council intends to explore other investment opportunities during 2022/23. However, as the Council is moving to a borrowing position these could be limited. The Council however may seek to diversify its cash surplus into higher yielding asset classes such as strategic funds, fixed income securities and other interest-bearing financial instruments but will ensure an appropriate balance between risk and reward is maintained before such investment-making outcomes are undertaken. Such investments would however 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 (until March 2023). It should be noted that these types of interest-bearing investments do not have the primary aim of generating profit but to earn reasonable investment income in order to support and enhance the delivery of public services.

4.41 **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.

4.42 **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 3: Recommended Counterparties and Limits

Sector	Time limit	Counterparty limit:	Sector limit
The UK Government	50 years	Unlimited	n/a
Local authorities & other government entities	25 years	£7m	Unlimited
Secured investments *	25 years	£7m	Unlimited
Banks (unsecured) *	13 months	£4m	Unlimited
Building societies (unsecured) *	13 months	£4m	£7m
Registered providers (unsecured) *	5 years	£4m	£20m
Money market funds *	n/a	£7m	Unlimited
Strategic pooled funds	n/a	£7m	£40m
Real estate investment trusts	n/a	£7m	£20m
Other investments *	5 years	£4m	£7m

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

4.43 **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 £4m.

4.44 **Credit rating:** Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating is no lower than [A-]. 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 considered. Types of investments are detailed included as an appendix within the Investment Strategy Appendix 3.

4.45 **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. The credit rating agencies in current use are listed in the Treasury Management Practices document.

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 "negative watch") 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.

4.46 **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.

4.47 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, 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 investment returns to fall but will protect the principal sum invested.

4.48 **Investment Limits**: The Council focus on security as its primary investment criteria as well as limiting investment in any counterparty or sector. This reduces the potential for investment losses. In order that no more than 5% 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 £7m. A group of entities 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 4:– Additional Investment Limits

Provider	Cash Limit
The Councils Banking Provider - Lloyds	£7m
Any group of organisations under the same ownership	£7m per group
Any group of pooled funds under the same management	£20m per manager
Negotiable instruments held in a broker's nominee account	£20m per Broker
Foreign Countries	£7m per Country
Loans to unrated companies	£7m in total
Bonds	£7m 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 Strategic Director of Corporate Resources.

4.49 **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.

4.50 The Authority will spread its liquid cash over at *least* four providers (e.g. bank accounts and money market funds) to ensure that access to cash is maintained in the event of operational difficulties with any one provider.

4.51 **Treasury Management Strategy – Other Items**
The CIPFA Code requires the Council to include the following additional items in its Treasury Management Strategy.

4.52 **Policy relating to environment, social and governance (ESG) investment considerations**
There is a growing expectation that the Council embraces "sustainability", recognising the importance of environmental, social and governance matters and associated risks and incorporating these considerations into its decision making framework to ensure that investments made are compatible with the Council's objectives and risk appetite whilst striking a balance with the security, liquidity and yield requirements.

4.53 From 2023/24 CIPFA's Treasury Management Code currently requires Council's to incorporate ESG policy when making treasury investment decisions. This policy will be incorporated into the Council's future strategies.

4.54 **Policy on the use of Financial Derivatives**
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.

4.55 Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria, assessed using the appropriate credit rating for derivative exposures. An allowance for credit risk calculated using the methodology in the Treasury Management Practices document will count against the counterparty credit limit and the relevant foreign country limit.

4.56 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.

4.57 **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 is above the HRA Capital Financing Requirement, meaning the HRA is over-borrowed. This represents a loan from the HRA to the General Fund. The rate of interest charged to the General Fund for this over 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.

4.58 **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 under the MiFID II regulation. As a result, the Council has 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 Strategic Director of Corporate Resources has assessed this to be the most appropriate status.

4.59 **Financial Implications**
The budget for investment income in 2022/23 is £0.041m based on an average investment portfolio of £67.663m and at an expected rate of return of 0.06%. The total budget for debt interest paid in 2022/23 is £16.780m based on an average debt portfolio of £404m and residual transferred debt. £9.816 of this debt interest is charged to the HRA based on the average HRA debt of £214.8m. If actual levels of investments, borrowing, and interest rates differ from those forecasts, performance against budget will be different, the budget is monitored throughout the year and variances are reported quarterly to Cabinet within the forecast quarterly outturn report.

4.60 Capital and Treasury management expenditure can be volatile and therefore if budgetary savings or pressures are generated, these will be smoothed through the earmarked Treasury Management Reserve created for this purpose.

4.61 **Treasury Management Indicators**
The Council measures and manages its exposures to treasury management risks using the following indicators.

4.62 **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 of 31st December 2021	**Target**
Portfolio average credit score	1.37	<3.00

4.63 **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	>£15m

4.64 **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	£450,000
Upper limit on one-year revenue impact of a 1% fall in interest rates	£880,000

4.65 **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 31/03/2022 (%)	Lower Limit (%)	Upper Limit (%)
under 12 months	2.07	0	10
under 24 months	3.30	0	20
under 5 years	7.50	0	30
under 10 years	16.20	0	50
under 20 years	30.00	0	70
under 30 years	49.73	0	80
under 40 years	99.69	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.

4.66 **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	2021/22	2022/23	2023/24
Limit on principal invested for longer than 364 days	£20m	£20m	£20m

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

4.68 The CIPFA Code requires the responsible officer to ensure that councillors with responsibility for treasury management are 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 carried out a detailed consultation exercise between 22nd December 2021 to 28th January 2022 with Councillors, key stakeholder groups, members of the public, Trade Unions and the business community. Further details of the consultation process and feedback are included in the Medium Term Financial Plan included on this meeting's agenda. The consultation document can be found on the council's website. 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. The Council believe the above strategy represents an appropriate balance between risk management and cost effectiveness.

Financial and value for money issues

7.1 The financial and value for money implications are outlined in the main 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.

Climate implications

9.1 As outlined in the body of the report.

Other significant implications

10.1 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)	Alison Parkin, Director of Financial Services	
Report sponsor	Simon Riley, Strategic Director of Corporate Resources	
Other(s)		

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Appendix 1

Current Debt and Investment Portfolio Position 31st December 2021

	£m
External Borrowing:	
- Fixed Rate PWLB	291.000
- Fixed Rate Market	20.000
- Other Local Authorities	25.000
- SALIX Energy Efficiency	0.624
- University of Derby	0.600
Other Long-term Liabilities:	
- PFI Financing	83.414
- Finance Leases	1.296
- Transferred Debt from other Local Authorities	0.318
Total Gross External Debt	**422.252**
Treasury Investments:	
- Money Market Funds	(48.370)
- Local Authority Fixed Term Deposits	(7.000)
- Debt Management Office	(9.000)
- Unsecured Banks	(5.188)
Total Treasury Investments	**(69.558)**
Total Net External Debt	**352.694**

Appendix 2

Definitions of Types of Permitted Investments

Banks and Building Societies 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.

Secured investments: Investments secured on the borrower's assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies 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. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments.

Government: Loans to, and 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 Government are deemed to be zero credit risk due to its ability to create additional currency and therefore may be made in unlimited amounts for up to 50 years.

Registered Providers (unsecured): 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 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 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. 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.

Other investments: This category covers treasury investments not listed above, for example unsecured corporate bonds and company loans. Non-bank companies cannot be bailed-in but can become insolvent placing the Authority's investment at risk.

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 Committee (MPC)	The Monetary Policy Committee (MPC) is a committee of the Bank of England who decides what monetary policy action to take. The 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. (See appendix 15 of the MTFP report also included on this meeting's agenda)
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.

Appendix 3

Investment Strategy 2022/23

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), and
- 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 (CIPFA). The balance of Treasury Management Investments is expected to fluctuate between £103m and £15m during the 2022/23 financial year.

1.5 **Contribution**: The contribution that these investments make to the objectives of the Authority is to support effective treasury management activities and contribute to the Council's revenue budget.

1.6 Full details of the Authority's policies and its plan for 2022/23 for Treasury Management Investments are covered by the main body of this report.

1.7 **Investing for Commercial or Social Return**

1.8 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 consider 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 service outcomes, investment in subsidiaries, and investment property portfolios.

1.10 The Council will ensure that all its investments are covered in either the financial strategy or a separate commercial investment cabinet report, that sets out, where relevant, the Authority's risk tolerance, and specific policies and arrangements for non-treasury instruments. The Council recognises that the risk appetite for investment types may differ from traditional treasury management activities. However, irrespective of the purpose, the Council undertakes a vigorous risk assessment and devises a robust risk management framework to safeguard its money against financial risks before committing into and whilst holding any investment opportunity.

1.11 The funding of any such commercial investments would be carefully considered with due consideration to the new PWLB borrowing guidance.

1.12 **Service Investments: Loans**

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

1.14 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.

1.15 **Table : Loans for service purposes**

Borrower	Balance Owing 31/03/21 £m	Loss Allowance 31/03/21 £m	Net Figure in Accounts 31/03/21 £m	Approved Limit 2022/23 £m
Derby Homes	2.917	-	2.917	
DEGF	0.588	0.233	0.354	
Old Bell	0.150	0.071	0.080	
Cricket Club	1.285	0.005	1.280	
Ascend	-	-	-	
TOTAL	**4.940**	**0.309**	**4.631**	**2.328**

1.16 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.

1.17 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.

1.18 **Financial Guarantees**

1.19 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.

1.20 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 £40.197m as at 31st March 2021.

1.21 **Capacity, Skills and Culture**

1.22 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.

1.23 The CIPFA code requires the responsible S151 officer (Strategic Director of Corporate Resources) 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.

1.24 **Investment Indicators**

1.25 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.

1.26 **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.

1.27 **Table : Total Risk Exposure**

Total investment exposure	**31.03.2021 Actual £m**	**31.03.2022 Forecast £m**	**31.03.2023 Forecast £m**
Treasury Management Investments	37.159	49.859	53.389
Service investments: Loans	2.023	1.552	0.973
TOTAL EXPOSURE	**39.182**	**51.411**	**54.362**

1.28 **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.

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

Investments funded by borrowing	**31.03.2021 Actual £m**	**31.03.2022 Forecast £m**	**31.03.2023 Forecast £m**
Service investments: Loans	0	0	0
TOTAL FUNDED BY BORROWING	0	0	0

1.30 **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

1.31 **Table: Investment Rate of Return**

Investments net rate of return	2020/21 Actual %	2021/22 Forecast %	2022/23 Forecast %
Treasury management investments	0.15	0.07	0.06
Service investments: Loans	4.09	10.18	5.00

1.32 **Operational Bank Balance Limit Tolerance**

Operational Bank Account Limit Tolerances	Limit £m	Limit Tolerance £m
Minimum closing balance	4.000	0.500
Maximum closing balance	0.000	0.500