AGENDA ITEM NO:

24th February 2021

TREASURY MANAGEMENT STRATEGY 2021/2022

Purpose of the Report

1. This report discusses and asks the Commissioner to approve:

   a) The proposed Prudential (PrIs) and Treasury (TrIs) Indicators for the next three years (Appendix A);

   b) The proposed Annual Investment Strategy for 2021/2022; and

   c) Other treasury management decisions required for 2021/2022 that do not form part of the PrIs/TrIs (paragraphs 15 to 17 below).

Background

2. The Codes of Practice require the Commissioner to consider and approve a Treasury Management Strategy (TMS), which incorporates the Prudential and Treasury Indicators and an Annual Investment Strategy. This is required under the provisions of the latest CIPFA Code of Practice on Treasury Management in the Public Services (the CIPFA Code) and the Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

3. This Treasury Management Strategy is closely linked to both the current Capital Strategy and the Capital Financing Strategy as agreed by CMB.

4. Before looking at the TMS for 2021/2022 I need to review the current year's treasury management activity.

Treasury Management Strategy - Review of 2020/2021

5. A detailed analysis of the 2020/2021 activities will be made in the Annual Treasury Report.

6. In January 2020 the revised forecast cash flow deficit for the year was £1.1 million (Original forecast £2.6m deficit). Increased allocation of Officer Uplift/COVID related grants has reduced the expected deficit for the year. The actual cash flow position for 2020/2021 will be reported in the Annual Treasury Report.

7. During February 2021 a PWLB loan of £0.798m is planned in line with the approved Capital Strategy, the majority of this is to be used to fund the Estates strategy, specifically the investment in the Warminster development. This funding will be included as income along with the relevant expenditure for cashflow purposes.

8. Surplus funds invested at 31 December 2020 stood at £19.50 million, as follows,

   - £14.30 million invested in the market
   - £5.18 million invested in the Handelsbanken (formally Svenska) instant access call account
   - £0.02 million invested in the BNP Money Market Fund

9. At this date, the total funds invested in the market (£14.3 million) were all in fixed term deposits (for between 1 - 6 months). This money is being invested directly by our local treasury managers (Wiltshire Council) in short-term, approved investments or overnight as BNP or Handelsbanken deposits. The HSBC Overnight deposit account is not being used, as the interest rate is currently negative. An analysis of the annual return is given in the Annual Treasury Report.

Main Considerations for the Commissioner – Treasury Management Strategy

Prudential and Treasury Indicators

10. The Capital Strategy sets out a need for borrowing to finance future Capital plans. The Prudential and Treasury Indicators have increased relevance to the PCC with a borrowing strategy, he is responsible for calculating and formally approving these indicators in line with the Prudential Code.

11. Issues of affordability, prudence and sustainability of borrowing are of increased relevance to the PCC now that he is borrowing to finance the future capital expenditure plan. The PrIs/TrIs for borrowing limits, interest rate exposures and maturity structures have to be considered.

12. The PCC has responsibilities under the Prudential Code to ensure value for money (robust option appraisal) and practicality of capital investment, proper stewardship of assets (asset management planning) and sound links to service objectives.

13. The proposed Prudential and Treasury Indicators are set out in Appendix A, together with a brief summary on each one.

14. The latest Capital Financing Strategy sets out a requirement to borrow over future years. £0.8m borrowing is planned before the end of March 2021. For the next three years planned borrowing is £3.5m (21/22), £1.9m (22/23) and £6.9m (23/24) totaling a cumulative £12.3m. PrI3 considers borrowing requirements against capital expenditure. As borrowing does not exceed the capital expenditure the so called 'Golden Rule' is not broken.

15. The key indicator is PrI2, this forecasts the percentage of the organisations net revenue stream being spent on borrowing. Appendix A shows this turning from negative to positive as borrowing costs exceed investment returns in 2021/22. The question to be asked is can the organisation afford the repayment cost. Whilst in 2022/23 the organisation can afford 0.39% this is planned to increase during the 10 year life of the capital plan. It is forecast that in 2027/28 this could grow to 1.5%. Whilst this is not high compared to other organisations it is the year on year impact that needs to be considered. On review these increases can be afforded as long as the gradual increase in revenue costs occurred due to the borrowing is planned over a period of years to ease the impact.

16. Appendix A of this paper sets out new operational limits and authorised limits for borrowing with consideration for these amounts.

Cash Deficits and Surpluses

Short Term Deficits and Surpluses

17. Short term cash surpluses and deficits will arise regularly during the year. It is anticipated that the majority of these surpluses will only be available on a very temporary basis. Short term deposits are the most cost effective investment for such cash surpluses. Therefore, investments will normally be made through short term deposits at fixed rates to specific dates, with reference to the cash flow requirements.

18. Temporary loans (where both the borrower and lender have the option to redeem the loan within twelve months) are occasionally used to cover short term revenue cash deficits, where this is more cost effective than temporarily withdrawing funds from call accounts, pending the receipt of, for example, grant income.

19. I therefore recommend that the PCC continues to utilise temporary loans and deposits to manage these cash flows.

Longer Term Cash Balances

20. The longer term balances are managed by Wiltshire Council and are currently held, partly in longer term (above three and up to 12 months) investments and partly in call accounts.

21. The annualised weighted average return of the longer term investments (only) is currently 0.36%, which has decreased from 0.99% in the same period last year. The Bank of England base rate has been 0.10% since March 2020 and is expected to remain at this level for a considerable period. Therefore, it is unlikely that fixed term deposit rates will improve in 2021/2022.

22. A comparative benchmark, (the three month London Interbank Bid Rate LIBID), reflecting the rate at which a bank is willing to borrow from other banks, was, on average 0.04% for the same period.

Risk

23. The Prudential Code has been implemented to allow authorities' and PCC's freedom to invest if they consider it is affordable and prudent, this reduces risk. This paper reviews the indicators and suggests that as long as the MTFS includes the increase in borrowing costs and RCCO then the levels are affordable.

24. In 2021/2022 external advice is being provided by Link Asset Services, this will be surrounding where to lend and how to borrow. The intention is to borrow from the Public Works Loan Board (PWLB) at a fixed interest rate. The PWLB is a statutory body that issues loans to local authorities, and other specified bodies, from the National Loans Fund. As they are a public body rates are often lower than private enterprises. The PWLB is used by most local authorities and PCCs which borrow.

25. The Bank of England has maintained its emergency cuts in interest rates at 0.1% as a response to the emerging threat of the Coronavirus. In the past this would have a negative impact to the PCC where the interest on investments would reduce. As we now look to borrow funds, the reduced rates will have a positive impact to the overall finances as the cost of borrowing starts to exceed the return from investments.

Monitoring and Reporting of the Prudential Indicators

26. Wiltshire Council staff and the finance staff of the PCC will monitor progress against the PrIs/TrIs throughout the year. The PCC will be kept informed of any issues that arise, including potential or actual breaches, as these could be ultra-vires. I will normally update the PCC every six months in the Interim and Annual Treasury Reports.

Collaboration

27. The day to day Treasury Management function is outsourced to Wiltshire Council. Using their skills and contacts with market experts it is believed that value for money is achieved alongside good returns.

Diversity

28. No diversity issues have been identified

Recommendations

29. The Commissioner is asked to:

    a) adopt the Prudential and Treasury Indicators set out in Appendix A;

    b) adopt the Investment Strategy set out in Appendix B;

    c) agree that short term cash deficits and surpluses continue to be managed through temporary loans and deposits (paragraphs 16 to 18); and

    d) agree that, for longer term cash balances, the Chief Finance Officer continues to be delegated to negotiate the terms and conditions of any external arrangement.

Clive Barker
Chief Finance Officer to the PCC

APPENDIX A

PRUDENTIAL (PrIs) AND TREASURY (TrIs) INDICATORS 2021/2022 - 2023/2024

Prudential Indicators

PrI 1 - Capital Expenditure

1. The capital expenditure plans are set out in the Capital Plan, but under the Prudential Code, the PCC is required to confirm this as a Prudential Indicator. Capital expenditure plans for the years 2020/2021 to 2023/2024 are as follows (assuming 80% of spend occurs in the year with carry forward):

	2019/2020 Actual £million	2020/2021 Estimate £million	2021/2022 Estimate £million	2022/2023 Estimate £million	2023/2024 Estimate £million
Capital Expenditure	6.3	5.7	9.6	6.7	12.1

PrI 2 – Ratio of Financing Costs to Net Revenue Stream

2. This indicator expresses the net costs of financing as a percentage of the funding receivable from the Government and council tax payers. The net cost of financing includes interest and principal repayments for long and short term borrowing, as well as other credit-like arrangements, netted off by interest receivable in respect of cash investments. The indicator does not include the revenue contribution to capital expenditure.

3. The table below shows a negative percentage in the early years. This is because interest received is expected to exceed borrowing costs. In 2022/23 cumulative borrowing is expected to be £7.7m resulting in borrowing costs exceeding the interest received.

	2019/2020 Actual %	2020/2021 Estimate%	2021/2022 Estimate %	2022/2023 Estimate %	2023/2024 Estimate %
Ratio of Financing Costs to Net Revenue Stream	-0.18	0.00	0.02	0.39	0.46

PrI 3 – Gross Borrowing to Capital Financing Requirement

4. This indicator measures the so-called "Golden Rule" and focuses on prudence. To meet the 'Golden Rule' capital expenditure needs to exceed borrowing.

5. The Capital Financing Requirement (CFR) normally increases year-on-year by the amount of capital expenditure that is not funded from sources other than borrowing (i.e. government capital grant, capital receipts, developer contributions, direct revenue), reduced by the amount set-aside from the revenue budget and capital receipts for the repayment of debt. The CFR is equivalent to Gross Borrowing and is the PCC's long and short term external debt.

	2019/2020 Actual £million	2020/2021 Estimate £million	2021/2022 Estimate £million	2022/2023 Estimate £million	2023/2024 Estimate £million
Capital Expenditure	6.349	5.684	9.577	6.650	12.066
Financing (other than borrowing)	-5.603	-4.500	-6.043	-4.800	-5.199
Gap to fund from borrowing	0.746	1.184	3.534	1.850	6.867
MRP (repayments of borrowing)		-0.055	-0.112	-0.604	-0.691
Movement in CFR	**0.746**	**1.129**	**3.422**	**1.246**	**6.176**
Total Capital Financing Requirement	0.746	**1.875**	**5.297**	**6.543**	**12.719**

Treasury Management Indicators within the Prudential Code

TrI 1 – External debt

6. Under the Prudential Code, three limits must be set by the PCC for External Debt:
    a) Actuals for last year and an estimate for the end of the current year
    b) An Operational boundary for the next three years
    c) An Authorised limit for the next three years.

7. The Operational boundary is based on the most likely, prudent, but not worst case scenario of borrowing for the year. The Authorised limit is based on the Operational limit but with an additional margin (in the PCC's case a 15% allowance for temporary borrowing and a consideration for the possibility of Capital financing brought forward) to allow for unusual or unexpected cash movements. These borrowing limits are to be set gross of investments.

	31/03/2020 Actual	**31/03/2021 Estimated**
Short Term Borrowing (Temporary)	£0.0m	£0.0m
Long Term Borrowing	£1.1m	£0.8m
Other Long Term Liabilities	£0.0m	£0.0m
TOTAL	**£1.1m**	**£0.8m**

8. There was no temporary borrowing outstanding as at 31 March 2020. It is estimated that there will be no temporary borrowing outstanding at the end of the current financial year.

9. The PCC's Capital Strategy sets out a ten year spending and funding plan. This plan incorporates long term borrowing of £0.8m for 2020/21 and £3.5 million for 2021/22 in support of significant new Estates and ICT investments.

10. The PCC's long term contract surrounding the provision of Estate in Swindon is a PFI. This leads to, in accounting terms, a long term liability which is essentially a form of borrowing. Whilst included as a revenue payment in budgets, accounting practise requires us to split the capital element and report it separately in the Statement of Accounts. The unitary payment will include an amount for interest and capital repayment.

11. The PCC holds its surplus monies in approved investments in sufficient levels to finance its annual cash flow forecasts. However, during each year there are fluctuations in cash flow, the highest deficits are forecast as approximately £6.5 million (2021/2022), £6.5 million (2022/2023) and £6.5 million (2023/2024). There may also be a need to pay out capital expenditure prior to receipt of capital income, although previous experience shows that this is unlikely.

12. Invested cash could be reduced to cover these temporary deficits but this may not be the most cost effective approach for the PCC. Limits for temporary borrowing are therefore proposed, to allow flexibility to use borrowing as an alternative way of financing such temporary deficits, if this is in the PCC's best interest. The following limits should be authorised to deal with possible in-year cash flow shortfalls and to cover the levels of long term borrowing as set out in the latest Capital Financing Strategy.

Operational Boundary	**2021/2022**	**2022/2023**	**2023/2024**
Annual gross borrowing	£5.3m	£6.6m	£12.8m
Temporary borrowing	£6.5m	£6.5m	£6.5m
Total operational boundary	**£11.8m**	**£13.1m**	**£19.3m**

Authorised Limit	**2021/2022**	**2022/2023**	**2023/2024**
Annual gross borrowing	£5.8m	£7.1m	£13.3m
Temporary borrowing	£7.5m	£7.5m	£7.5m
Total authorised limit	**£13.3m**	**£14.6m**	**£20.8m**

Treasury Management Indicators within the Treasury Management Code

TrI 2 – Interest Rate Exposures

13. This TrI relates to net borrowing (i.e. borrowing less investments). As the PCC's long term borrowing will be at fixed rate there is no risk to borrowing costs of a change in interest rates over the term of the loan. There is however a risk of the rates increasing prior to the date that the borrowing is planned. The PCC does rely partly on returns from invested funds in order to finance revenue and capital expenditure.

14. Future returns will be affected by inflation and the Bank of England's decisions on interest rates. The Bank Rate is currently 0.10%, decreased from 0.25% in March 2020, where it had been set for eight days only. It had previously been 0.75% since August 2018.

15. Link Asset Services, the treasury adviser for the PCC, is currently reporting the following in terms of investment rates,

    a) The coronavirus outbreak has done huge economic damage to the UK and economies around the world. Bank rate is unlikely to rise from 0.10% for a considerable period. It is very difficult to say when it may start rising.
    b) Investment returns are likely to remain exceptionally low during 2021/22 with little increase in the following two years. However, as post Brexit Trade deals are progressed and agreed, then there is upside potential for earnings.
    c) Investor cash flow uncertainty, and the need to maintain liquidity in these unprecedented times, has meant that there is a surplus of money at the very short end of the market. This has seen a number of market operators (including the Debt Management Office) offer nil or negative returns for very short-term maturities. This is not universal, however, and some financial institutions are still offering a marginally positive return for investments.
    d) The suggested budgeted investment earnings rates for returns on investments placed for periods of up to three months during 2021/2022 is 0.10%, and remaining at this level until 2023/24.

16. Reflecting the low returns in 2019/20 and 2020/21 the PCC's budget in 2021/2022 for investment returns is set on a return of 0.6%

17. All funds are internally managed by Wiltshire Council and returns will be maximised whichever way interest rates move. The control of the investments is subject to the approved Annual Investment Strategy and the limits set in this TrI.

18. Any temporary or long term borrowing, as authorised in TrI 1 above, should be taken on a fixed interest rate. Investments on HSBC Bank Treasury and other financial institutions should also be taken at fixed interest rates.

The PCC's upper limit for fixed interest rate exposure for the period 2021/2022 to 2023/2024 is 100% of net outstanding principal sums.

The PCC's upper limit for variable interest rate exposure for the period 2021/2022 to 2023/2024 is 0% of net outstanding principal sums.

TrI 3 – Maturity Structure of Borrowing

19. A £1.1m loan was taken out in 2019/20 over a thirty year period to reflect the estimated useful operational life of the Estates asset in ownership of the PCC. The current Capital Strategy allows for further borrowing of £0.8 million in 2020/2021 and £0.4m in 2021/2022 relating mainly to significant Estates investments. Further borrowing of £3.1 million is planned for 2021/22 relating to the mobile communications project which will be taken over a period of 7 years to reflect the general lifespan of IST type assets.

TrI 4 – Total Principal Sums invested for periods longer than 365 days

20. This TrI is covered by the Annual Investment Strategy.

INVESTMENT STRATEGY FOR 2021/2022

1. The PCC will have regard to the Department for Communities and Local Government's (DCLG's) Guidance on Local Government Investments ("the Guidance") issued in March 2004, any revisions to that guidance, the Audit Commission's report on Icelandic investments and the 2018 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The general investment policy of the PCC will be the prudent investment of its surplus cash balances, priorities being:
    a) the security of capital and
    b) the liquidity of its investments.

2. Only in so far as is consistent with the priority of security and liquidity, the PCC will aim to achieve the optimum return on its investments.

3. The PCC will not borrow monies purely to invest or lend-on and make a return.

4. All investments of the PCC will be in sterling, as it does not wish to hold investments that are subject to foreign exchange rate risks.

5. All investments made other than those through an External Cash Investment Manager (where applicable – currently no PCC funds are managed by an External Cash Investment Manager) or certain investments placed with local authorities and other public bodies, subject to professional advice will be Specified Investments, as prescribed in the DCLG's Guidance on Local Government Investments (the "Guidance").

6. The investments identified in 5. above are the only non specified investments authorised for use and will only be:

    a) in Sterling;
    b) for investments in excess of 12 months, limited to £10 million; and
    c) not invested for a period exceeding five years.

7. Credit ratings will be monitored on a daily basis, by the PCC's treasury management providers (Wiltshire Council). The Council uses the creditworthiness service provided by Link Systems Ltd. This service is based on a sophisticated modelling approach, with credit ratings from all three rating agencies (Fitch, Moody's and Standard and Poor's), forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following as overlays:

    a) credit watches and credit outlooks from credit rating agencies;
    b) CDS spreads to give early warning of likely changes in credit ratings; and
    c) sovereign ratings to select counterparties from only the most creditworthy countries.

“**High Credit Quality” Policy**
In accordance with DCLG Guidance on Local Government Investments for selecting the creditworthiness of counterparties with whom investments are placed, the Police and Crime Commissioner will comply with the minimum requirements below.

All banks and building societies must be part of the credit list provided by Link Asset Services. The PCC will only invest with institutions on the list for the durations as specified by the colour coding used by Link and they must not be shown as out of range (with no colour) on the credit default swap analysis.

All Local Authorities and public bodies (ratings are not issued for most of these bodies).

Money Market Funds (MMF), must have been awarded the highest possible rating (AAA) from at least one of the credit rating agencies, Standard and Poor’s, Moody’s Investor Services Ltd and Fitch Ratings Ltd. (Deposits will only be placed with MMFs subject to individual signed management agreements.)

Limits are applied to the amount of money that can be lent to any of these institutions or groups of institutions using the ratings of Fitch Rating Agency as follows:

£8 million

UK incorporated banks with a short term credit rating of at least F1+ and a long term credit rating of at least AA

Overseas banks that have a long term credit rating of at least AA+

Local Authorities and other public bodies

£5 million

Other UK Incorporated banks

Other overseas banks

Building Societies

Money Market Funds