Treasury Management Strategy Statement 2022/23

Introduction

1. In 2018 the Ministry of Housing, Communities & Local Government (MHCLG) produced new Investment Guidance including the requirement to produce an Investment Strategy.

2. The County Council's Capital and Investment Strategy sets out the Council's broad approach to investment, including its capital programme, how this is funded, and investments held for service purposes or for commercial profit (as reported to Cabinet and County Council in the Revenue Budget and Precept 2022/23 report on 8 February 2022 and 17 February 2022 respectively).

3. This Treasury Management Strategy Statement (TMSS) supports the Capital and Investment Strategy in setting out the arrangements for the management of the County Council's cash flows, borrowing and investments, and the associated risks.

4. The County Council has borrowed and invested sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the County Council's prudent financial management.

5. Treasury risk management at the County Council is conducted within the framework of the CIPFA Code which requires the County Council to approve a Treasury Management Strategy Statement (TMSS) before the start of each financial year. This Strategy fulfils the County Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

6. Investments held for service purposes or for commercial profit are considered separately in the Capital and Investment Strategy.

External Context

7. The following paragraphs explain the economic and financial background against which the TMSS is being set.

Economic background

8. 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 County Council's treasury management strategy for 2022/23.

9. The Bank of England (BoE) increased Bank Rate to 0.25% in December 2021 while maintaining its Quantitative Easing programme at £895bn. Within this announcement the Monetary Policy Committee (MPC) noted that the pace of the global recovery was broadly in line with its November Monetary Policy Report. Prior to the emergence of the Omicron coronavirus variant, the BoE also considered the UK economy to be evolving in line with expectations, however due to the increased uncertainty and risk to activity that the new variant presents, the BoE revised down its estimates for Quarter 4 of 2021 Gross Domestic Product (GDP) growth. The BoE projects that inflation will be higher than previously forecast, with the Consumer Price Index (CPI) likely to remain above 5% throughout the winter and peak at 6% in April 2022. The labour market was generally performing better than previously forecast and the BoE now expects the unemployment rate to fall to 4%, but notes that Omicron could potentially weaken the demand for labour.

Credit outlook

10. Since the start of 2021, relatively benign credit conditions have led to credit default swap (CDS) prices for the larger UK banks to remain low and had steadily edged down throughout the year up until mid-November when the emergence of Omicron has caused them to rise modestly. CDS prices are used as an indicator of credit risk, where higher premiums indicate higher perceived risks.

11. The generally improved economic outlook during 2021 helped UK banks' profitability and reduced the level of impairments many had made as provisions for bad loans. However, the relatively recent removal of coronavirus-related business support measures by the government means the full impact on bank balance sheets may not be known for some time.

12. The improved economic picture during 2021 led the credit rating agencies to reflect this in their assessment of the outlook for the UK sovereign as well as several financial institutions, revising them from negative to stable and even making a handful of rating upgrades.

13. Looking ahead, while there is still the chance of bank losses from bad loans as government and central bank support is removed, the institutions on the County Council's counterparty list are well-capitalised and general credit

conditions across the sector are expected to remain benign. Duration limits for counterparties on the County Council's lending list are under regular review and will continue to reflect economic conditions and the credit outlook.

Interest rate forecast

14. The County Council's treasury management adviser Arlingclose forecast that Bank Rate will continue to rise in Quarter 1 of 2022 to subdue inflationary pressures and the perceived desire by the BoE to move away from emergency levels of interest rates.

15. Investors continue to price in multiple rises in Bank Rate over the next forecast horizon, and Arlingclose believes that although interest rates will rise again, the increases will not be to the extent predicted by financial markets.

16. Yields are expected to remain broadly at current levels over the medium-term, with the 5, 10 and 20 year gilt yields expected to average around 0.65%, 0.90%, and 1.15% respectively. However, as ever there will almost certainly be short-term volatility due to economic and political uncertainty and events.

17. A more detailed economic and interest rate forecast provided by Arlingclose is attached at Annex A.

Balance Sheet Summary and Forecast

18. On 31 December 2021, the County Council held £298m of borrowing and £692m of investments. This is set out in further detail at Annex B.

19. Forecast changes in these sums are shown in the balance sheet analysis in Table 1.

Table 1: Balance sheet summary and forecast

	31/03/21 Actual £m	31/03/22 Estimate £m	31/03/23 Forecast £m	31/03/24 Forecast £m	31/03/25 Forecast £m
Capital Financing Requirement pre IFRS 16	776	784	770	763	723
Add: impact of IFRS 16 - Leases	-	-	19	17	15
New Capital Financing Requirement	**776**	**784**	**789**	**780**	**738**
Less: Other debt liabilities*:					
- Leases**	N/A	N/A	(19)	(17)	(15)
- Street Lighting PFI	(96)	(91)	(86)	(81)	(75)
- Waste Management Contract	(46)	(42)	(38)	(34)	(30)
Loans CFR	**634**	**651**	**646**	**648**	**618**
Less: External borrowing***:					
- Public Works Loans Board	(217)	(208)	(200)	(192)	(182)
- Other Loans (incl. LOBOs)	(41)	(41)	(41)	(41)	(41)
- Other short-term borrowing	(43)	(43)	(43)	(43)	(43)
Total external borrowing	**(301)**	**(292)**	**(284)**	**(276)**	**(266)**
Internal borrowing	**333**	**359**	**362**	**372**	**352**
Less: Balance sheet resources:					
- Usable Reserves	(755)	(733)	(688)	(671)	(600)
- Allowance for Working Capital	(123)	(270)	(345)	(195)	(270)
Balance sheet resources	**(878)**	**(1,003)**	**(1,033)**	**(866)**	**(870)**
Treasury investments	**(545)**	**(644)**	**(671)**	**(494)**	**(518)**

* Leases and PFI liabilities that form part of the County Council's debt

** IFRS 16 requires the County Council to change how it recognises its leases from 1 April 2022.

*** shows only loans to which the County Council is committed and excludes optional refinancing

20. 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 County

Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

21. It is forecast that the County Council will continue to take advantage of internal borrowing, which will increase through until 2023/24, whilst paying off Public Works Loan Board (PWLB) debt as maturities arise.

22. Reserves and balances are due to reduce over the forecast period due to the anticipated funding of the Capital Programme and use of the Budget Bridging Reserve (BBR) to balance the budget in the interim year of the SP2023 savings programme (2022/23) and to meet the additional deficit now expected in 2023/24 as a result of increased social care costs. The County Council's investment balances are however due to initially rise over the forecast period and then fall during 2023/24, as shown in Table 1. This is because the County Council's employer's LGPS pension contributions were paid early in April 2020 for the period to March 2023, and subject to any unforeseen cash flow requirements the County Council plans to prepay its employer's LGPS pension contributions for three years again on 1 April 2023.

23. CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the County Council's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the County Council expects to comply with this recommendation during 2022/23.

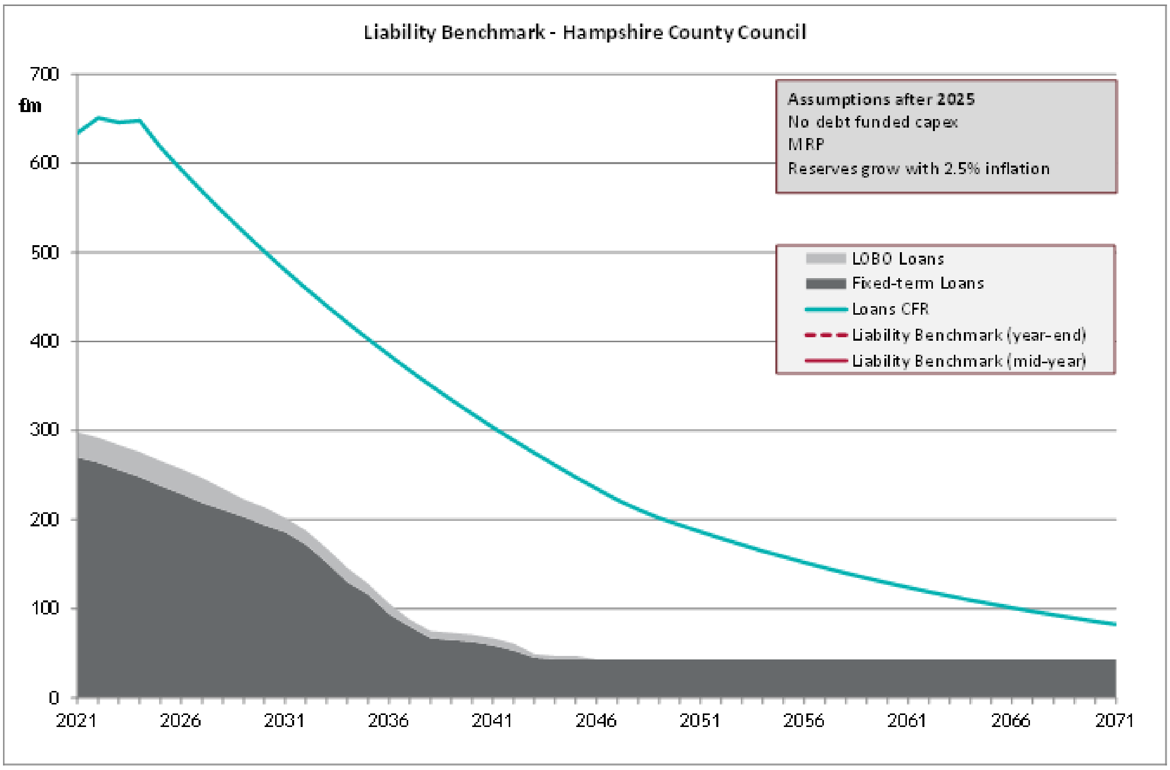
Liability benchmark

24. To compare the County Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as Table 1, but that cash and investment balances are kept to a minimum level of £10m at each year-end to maintain sufficient liquidity but minimise credit risk.

Table 2: Liability benchmark

	31/03/21 Actual £m	31/03/22 Estimate £m	31/03/23 Forecast £m	31/03/24 Forecast £m	31/03/25 Forecast £m
Loans CFR	634	651	646	648	618
Less: Balance sheet resources	(878)	(1,003)	(1,033)	(866)	(870)
Net loans requirement	**(244)**	**(352)**	**(387)**	**(218)**	**(252)**
Plus: Liquidity allowance	10	10	10	10	10
Liability benchmark	**(234)**	**(342)**	**(377)**	**(208)**	**(242)**

25. At the start of the period, 31 March 2021, the County Council had a Loans CFR of £634m, external borrowing of £301m, balance sheet resources of £878m and a liability benchmark of -£234m. The difference of £333m between the CFR and external borrowing is internal borrowing which is where the County Council has used its own resources to fund its borrowing requirement.



26. The liability benchmark is the lowest level of debt the County Council could hold if it used all of its balances, reserves and cash flow surpluses to fund its CFR. The County Council expects a negative liability benchmark across the forecast period, which means that currently there is not a requirement to borrow, and that the County Council could potentially repay its current external borrowing and still fund the planned capital programme. Although the County Council would like to reduce its external borrowing, the premium charged by the PWLB means that it would cost more to repay the borrowing early than it would to repay at maturity, therefore at this time the County Council will not repay its external borrowing early and will continue to repay as maturities come due.

Borrowing Strategy

27. The County Council held £298.4m of loans as at 31 December 2021, which is £7.2m lower than the previous year; this reduction in borrowing balances primarily reflects the repayment of maturing Public Works Loan Board (PWLB) debt, which has not been replaced.

28. The loans are predominantly as a result of the County Council's strategy for funding previous years' capital programmes, but also includes amounts held on behalf of others for governance or administrative purposes. The balance sheet forecast in Table 1 shows that the County Council does not expect to need to take on new external borrowing in 2022/23. The County Council has the option to borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £790m, but does not currently expect to do so.

Objectives

29. The County Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the County Council's long-term plans change is a secondary objective.

Strategy

30. Given the significant cuts to public expenditure and in particular to local government funding, the County Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, the County Council expects to continue its approach of internally borrowing instead of taking on additional external borrowing.

31. By internally borrowing, the County Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. Arlingclose will assist the County Council in regularly monitoring the benefits of this approach against taking on short term external borrowing and the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly.

32. The County Council has previously raised the majority of its long-term borrowing from the PWLB. The County Council does not expect to take on any new long-term borrowing in 2022/23, however should the County Council need to borrow any long-term amounts, the County Council will consider long-term loans from other sources including banks, pension funds 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, however the County Council's investment strategy does not support this activity and so will retain its access to PWLB loans.

33. The County Council may also arrange forward starting loans, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

34. In addition, the County Council may borrow short-term loans (normally for up to one month) to cover unplanned cash flow shortages.

Sources of borrowing

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

- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
- Any institution approved for investments
- Any other bank or building society authorised to operate in the UK.
- Any other UK public sector body.
- UK public and private sector pension funds (except Hampshire Pension Fund).
- Capital market bond investors.
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues.

Other sources of debt finance

36. 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 (PFI)
- sale and leaseback.

LOBOs

37. The County Council holds £20m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the County Council has the option to either accept the new rate or to repay the loan at no additional cost.

38. All of these loans have options during 2022/23, and although the County Council understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The County Council will take the option to repay LOBO loans at no cost if it has the opportunity to do so. Total borrowing via LOBO loans will be limited to the current level of £20m.

Short-term and variable rate loans

39. These loans leave the County Council exposed to the risk of short-term interest rate rises. This risk is monitored through the indicator on interest rate exposure in the treasury management indicators in this report.

Debt rescheduling

40. 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 County 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. Currently the cost of premiums charged by the PWLB for repaying loans prior to maturity outweighs the cost of repaying at maturity.

Treasury Investment Strategy

41. The County Council holds invested funds representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the County Council's treasury investment balance has ranged between £480m and £788m.

42. Over the last 12 months the investment balance has risen due to a number of factors. The increase in investment balances partly reflects the higher balances typically seen at this time of year, due to the difference in timing between income and expenditure. Also, investment balances have been impacted by the decision to pay employer's LGPS pension contributions in advance on 1 April 2020 for the three-year period to March 2023 at a cost of approximately £225m. It is now past the half-way point of the three-year period that the County Council pre-paid LGPS pension contributions for, and so it is expected that underlying core balances will continue to rise until the end of the three-year period. The Covid-19 pandemic has had a significant impact on the County Council's balances with Government grants received that will be spent over the coming months. Adult Services has experienced a significantly lower spend on social care activity as a consequence of excess deaths and alternative support being taken by residents, rather than be admitted to residential and nursing settings, albeit

the current rate of growth and price of care in the market are now rising.at an unprecedented speed.

Objectives

43. The CIPFA Code requires the County Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The County Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

Negative interest rates

44. The Covid-19 pandemic has increased the risk that the Bank of England will set its Bank Rate at or below zero, which would likely to have fed through to negative interest rates on all low risk, short-term investment options, and in some instances negative interest rates were being seen. As the Bank of England has started to raise Bank Rate this eventuality is now not an immediate concern, however in the event of negative investment interest rates, since investments cannot pay negative income, negative rates will be 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.

Strategy

45. Given the increasing risk and very low returns from short-term unsecured bank investments, the County Council aims to continue to hold a diversified investment portfolio, including investments in more secure and/or higher yielding asset classes. This is especially the case for the estimated funds that are available for longer-term investment.

46. At 31 December 2021 approximately 85% of the County Council's investment balances were invested so that they were not subject to bail-in risk (that investors funds are taken to sure a failing bank), as they were invested in Government investments, secured bank bonds and pooled property, equity and multi-asset funds.

47. Of the 15% of investment balances that were subject to bail-in risk at 31 December 2021, 54% was held in very short-term notice accounts providing a comparatively favourable rate of interest in exchange for a short notice period within the 100-day maximum recommended by Arlingclose, 25% was held in overnight money market funds and cash plus funds which are subject to a reduced risk of bail-in due to the high level of diversification

within these investments, and the remainder was held in overnight bank call accounts for liquidity purposes.

48. Unfortunately, the availability of appropriate longer term investment opportunities has been reduced in comparison to previous years due to an uncertain economic market, very low interest rates and the local authority market has been much reduced due to the amount of funding that has been supplied to the sector from Central Government in relation to the pandemic.

49. Further detail is provided at Annex B. This diversification is a continuation of the strategy adopted in 2015/16.

Business models

50. Under the new IFRS 9, the accounting for certain investments depends on the ‘business model’ for managing them. The County Council aims to achieve value from its internally managed treasury investments through 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.

Investments targeting higher returns

51. The County Council agreed in 2021 to increase the amount of its cash balances earmarked for investments targeting higher yields of around 4% to £250m.

52. The CIPFA Code requires the County Council to invest its funds prudently and to have regard to the security and liquidity of its investments before seeking the highest yield. As a result, the County Council’s investments targeting higher yields have been made from its most stable balances and with the intention that they will be held for at least the medium term. This means that the initial costs of any investment and any periods of falling capital values can be overcome and mitigates the risk of having to sell an asset for liquidity purposes, helping to ensure the long-term security of the County Council’s investments.

53. Higher yields can be targeted through longer term cash investments and by investing in asset classes other than cash. Following advice from Arlingclose, the County Council has constructed an investment portfolio that is diversified across asset classes and regions. This has been achieved by investing in pooled investment vehicles (pooled funds) alongside long term lending to other local authorities and loans relating to the Manydown development project. This diversification helps to mitigate the risk of overexposure to a single event affecting a specific asset class.

54. The use of pooled funds also enables the County Council to achieve a greater degree of diversification than could effectively be achieved by directly owning individual assets. Pooled funds are managed by specialist external fund managers who are best placed to select and manage investments, for example with property investments in selecting appropriate buildings and then managing the relationship with tenants and the maintenance of those buildings.

55. Diversification in itself does not guarantee positive outcomes. The selection of pooled funds is carefully managed to target funds with a strong performance track record and objectives that are well aligned to the County Council's aim of achieving income returns of around 4% per annum (pa) without putting its initial investment at undue risk over the longer term. The County Council is therefore currently invested in pooled funds that specialise in providing income returns to support the revenue budget. As a result of their income focus these funds may not achieve the same capital growth and therefore total return, as other more general investment funds, however they are likely to deliver significantly greater income returns than cash investments, particularly in the current interest rate environment.

56. The investible universe for pooled funds is vast and part of the service provided by Arlingclose as treasury advisors is to conduct research and suitable due diligence on pooled funds prior to making recommendations to their clients.

57. Past performance does not guarantee that funds can replicate successful outcomes in future and knowing which funds will perform well is not an exact science. The County Council will therefore continue to conduct its own ongoing review and scrutiny of the performance of its pooled fund investments. The County Council will also discuss these investments regularly with Arlingclose, who provide advice based on regular meetings with representatives from the pooled funds and their own ongoing due diligence on areas such as performance and investment style, strategy and process.

58. Just under £217m of the allocation to higher yielding investments has now been invested, with the remaining balance earmarked. The total amount invested includes £10m invested on behalf of the Thames Basin Heaths Joint Strategic Partnership Board (TBH JSPB), where the County Council acts as the administrative body. Any investments made from cash held on behalf of the TBH JSPB are made with the agreement that the TBH JSPB has received its own financial advice and assumes all risks associated with these investments.

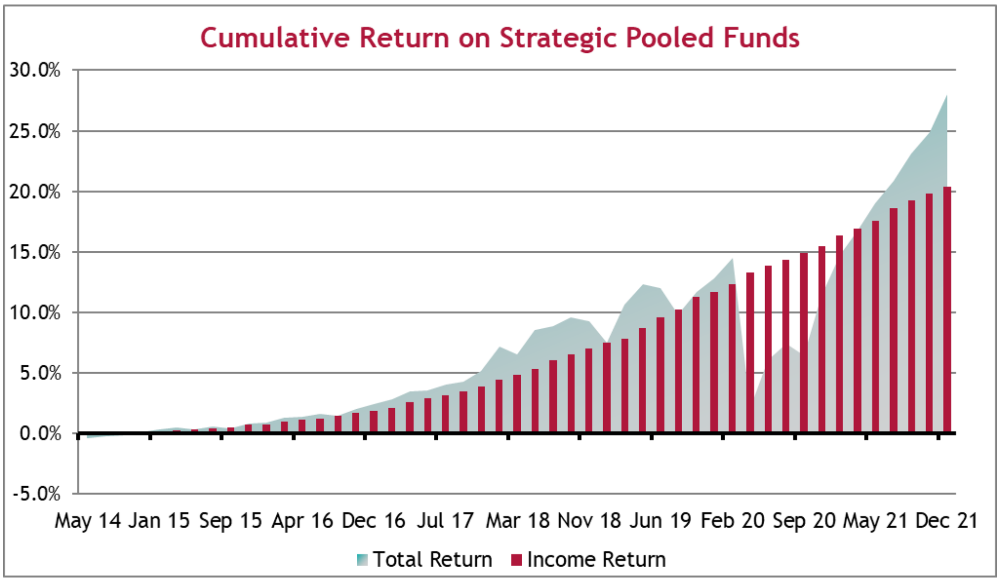
59. The current portfolio of investments targeting higher yields is summarised in Table 3.

Table 3: Investments targeting higher yields portfolio

Investment type*	Amount invested	Market value at 31/12/2021	Gain/(fall) in capital value	
			Since purchase	One year
	£m	£m	£m	£m
Fixed deposits	22.1	22.1	-	-
Pooled property funds	75.0	83.1	8.1	9.4
Pooled equity funds	50.0	53.9	3.9	7.0
Pooled multi-asset funds	48.0	49.1	1.1	0.6
Total	**195.1**	**208.2**	**13.1**	**16.9**

* Excludes £10.2m invested in pooled funds on behalf of TBH JSPB

60. The County Council's investments in pooled funds bring significant benefits to the revenue budget, with over £25m of dividends earned since it first made these investments. Capital values have shown a strong recovery since the lows experienced in March 2020 as a result of the coronavirus pandemic and now all pooled funds are showing capital above the amount originally invested, and with the dividends earned, the total return is significantly positive. The total return for pooled funds since purchase was 28% at 31 December 2021.



Note: the graph above excludes the performance related to £10.2m invested on behalf of Thames Basin Heaths JSPB

61. At the current time, given the medium to long term nature of the investments, it is unlikely that a capital loss would ever be realised, since the County Council would avoid selling investments that realised a capital loss.

62. In addition to the risk of realising a capital loss, changes to IFRS 9 mean that capital gains and losses on investments need to be reflected in the revenue account on an annual basis, although there is currently a statutory override in place for local authorities that exempts them from complying with this requirement for the next two years.

63. The County Council is aware of the risks involved with investing in pooled funds that hold underlying investments in bonds, equities, property and other financial instruments. When the County Council began to specifically target higher returns from a proportion of its investments, it also established an Investment Risk Reserve to mitigate the risk of an irrecoverable fall in the value of these investments. The balance held in this reserve is currently £6.25m. This equates to 2.5% of the total earmark of £250m. The County Council intends to continue to contribute towards the Investment Risk Reserve when required to ensure 2.5% of the total amount invested is held in reserve (in line with the recommendation of 2.5% for the general fund balance).

64. In the short term the County Council continues to take a prudent approach to forecasting income returns from its investments targeting higher yields, anticipating lower percentage returns than in previous years, due to the ongoing impacts of the coronavirus pandemic on property rents, company dividends and other sources of income being sought by its pooled fund investment managers. This could reduce the income return of pooled funds to below the target of 4% per annum. However the County Council expects to achieve significantly greater income returns from these investments than from the rest of its investment portfolio. Table 4 provides an example of the difference in the annualised average income return from the higher yielding strategy at 31 December 2021 and the returns being achieved on the County Council's other investments for the 12 months to that date.

Table 4: Weighted Average Returns and Indicative Annualised Income

	Cash Balance 31/12/2021 £m	Weighted Average Return %	Annualised Income £m
Short-term and Long-term Cash Investments	486.6	0.22	1.08
Investments Targeting Higher Yields	195.2	4.31	8.81
Total	**681.8**	**1.39**	**9.49**

Investment Limits

65. The maximum that will be lent to any one organisation (other than the UK Government) will be £90m, which is an increase in comparison to the previous TMSS due to temporarily increased investment balances. Although over the longer term it is expected that the County Council's cash balances will reduce, the ongoing pandemic has resulted in world supply issues and so the delivery of elements of the agreed capital programme has been delayed, which may result in raised investment balances for a short time. Increased limits allow the flexibility to ensure that all of the County Council's cash can be invested in accordance with this TMSS.

66. A group of entities under the same ownership will be treated as a single organisation for limit purposes. Limits are also placed on fund managers as shown in Table 5.

Table 5: Investment Limits

	Cash Limit
Any single organisation, except the UK Central Government	£90m each
UK Central Government	Unlimited
Any group of pooled funds under the same management	£225m per manager

Approved Counterparties

67. The County Council may invest its surplus funds with any of the counterparty types in Table 6, subject to the limits shown:

Table 6: Sector and counterparty limits

Sector	Time limit	Counterparty limit	Sector limit
The UK Government	30 years	Unlimited	n/a
Local authorities & other government entities	25 years	£90m	Unlimited
Secured investments *	25 years	£90m	Unlimited
Banks (unsecured) *	13 months	£45m	Unlimited
Building societies (unsecured) *	13 months	£45m	£90m
Registered providers (unsecured) *	5 years	£45m	£90m
Money market funds *	n/a	£90m	Unlimited
Strategic pooled funds	n/a	£90m	£450m
Real estate investment trusts	n/a	£45m	£90m
Other investments *	5 years	£45m	£90m

This table must be read in conjunction with the notes below

*** Minimum credit rating**

68. 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 known factors including external advice will be taken into account.

69. For entities without published credit ratings, investments may be made where external advice indicates the entity to be of similar credit quality.

Government

70. 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 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 30 years.

Secured investments

71. 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.

Banks and building societies (unsecured)

72. Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

Registered providers (unsecured)

73. 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 (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

Money market funds

74. Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the County Council will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

Strategic pooled funds

75. Shares or units in diversified investment vehicles consisting of bond, equity and property investments. These funds offer enhanced returns over the longer term but are more volatile in the short term and allow the County Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. This sector also includes

cash plus funds which are also a type of pooled fund, but are used for short-term funds, with a lower risk appetite. Because strategic pooled funds have no defined maturity date, but are available for withdrawal after a notice period; their performance and continued suitability in meeting the County Council's investment objectives will be monitored regularly.

Real estate investment trusts (REITs)

76. 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.

Other investments

77. 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 County Council's investment at risk.

78. In addition the County Council can invest in an unrated corporate where it owns an interest in the corporation that gives participation in the company's governance, in which case a limit of £35m for an investment of up to 20 years will apply.

Operational bank accounts

79. The County Council may incur operational exposures, for example through current accounts, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be kept low. The County Council's operational bank account is with National Westminster and aims to keep the overnight balances held in current accounts positive, and as close to zero as possible. 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 County Council maintaining operational continuity.

Risk assessment and credit ratings

80. Credit ratings are obtained and monitored by the County 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.

81. 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.

Other Information on the security of investments

82. The County Council understands that credit ratings are good but not perfect predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press and analysis and advice from the County Council’s treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

83. 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 County 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 County 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.

Liquidity management

84. The County Council has due regard for its future cash flows when determining the maximum period for which funds may prudently be committed. Historic cash flows are analysed in addition to significant future

cash movements, such as payroll, grant income and council tax precept. Limits on long-term investments are set by reference to the County Council's medium term financial position (summarised in Table 1) and forecast short-term balances.

85. The County Council 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 at any one provider, except in cases of extreme market stress whereby the County Council will be able to invest all of its liquid cash in one provider only, being the Debt Management Office.

Treasury Management Indicators

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

Interest rate exposures

87. The following indicator shows the sensitivity of the County Council's current investments and borrowing to a change in interest rates. Fixed rate investments maturing during the year are assumed to be variable for the remainder of the year.

Table 7: Interest rate risk indicator

	31 December 2021	**Impact of +/- 1% interest rate change**
	£m	**£m**
Sums subject to variable interest rates:		
Investment	672	+/-6.7
Borrowing	(20)	+/-0.2

Maturity structure of borrowing

88. This indicator is set to control the County Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

Table 8: Refinancing rate risk indicator

	Upper	**Lower**
Under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	75%	0%
10 years and within 20 years	75%	0%
20 years and within 30 years	75%	0%
30 years and above	100%	0%

89. 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.

Principal sums invested for periods longer than a year

90. The purpose of this indicator is to control the County Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

Table 9: Price risk indicator

	2022/23	**2023/24**	**2024/25**
Limit on principal invested beyond year end	£330m	£300m	£300m

Related Matters

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

Financial derivatives

92. Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

93. The County 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 County 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.

94. 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.

95. In line with the CIPFA Code, the County Council will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.

Investment training

96. The needs of the County Council's treasury management staff for training in investment management are assessed annually as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.

97. Staff regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA, and other appropriate organisations.

98. CIPFA's Code of Practice requires that the County Council ensures that all members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities. All members were invited to a workshop presented by Arlingclose on 15 November 2021, which gave an update of treasury matters. A further Arlingclose workshop has been planned for 2022.

Investment advisers

99. The County Council has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues. The quality of this service is controlled through

quarterly review meetings with the Director of Corporate Operations, his staff and Arlingclose.

Markets in Financial Instruments Directive

100. The County Council has opted up to professional client status with its providers of financial services, including advisers, brokers, and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the County Council's treasury management activities, the Section 151 Officer believes this to be the most appropriate status.

Other Options Considered

101. The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Director of Corporate Operations believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed in Table 10.

Table 10: Alternative strategies and their implications

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

Table 10: Alternative strategies and their implications

Alternative	**Impact on income and expenditure**	**Impact on risk management**
		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

Annex A – Arlingclose Economic & Interest Rate Forecast - December 2021

Underlying assumptions:

- The global recovery from the pandemic has entered a more challenging phase. The resurgence in demand has led to the expected rise in inflationary pressure, but disrupted factors of supply are amplifying the effects, increasing the likelihood of lower growth rates ahead. The advent of the Omicron variant of coronavirus is affecting activity and is also a reminder of the potential downside risks.
- Despite relatively buoyant activity survey data, official Gross Domestic Product (GDP) data indicates that growth was weakening into Quarter 4 of 2021. Other data, however, suggested continued momentum, particularly for November. Retail sales volumes rose 1.4%, and the labour market continued to strengthen. The end of furlough did not appear to have had a significant impact on unemployment. Wage growth is elevated.
- The Consumer Price Index (CPI) rate rose to 5.1% for November and will rise higher in the near term. While the transitory factors affecting inflation are expected to unwind over time, policymakers' concern is persistent medium term price pressure.
- These factors prompted the Monetary Policy Committee (MPC) to raise Bank Rate to 0.25% at the December 2021 meeting. Short term interest rate expectations remain elevated.
- The outlook, however, appears weaker. Household spending faces pressures from a combination of higher prices and tax rises. In the immediate term, the Omicron variant has already affected growth – activity for Quarter 4 of 2021 and Quarter 1 of 2022 could be weak at best.
- Longer-term government bond yields remain relatively low despite the more hawkish signals from the Bank of England (BoE) and the Federal Reserve. Investors are concerned that significant policy tightening in the near term will slow growth and prompt the need for looser policy later. Geo-political and coronavirus risks are also driving safe haven buying. The result is a much flatter yield curve, as short-term yields rise even as long-term yields fall.
- The rise in Bank Rate despite the Omicron variant signals that the MPC will act to bring inflation down whatever the environment. It has also made clear its intentions to tighten policy further. While the economic outlook will be challenging, the signals from policymakers suggest their preference is to tighten policy unless data indicates a more severe slowdown.

Forecast:

- The MPC will want to build on the strong message it delivered this month by tightening policy despite Omicron uncertainty.
- Arlingclose therefore expects Bank Rate to rise to 0.50% in Quarter 1 of 2022, but then remain there. Risks to the forecast are initially weighted to the upside, but becoming more balanced over time. The Arlingclose central forecast remains below the market forward curve.

- Gilt yields will remain broadly flat from current levels. Yields have fallen sharply at the longer end of the yield curve, but expectations of a rise in Bank Rate have maintained short term gilt yields at higher levels.
- Easing expectations for Bank Rate over time could prompt the yield curve to steepen, as investors build in higher inflation expectations.
- The risks around the gilt yield forecasts vary. The risk for short and medium term yields is initially on the upside but shifts lower later. The risk for long-term yields is weighted to the upside.

	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Official Bank Rate													
Upside risk	0.00	0.00	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk	0.00	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
3-month money market ra													
Upside risk	0.05	0.05	0.25	0.35	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.25	0.55	0.55	0.60	0.60	0.60	0.60	0.65	0.65	0.65	0.65	0.65	0.65
Downside risk	0.00	-0.25	-0.25	-0.30	-0.30	-0.30	-0.30	-0.35	-0.35	-0.35	-0.35	-0.35	-0.35
5yr gilt yield													
Upside risk	0.00	0.35	0.45	0.55	0.55	0.55	0.55	0.55	0.55	0.50	0.50	0.45	0.45
Arlingclose Central Case	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.65	0.70	0.75	0.75
Downside risk	-0.10	-0.20	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.30	-0.35	-0.40	-0.40
10yr gilt yield													
Upside risk	0.10	0.25	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.55	0.55	0.55
Arlingclose Central Case	0.80	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.90	0.90	0.95	0.95
Downside risk	-0.10	-0.25	-0.30	-0.35	-0.35	-0.35	-0.35	-0.35	-0.35	-0.40	-0.40	-0.40	-0.40
20yr gilt yield													
Upside risk	0.30	0.40	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	1.00	1.05	1.10	1.10	1.10	1.10	1.15	1.15	1.15	1.20	1.20	1.20	1.20
Downside risk	-0.15	-0.30	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45
50yr gilt yield													
Upside risk	0.25	0.30	0.40	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.70	0.75	0.80	0.85	0.90	0.95	1.00	1.05	1.05	1.10	1.10	1.15	1.15
Downside risk	-0.15	-0.30	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45

PWLB Standard Rate (Maturity Loans) = Gilt yield + 1.00%
PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%
PWLB Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

Annex B - Existing Investment & Debt Portfolio Position at 31 December 2021

Treasury investments position

Investments	31/08/2021 Balance £m	Net movement £m	31/12/2021 Balance £m	31/12/2021 Income return %	31/12/2021 Weighted average maturity years
Short term investments					
Banks and building societies:					
- Unsecured	114.6	(39.9)	74.7	0.07	0.08
- Secured	121.9	24.4	146.3	0.12	0.42
Money Market Funds	3.8	10.8	14.6	0.04	0.01
Government:					
- Local authorities	137.0	49.0	186.0	0.37	0.52
- UK treasury bills	15.0	13.0	28.0	0.15	0.32
- Supranational banks	0.0	10.0	10.0	0.14	0.96
- UK gilts	20.0	(20.0)	-	-	-
Cash Plus Funds	10.0	-	10.0	0.55	0.02
	422.3	47.3	469.6	0.22	0.39
Long term investments					
Banks and building societies:					
- Secured	32.5	(15.5)	17.0	0.29	1.26
Government:					
- Local authorities	10.0	(10.0)	-	-	-
	42.5	(25.5)	17.0	0.29	1.26
Long term investments – higher yielding strategy					
Government:					
- Local authorities	21.9	0.3	22.2	4.44	11.58
Pooled funds:					
- Pooled property*	75.0	-	75.0	3.60	N/A
- Pooled equity*	50.0	-	50.0	5.58	N/A
- Pooled multi-asset*	48.0	-	48.0	4.02	N/A
	194.9	0.3	195.2	4.31	11.58
Total Investments	**659.7**	**22.1**	**681.8**	**1.39**	**0.69**
Thames Basin Heath pooled fund investments	10.2	-	10.2		
Total	**669.9**	**22.1**	**692.0**		

* The rates provided for pooled fund investments are reflective of annualised income returns over the year to 31 December 2021 based on the market value of investments 12 months earlier.

Treasury management position	**31/12/2021 Balance £m**	**31/12/2021 Rate %**
External Borrowing:		
- PWLB Fixed Rate	(214.0)	(4.74)
- Other Loans (including LOBO Loans)	(41.2)	(4.35)
- Other Short-term Borrowing*	(43.2)	N/A
Total External Borrowing	(298.4)	(4.00)
Other Long-Term Liabilities:		
- Street Lighting PFI	(91.0)	
- Waste Management Contract	(42.1)	
- Leases	0.0	
Total Other Long-Term Liabilities	(133.1)	
Total Gross External Debt	**(431.5)**	
Investments	**692.0**	**1.44**
Net (Debt) / Investments	**260.5**	

* includes balances held by the County Council on behalf of others for governance or administrative reasons