



**FLINTSHIRE COUNTY COUNCIL**

**DRAFT TREASURY MANAGEMENT  
STRATEGY**

**2021/22**

# CONTENTS

| <b><u>Section</u></b>   |  | <b><u>Page</u></b> |
|---|--|--------------------|
| 1.0   | Introduction   | 1                  |
| 2.0   | Economic Context   | 1                  |
| 3.0   | Current Treasury Portfolio                                 | 4                  |
| 4.0   | Local Context  | 5                  |
| 5.0   | Investment Strategy  | 6                  |
| 6.0   | Borrowing Strategy   | 12                 |
| 7.0   | Policy on the use of Financial Derivatives                 | 14                 |
| 8.0   | Policy on apportioning interest to Housing Revenue Account | 15                 |
| 9.0   | Markets in Financial Instruments Directive                 | 15                 |
| 10.0  | Treasury Management Indicators                             | 15                 |
| 11.0  | Other Matters  | 16                 |
| APPENDIX A – Debt Maturity Profile                                |  | 19                 |
| APPENDIX B – Additional Requirements of Welsh Government Guidance |  | 20                 |

# Treasury Management Strategy Report 2021/22

The Council is recommended to:

- approve the Treasury Management Strategy for 2021/22
- approve the Treasury Management Indicators for 2021/22

## 1.0 Introduction

In April 2019 the Council adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition* (the CIPFA Code) which requires the Council to approve a Treasury Management Strategy before the start of each financial year.

In addition, the Welsh Government (WG) issues guidance on local authority investments that requires the Council to approve an investment strategy before the start of each financial year. Welsh Government updated this guidance in November 2019.

This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the WG Guidance.

The successful identification, monitoring and control of risk are central to the Council's Treasury Management Strategy as the Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates.

In accordance with the WG Guidance, the Council will be asked to approve a revised Treasury Management Strategy should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates, in the Council's capital programme or in the level of its investment balance.

## 2.0 Economic Context (including interest rate forecast – as provided by Arlingclose Ltd, January 2021)

**Economic background:** The impact on the UK from coronavirus, lockdown measures, the rollout of vaccines, as well as the new trading arrangements with the European Union (EU), will remain major influences on the Authority's Treasury Management Strategy for 2021/22.

The Bank of England (BoE) maintained Bank Rate at 0.10% in December 2020 and Quantitative Easing programme at £895 billion having extended it by £150 billion in the previous month. The Monetary Policy Committee (MPC) voted unanimously for both, but no mention was made of the potential future use of negative interest rates. In the November Monetary Policy Report (MPR)

forecasts, the Bank expects the UK economy to shrink -2% in Q4 2020 before growing by 7.25% in 2021, lower than the previous forecast of 9%. The BoE also forecasts the economy will now take until Q1 2022 to reach its pre-pandemic level rather than the end of 2021 as previously forecast. By the time of the December MPC announcement, a COVID-19 vaccine was approved for use, which the Bank noted would reduce some of the downside risks to the economic outlook outlined in the November MPR.

UK Consumer Price Inflation (CPI) for November 2020 registered 0.3% year on year, down from 0.7% in the previous month. Core inflation, which excludes the more volatile components, fell to 1.1% from 1.5%. The most recent labour market data for the three months to October 2020 showed the unemployment rate rose to 4.9% while the employment rate fell to 75.2%. Both measures are expected to deteriorate further due to the ongoing impact of coronavirus on the jobs market, particularly when the various government job retention schemes start to be unwound in 2021, with the BoE forecasting unemployment will peak at 7.75% in Q2 2021. In October, the headline 3-month average annual growth rate for wages were 2.7% for total pay and 2.8% for regular pay. In real terms, after adjusting for inflation, total pay growth was up by 1.9% while regular pay was up 2.1%.

GDP growth rebounded by 16.0% in Q3 2020 having fallen by -18.8% in the second quarter, with the annual rate rising to -8.6% from -20.8%. All sectors rose quarter-on-quarter, with dramatic gains in construction (41.2%), followed by services and production (both 14.7%). Monthly GDP estimates have shown the economic recovery slowing and remains well below its pre-pandemic peak. Looking ahead, the BoE's November MPR forecasts economic growth will rise in 2021 with GDP reaching 11% in Q4 2021, 3.1% in Q4 2022 and 1.6% in Q4 2023.

GDP growth in the euro zone rebounded by 12.7% in Q3 2020 after contracting by -3.7% and -11.8% in the first and second quarters, respectively. Headline inflation, however, remains extremely weak, registering -0.3% year-on-year in November, the fourth successive month of deflation. Core inflation registered 0.2% y/y, well below the European Central Bank's (ECB) target of 'below, but close to 2%'. The ECB is expected to continue holding its main interest rate of 0% and deposit facility rate of -0.5% for some time but expanded its monetary stimulus in December 2020, increasing the size of its asset purchase scheme to €1.85 trillion and extended it until March 2022.

The US economy contracted at an annualised rate of 31.4% in Q2 2020 and then rebounded by 33.4% in Q3. The Federal Reserve maintained the Fed Funds rate at between 0% and 0.25% and announced a change to its inflation targeting regime to a more flexible form of average targeting. The Fed also provided strong indications that interest rates are unlikely to change from current levels over the next three years.

Former vice-president Joe Biden won the 2020 US presidential election. Mr Biden is making tackling coronavirus his immediate priority and will also be reversing several executive orders signed by his predecessor and take the US back into the Paris climate accord and the World Health Organization.

**Credit outlook:** After spiking in late March as coronavirus became a global pandemic and then rising again in October/November, credit default swap (CDS) prices for the larger UK banks have steadily fallen back to almost pre-pandemic levels. Although uncertainly around COVID-19 related loan defaults lead to banks provisioning billions for potential losses in the first half of 2020, drastically reducing profits, reported impairments for Q3 were much reduced in some institutions. However, general bank profitability in 2020 and 2021 may be significantly lower than in previous years.

The credit ratings for many UK institutions were downgraded on the back of downgrades to the sovereign rating. Credit conditions more generally though in banks and building societies have tended to be relatively benign, despite the impact of the pandemic.

Looking forward, the potential for bank losses to be greater than expected when government and central bank support starts to be removed remains a risk, suggesting a cautious approach to bank deposits in 2021/22 remains advisable.

**Interest rate forecast:** The Authority's Treasury Management adviser Arlingclose is forecasting that BoE Bank Rate will remain at 0.1% until at least the first quarter of 2024. The risks to this forecast are judged to be to the downside as the BoE and UK government continue to react to the coronavirus pandemic and the new EU trading arrangements. The BoE extended its asset purchase programme to £895 billion in November while keeping Bank Rate on hold and maintained this position in December. However, further interest rate cuts to zero, or possibly negative, cannot yet be ruled out but this is not part of the Arlingclose central forecast.

Gilt yields are expected to remain very low in the medium-term while short-term yields are likely remain below or at zero until such time as the BoE expressly rules out the chance of negative interest rates or growth/inflation prospects improve. The central case is for 10-year and 20-year to rise to around 0.60% and 0.90% respectively over the time horizon. The risks around the gilt yield forecasts are judged to be broadly balanced between upside and downside risks, but there will almost certainly be short-term volatility due to economic and political uncertainty and events.

**Table 1: Interest rate forecast**

|         | Bank Rate | 3 month Money Market Rate | 5 year Gilt Yield | 20 year Gilt Yield | 50 year Gilt Yield |
|---------|-----------|---------------------------|-------------------|--------------------|--------------------|
| Q1 2021 | 0.10      | 0.10                      | 0.00              | 0.70               | 0.60               |
| Q2 2021 | 0.10      | 0.10                      | 0.00              | 0.70               | 0.60               |
| Q3 2021 | 0.10      | 0.15                      | 0.05              | 0.75               | 0.65               |
| Q4 2021 | 0.10      | 0.15                      | 0.10              | 0.75               | 0.65               |
| Q1 2022 | 0.10      | 0.20                      | 0.15              | 0.75               | 0.65               |
| Q2 2022 | 0.10      | 0.20                      | 0.20              | 0.80               | 0.70               |
| Q3 2022 | 0.10      | 0.20                      | 0.20              | 0.80               | 0.70               |
| Q4 2022 | 0.10      | 0.20                      | 0.25              | 0.85               | 0.75               |
| Q1 2023 | 0.10      | 0.20                      | 0.25              | 0.85               | 0.75               |
| Q2 2023 | 0.10      | 0.20                      | 0.25              | 0.85               | 0.75               |
| Q3 2023 | 0.10      | 0.20                      | 0.25              | 0.90               | 0.80               |
| Q4 2023 | 0.10      | 0.20                      | 0.25              | 0.90               | 0.80               |

For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 0.10%, and that new long-term loans will be borrowed at an average rate of 2.1%.

### **3.0 Current Treasury Portfolio**

The Council's treasury portfolio as at 31<sup>st</sup> December 2020 was as follows:

**Table 2: Current Treasury Portfolio**

|                                 | Principal £m | Interest rate % |
|---------------------------------|--------------|-----------------|
| <b>Investments:</b>             |              |                 |
| Call accounts                   | 4.0          | 0.01            |
| Money market funds              | 6.0          | 0.03            |
| Short-term deposits             | 24.0         | -0.03           |
| Long-term deposits              | 0.0          | n/a             |
| <b>Total Investments</b>        | <b>34.0</b>  |                 |
| <b>Borrowing:</b>               |              |                 |
| Short-term loans                | 38.0         | 0.04            |
| Long-term PWLB loans (fixed)    | 262.6        | 4.73            |
| Long-term PWLB loans (variable) | 0.0          | n/a             |
| Long-term market loans (LOBOs)  | 18.9         | 4.53            |
| Other Government loans          | 5.1          | 0.00            |
| <b>Total Borrowing</b>          | <b>324.6</b> |                 |
| <b>Net Borrowing</b>            | <b>290.6</b> |                 |

### **4.0 Local Context**

Forecast changes in the sums in section 3 are shown in the balance sheet analysis in the table below.

**Table 3: Balance Sheet Summary and Forecast**

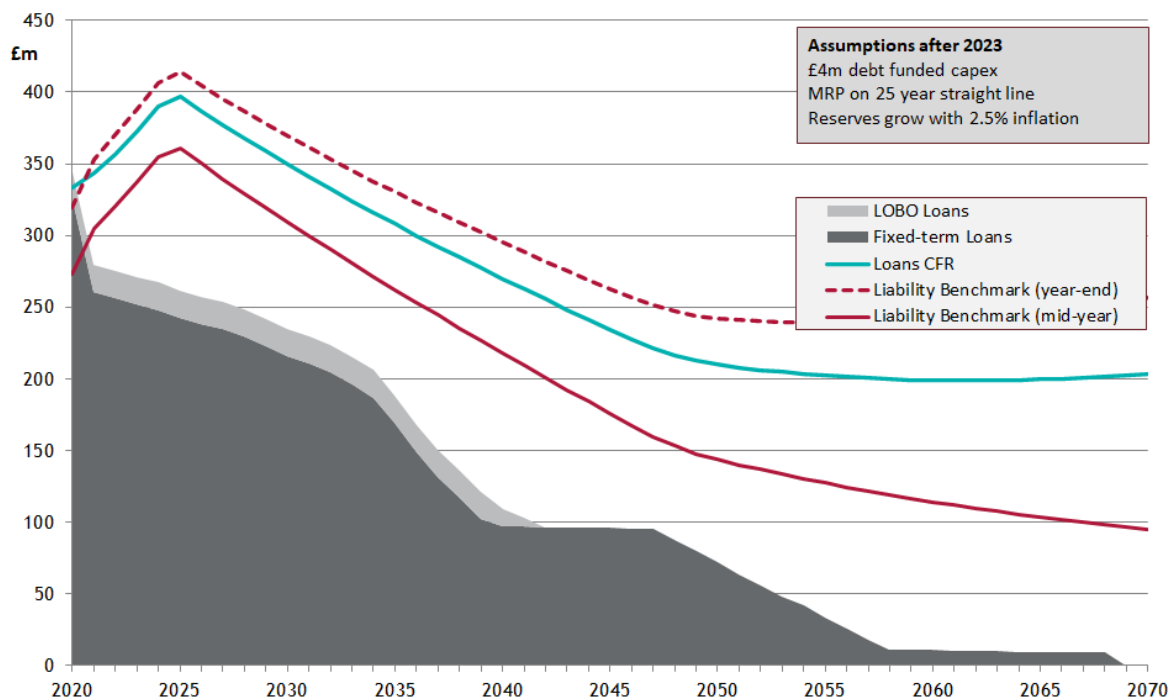
|  | <b>31.3.20<br/>Actual<br/>£m</b> | <b>31.3.21<br/>Estimate<br/>£m</b> | <b>31.3.22<br/>Estimate<br/>£m</b> | <b>31.3.23<br/>Estimate<br/>£m</b> | <b>31.3.24<br/>Estimate<br/>£m</b> |
|--|----------------------------------|------------------------------------|------------------------------------|------------------------------------|------------------------------------|
| Council Fund Capital Financing Requirement (Borrowing only)            | 211                              | 223                                | 231                                | 244                                | 256                                |
| Housing Revenue Account Capital Financing Requirement (Borrowing only) | 135                              | 137                                | 139                                | 147                                | 157                                |
| <b>Capital Financing Requirement (Borrowing only)</b>                  | <b>346</b>                       | <b>360</b>                         | <b>370</b>                         | <b>391</b>                         | <b>413</b>                         |
| Less: Current ST borrowing   | (53)                             | (280)                              | (275)                              | (271)                              | (267)                              |
| Less: Current LT borrowing   | (291)                            |                                    |                                    |                                    |                                    |
| <b>Funding Required</b>  | <b>2</b>                         | <b>80</b>                          | <b>95</b>                          | <b>120</b>                         | <b>146</b>                         |
| Less: Usable reserves  | (53)                             | (30)                               | (26)                               | (24)                               | (23)                               |
| Adj: Working capital   | 20                               | 21                                 | 21                                 | 21                                 | 21                                 |
| <b>Investments /<br/>New borrowing</b>                                 | <b>31</b>                        | <b>(71)</b>                        | <b>(90)</b>                        | <b>(117)</b>                       | <b>(144)</b>                       |

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 below the CFR, sometimes known as internal borrowing. Internal borrowing is currently cheaper and incurs lower credit risk than external long term borrowing.

Table 3 shows the Council's CFR increases during 2021/22, this is linked with the capital programme (examples of schemes funded by borrowing include the 21<sup>st</sup> century schools building programme and the HRA capital programme which includes building new social housing). The level of reserves the Council has is expected to fall in 2020/21 as funding earmarked for specific purposes falls due for payment. The combination of the increase in capital expenditure and a reduction in reserves, results in a sustained requirement for new borrowing over the medium term.

The graph in table 4 shows the Council's anticipated liability benchmark over the next 50 years, being the net requirement for borrowing after considering resources available from reserves and working capital. The rise in the liability benchmark corresponds with the need to borrow to fund the increase in capital expenditure described above. The strategy in 2021/22, the same as in previous years, is to ensure that any new borrowing undertaken does not exceed the liability benchmark and cause the council to borrow more than it needs.

**Table 4: Liability Benchmark - Flintshire County Council (January 2021)**



### Budget implications

The budget for investment income in 2021/22 is £10k, based on an average investment portfolio of £10m at an average interest rate of 0.1%. The total budget for loan interest paid in 2021/22 is £14.8m, based on a debt portfolio of £369m at an average interest rate of 4.06%. This will be apportioned between the Council Fund and the HRA. If levels of investments, borrowing and interest rates differ from those forecast, performance against budget will be correspondingly different.

## **5.0 Treasury Investment Strategy**

The Council holds surplus funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council’s treasury average investment balance was £35m, with similar or slightly lower levels expected to be maintained in the forthcoming year.

Non-treasury investments including loans to subsidiaries and purchases of investment property are not normally considered to be treasury investments, and these are therefore covered separately in Appendix B.

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

### Strategy



Given the increasing risk and very low returns from short-term unsecured bank investments, the Council continues its aim to diversify into more secure and/or higher yielding asset classes during 2021/22, so far as cash liquidity requirements allow. This is especially the case if any medium to longer-term investments are made. This represents a continuation of the strategy adopted in recent years.

#### Investment criteria and limits

The Council may invest its surplus funds with any of the counterparties in the following table, subject to the monetary and time limits shown.

**Table 5: Treasury investment counterparties and limits**

This table must be read in conjunction with the notes below

| Sector  | Time limit | Counterparty limit | Sector limit |
|---|------------|--------------------|--------------|
| The UK Government                             | 50 years   | Unlimited          | n/a          |
| Local authorities & other government entities | 25 years   | £3m                | Unlimited    |
| Secured investments *                         | 25 years   | £3m                | Unlimited    |
| Banks (unsecured) *                           | 13 months  | £2m                | Unlimited    |
| Building societies (unsecured) *              | 13 months  | £2m                | Unlimited    |
| Registered providers (unsecured) *            | 5 years    | £2m                | Unlimited    |
| Money market funds *                          | n/a        | £3m                | Unlimited    |
| Strategic pooled funds                        | n/a        | £1m                | £5m          |
| Real estate investment trusts                 | n/a        | £1m                | £1m          |
| Other investments *                           | 5 years    | £2m                | £10m         |

**\* Minimum 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 taken into account.

For entities without published credit ratings, investments may be made either (a) where external advice indicates the entity to be of similar credit quality; or (b) to a maximum of £100k per counterparty as part of a diversified pool.

**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.

**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.

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

**Registered providers (unsecured):** Loans to, and bonds issued or guaranteed by, registered providers of social housing or 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:** 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 Authority will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

**Strategic pooled funds:** Bond, equity and property funds that offer enhanced returns over the longer term but are more volatile in the short term. These allow the Authority 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 Authority'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.

**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.

**Operational bank accounts:** The Authority may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be kept as low 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 Authority maintaining operational continuity.

### Risk assessment and credit ratings

Credit ratings are obtained and monitored by the Authority'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 rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it is likely to fall below the above criteria, then no further investments will be made in 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

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

When deteriorating financial market conditions affect the creditworthiness of all organisations, as 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 for example, or with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

### Specified investments

The WG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement unless the counterparty is a local authority,
- not defined as capital expenditure by legislation, and
- invested with one of:
  - the UK Government,
  - a UK local authority, parish council or community council, or
  - a body or investment scheme of “high credit quality”.

The Council defines ‘high credit quality’ organisations as those having a credit rating of A- or higher that are, domiciled in the UK, or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds “high credit quality” is defined as those having a credit rating of A- or higher.

### Non-Specified Investments

Any financial investment not meeting the definition of a specified investment is classed as non-specified. The Council does not intend to make any investments in foreign currencies. Given the wide definition of a loan, this category only applies to units in pooled funds and shares in companies. Limits on non-specified investments are shown in the table below. The Authority confirms that its current non-specified investments remain within these limits.

## **Table 6: Non-Specified Investment Limits**

|  | Cash Limit |
|--|------------|
| Total invested in pooled funds without credit rating | £5m        |
| Shares in real estate investment trusts              | £1m        |
| Shares in local organisations                        | £1m        |
| Total non-specified investments                      | £7m        |

### Foreign countries

Investments in foreign countries will be limited to a maximum of £5 million per foreign country. Investments in countries whose lowest sovereign rating is not AAA will be limited to one year's duration. No country limit will apply to investments in the UK, irrespective of the sovereign credit rating.

### Liquidity management

The Council uses purpose-built cash flow forecasting software to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis, with receipts under-estimated and payments over-estimated to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium term financial plan and cash flow forecast.

### Negative Interest Rates

The COVID-19 pandemic has increased the risk that the Bank of England will set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. 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.

### Business models

Under the new IFRS 9 standard, the accounting for certain investments depends on the Council's "business model" for managing them. The Council 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.

## **6.0 Borrowing Strategy**

The Council currently holds £286.7m of long-term loans, as part of its strategy for funding previous years' capital programmes, which includes £6.87m of new long-term borrowing undertaken to date during 2020/21. The balance sheet forecast in section 4 shows that the Council expects to undertake new borrowing during the remainder of 2020/21 and 2021/22.

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

The Council's capital expenditure plans will continue to be monitored throughout 2021/22 to inform and confirm the Council's long term borrowing need (figures in section 4 are an estimate). This is to ensure that the Council does not commit to long term borrowing too early and borrow unnecessarily which will be costly. The use of short-term borrowing will assist with such. This will be balanced against securing low long term interest rates currently being forecast.

Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently lower than long-term rates, it is likely to be more cost effective in the short-term to use internal resources, and to borrow short-term instead.

By doing so, the Council is able to reduce net borrowing costs (despite forgone investment income) and reduce overall treasury risk, credit risk as a result of bail-in legislation in particular. The benefit of internal and short term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when the long term borrowing rates are forecast to rise modestly. Arlingclose will assist the Council with this 'cost of carry' and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2021/22 with a view to keeping future interest costs low, even if this causes additional costs in the short-term.

The Authority 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.

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

In addition, the Council may borrow for short periods of time to cover unexpected cash flow shortages.

### Sources of borrowing

The approved sources of long-term and short-term borrowing will be:

- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
- any institution approved for investments (see above)
- 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 Clwyd Pension Fund)
- Insurance companies
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

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
- WG Mutual Investment Model

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

### LOBOs

The Council holds £18.95m 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 Council has the option to either accept the new rate or to repay the loan at no additional cost. All of these LOBOs have options during 2021/22, and although the 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 Council will take the option to repay LOBO loans at no cost if it has the opportunity to do so.

### Short-term and Variable Rate loans

As at 31<sup>st</sup> December 2020, the Council held £38m of short term (temporary) loans with an average rate of 0.044% and no variable rate loans. These loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators in section 10.

### 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.

### Planned borrowing strategy for 2021/22

The Corporate Finance Manager will:

- Manage the Council's debt maturity profile, i.e. to leave no one future year with a high level of repayments that could cause problems in re-borrowing with the limits stated in this Strategy Statement. Appendix A analyses the debt portfolio of the Council, as at 31st December, 2020.
- Effect any borrowing that may be required in 2021/22 at the cheapest cost commensurate with future risk based on interest rate forecasts.
- Monitor and review the level of variable interest rate loans in order to take greater advantage of interest rate movements, within the limits stated in this Strategy.
- Continue to monitor options for debt-restructuring and debt re-payment.

The Corporate Finance Manager will monitor the interest rate market and adopt a pragmatic approach to any changing circumstances, reporting any decisions and actions taken under delegated powers to Cabinet via the Audit Committee.

## **7.0 Policy on Use of Financial Derivatives**

In the absence of any explicit legal power to do so, the Council will not use standalone financial derivatives (such as swaps, forwards, futures and options). Derivatives embedded into loans and investments, including pooled funds and forward starting transactions, may be used, and the risks that they present will be managed in line with the overall treasury risk management strategy.

## **8.0 Policy on Apportioning Interest to HRA**



The Council has adopted a single pool of loans which funds the capital expenditure of both Council Fund and HRA activities. The interest payable and other costs/income arising from long term loans (e.g. premiums and discounts on early redemption) is apportioned between the revenue accounts using the average Capital Financing Requirement (which measures the underlying need to borrow to fund capital expenditure) during the year.

Given that the HRA has minimal level of reserves compared to the total level of reserves held by the Council, any interest received on investments will be credited to the Council Fund revenue account.

## **9.0 Markets in Financial Instruments Directive**

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

## **10.0 Treasury Management Indicators**

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

### Interest rate exposures

This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as an amount of net principal borrowed will be:

|   | 2021/22 | 2022/23 | 2023/24 |
|---|---------|---------|---------|
| Upper limit on fixed interest rate exposures    | £390m   | £411m   | £433m   |
| Upper limit on variable interest rate exposures | £100m   | £100m   | £100m   |

Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate.

### Maturity structure of borrowing

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

|                 | Lower | Upper |
|-----------------|-------|-------|
| Under 12 months | 0%    | 20%   |

|                                 |    |      |
|---------------------------------|----|------|
| 12 months and within 24 months  | 0% | 20%  |
| 24 months and within five years | 0% | 30%  |
| Five years and within 10 years  | 0% | 50%  |
| 10 years and above              | 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.

#### Principal sums invested for periods longer than 364 days

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

|   | 2021/22 | 2022/23 | 2023/24 |
|---|---------|---------|---------|
| Limit on total principal invested beyond year end | £5m     | £5m     | £5m     |

Any long term investments carried forward from previous years will be included in each years limit.

#### Borrowing limits

The Council is being asked to approve these Prudential Indicators as part of the Capital Strategy report. However they are repeated here for completeness.

|  | 2021/22     | 2022/23     | 2023/24     |
|--|-------------|-------------|-------------|
| Operational boundary – borrowing                   | £370m       | £391m       | £413m       |
| Operational boundary – other long-term liabilities | <u>£20m</u> | <u>£20m</u> | <u>£20m</u> |
| Operational boundary – TOTAL                       | £390m       | £411m       | £433m       |
| Authorised limit – borrowing                       | £390m       | £411m       | £433m       |
| Authorised limit – other long-term liabilities     | <u>£35m</u> | <u>£35m</u> | <u>£35m</u> |
| Authorised limit – TOTAL                           | £425m       | £446m       | £468m       |

## **11.0 Other Matters**

The WG Investment Guidance requires the Council to note the following matters each year as part of the investment strategy:

#### Treasury Management Advisers

The Council's treasury management adviser, Arlingclose continues to provide advice and information on the Council's investment and borrowing activities, although responsibility for final decision making remains with the Council and its officers. The services received include:

- advice and guidance on relevant policies, strategies and reports,
- advice on investment decisions,
- notification of credit ratings and changes,
- other information on credit quality,
- advice on debt management decisions,

- accounting advice,
- reports on treasury performance,
- forecasts of interest rates, and
- training courses.

The quality of this service is controlled by Financial Procedure Rules and Contract Procedure Rules.

#### Capacity and skills training

The needs of the Council's treasury management team for training in treasury management are assessed as part of the employee appraisal process, and additionally when the responsibilities of individual members of the treasury team change.

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

Training for elected Members is provided by Arlingclose on an annual basis and by the treasury management team on an ongoing basis.

Training ensures that those elected members and statutory officers involved in the investments decision-making process have appropriate capacity, skills and information to enable them to: 1. take informed decisions as to whether to enter into a specific investment; 2. to assess individual investments in the context of the strategic objectives and risk profile of the Council; and 3. understand how the quantum of these decisions have changed the overall risk exposure of the Council.

The Council is reviewing steps taken to ensure that those negotiating commercial deals are aware of the core principles of the prudential framework and of the regulatory regime within which local authorities operate.

#### Investment of Money Borrowed in Advance of Need

Welsh Government guidance states that local authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed.

The Council will not borrow more than or in advance of their needs to profit from the investment but may, from time to time, borrow in advance of need, where this is expected to provide the best long term value for money for example in a climate of rising interest rates. Since amounts borrowed will be invested until spent, the Council is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Council's overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit of £425million. The maximum period between borrowing and expenditure is

expected to be two years, although the Council is not required to link particular loans with particular items of expenditure.

### Climate change

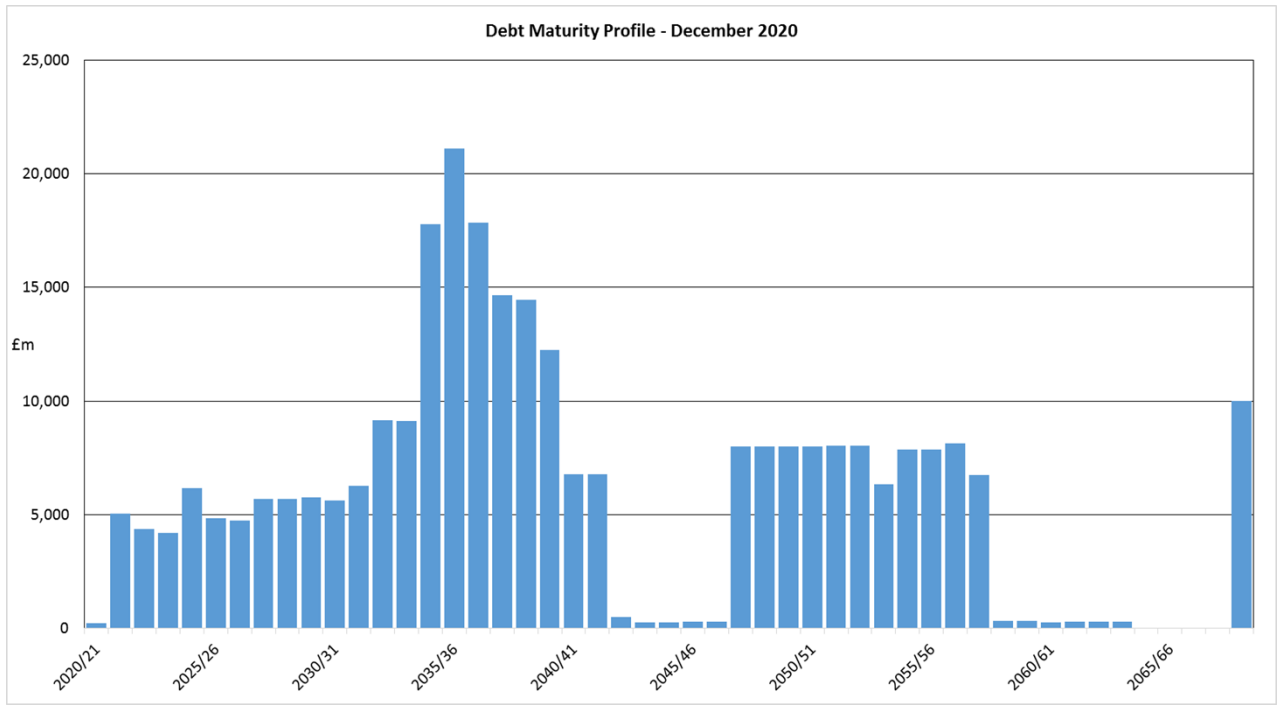
The Council is reviewing its approach to investment decisions to consider long-term climate risks to support a low carbon economy.

### **Other Options Considered**

The WG Investment Guidance and the CIPFA Code of Practice do not prescribe any particular treasury management strategy for local authorities to adopt. The Corporate Finance Manager 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 the following table.

| <b>Alternative</b>   | <b>Impact on income and expenditure</b>  | <b>Impact on risk management</b>   |
|--|--|--|
| Invest in a narrower range of counterparties and/or for shorter periods. | Interest income will be lower  | Reduced risk of losses from credit related defaults, but any such losses may be greater  |
| Invest in a wider range of counterparties and/or for longer periods.     | 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 will be more certain            |
| Borrow short-term or variable loans instead of long-term fixed rates     | Debt interest costs will initially be lower  | Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long term costs will 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 will be less certain            |

## **APPENDIX A – DEBT MATURITY PROFILE**



**APPENDIX B: Additional requirements of Welsh Government**

## ***Investment Guidance – Non-Treasury Investments***

The Welsh Government (WG) published revised Investment Guidance in November 2019 which places additional reporting requirements upon local authorities and covers investments that are not part of treasury management. In this appendix the Council sets out the information required to comply with the WG guidance for Non-Treasury Investments.

The Council has given loans to wholly owned companies for service purposes and has historical non-financial investments in property defined as Investment Properties within the Council's Statement of Accounts. The Council considers both to be non-treasury investments.

### **Loans to Wholly Owned Subsidiaries**

The WG Guidance defines a loan as a written or oral agreement where the Council temporarily transfers cash to a third party, joint venture, subsidiary or associate who agrees a return according to the terms and conditions of receiving the loan, except where the third party is another local authority.

#### Contribution:

The Council's investments in the form of loans to wholly owned companies contribute to its service delivery objectives and/or to promote wellbeing as follows:

The Council has embarked on an ambitious house building programme as part of its Strategic Housing and Regeneration Programme (SHARP). Over a 5 year period 500 new homes will be built at a range of sites across the county, a mixture of new council houses and affordable homes, alongside commissioning a range of linked regeneration initiatives and community benefits.

Affordable homes are being developed through the Council's wholly owned subsidiary North East Wales Homes (NEW Homes) in partnership with the Council. Affordable homes for rent are built or purchased by NEW Homes funded by loans from the Council. New affordable homes for rent have been built in Flint, Penyffordd (Holywell), Dobshell and are under construction in Gronant, and Mold.

#### Controls and Limits:

The Council considers that its financial exposure to loans to wholly owned companies is proportionate and has set the limits in table B1. The Council's loan book is currently within these self-assessed limits.

NEW Homes was established on 3<sup>rd</sup> April 2014 to own, lease and manage properties with the aim of increasing the quantity and quality of affordable housing across the county.

NEW Homes is a company limited by shares, wholly owned by the Council (1 at £1 par value), established under section 95 of the Local Government Act 2003. The Council has a high level of control over NEW Homes as the single shareholder, approving:

- the issue of share capital
- the distribution of trading surplus
- the annual business plan
- any asset disposals
- any borrowing against assets
- appointment of directors to the board

**Table B1: Loan limits**

| <b>Borrower</b>  | <b>Cash Limit</b> |
|--|-------------------|
| Wholly owned companies   | £40m              |
| Treasury management investments meeting the definition of a loan | Unlimited         |

The Council, as required, has considered allowing for an ‘expected credit loss’ model for loans and receivables as set out in International Financial Reporting Standard 9: *Financial Instruments* as adopted by proper practices to measure the credit risk of its loan portfolio. When calculated the expected credit loss was very small. Given the high level of control the Council has over NEW Homes and the security arrangements, the Council decided against setting up a provision for expected credit loss from the loans to NEW Homes.

Appropriate consideration is given to state aid rules and competition law. The Council sought specific legal and finance advice to ensure existing and future loans are compliant with State Aid regulations. The rates applied are below what NEW Homes would receive on the open market, and therefore are granted to NEW Homes under the Services of General Economic Interest Decision (a State Aid exemption). Arrangements are in place to monitor and ensure that the amount of aid granted through the loan does not exceed the net cost of providing the Service of General Economic Interest. A deed of entrustment is in place to clearly set out the requirements of both parties.

Liquidity

The Council has borrowed from the PWLB to on-lend at a small margin to NEW Homes on the same terms and conditions, therefore the impact on the Council’s Treasury Management activities is limited.

The length of the loans has been determined by assessing the cash flow of each housing development scheme to ensure over the long term affordable rents are sufficient to repay borrowing, interest, management costs, cyclical maintenance costs and reasonable allowances for voids and bad debts. Most schemes require an annuity loan commitment of 45 years, the maximum the Council would commit to is 50 years.

Agreements are in place ensuring that the Council has security on all NEW Homes properties which includes properties built using the loan funding and also other properties that NEW Homes owns outright (acquired from developers as part of Section 106 Planning Act agreements to provide affordable housing). In the event of a default, the Council could either sell the properties to repay its borrowing, or include within the Housing Revenue Account and continue to rent at social housing rent levels.

Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice and can take a considerable period to sell in certain market

conditions. The Council accepts that the invested funds have been invested in NEW Homes for the length of the loans – approx. 45 years – and cannot readily be accessed for other purposes.

Yield (net profit)

The loans generate a small income for the Council as there is a margin of approx. 0.25% charged to NEW Homes on the Council’s borrowing rate from the PWLB. The income makes a very small contribution to achieving a balanced revenue budget. The yield as a proportion of net revenue budget is less than 0.01%.

**Investment Properties**

The Welsh Government guidance includes an investment category covering non-financial assets held primarily or partially to generate a profit, primarily investment property. Proper accounting practice defines an investment property as those that are held solely to earn rent and / or for capital appreciation.

The Council has a portfolio of investment properties, in the form of agricultural property and industrial units. Although these are classified as investment properties, they are legacy assets and the council is managing down its agricultural portfolio and is reviewing its position in regard to industrial units.

Contribution:

The Council’s investments, in the form of investment properties, contribute to its service delivery objectives and/or to promote wellbeing by providing a net financial surplus that is reinvested into local public services.

Security:

The Welsh Government guidance requires that security is determined by comparing each asset’s purchase price to its fair value using the model in International Accounting Standard 40: *Investment Property*, as adapted by proper practices.

As the Council’s Investment Portfolio is of a historic nature, built up over many years, property purchase prices are not readily available to compare with current fair values. The table below shows the fair values of the current portfolio over the last 5 years demonstrating that the historic capital invested has remained stable over the past 5 years.

**Table B2: Fair Value of Investment Properties**

|                               | 31.3.2020<br>£m | 31.3.2019<br>£m | 31.3.2018<br>£m | 31.3.2017<br>£m | 31.3.2016<br>£m |
|-------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Fair Value<br>Inv. Properties | 25.0            | 25.2            | 25.2            | 24.8            | 25.0            |

Liquidity



The Council’s investment properties are historical investment decisions and therefore will have limited impact on the Council’s liquidity. No recent investment has taken place in investment properties, and therefore there is no recent borrowing associated.

Yield (net profit)

The profit generated by investment activity makes a small contribution to achieving a balanced revenue budget. Table B3 below details the extent to which funding expenditure to meet the service delivery objectives and or promote wellbeing in the Council is dependent on achieving the expected yield over the life cycle of the Medium Term Financial Plan.

**Table B3: Proportionality of Investment Properties**

|                       | 2019/20<br>Actual £m | 2020/21<br>Budget £m | 2021/22<br>Budget £m |
|-----------------------|----------------------|----------------------|----------------------|
| Net Revenue Budget    | 271,350              | 271.350              | 286.986              |
| Net Investment income | 1.72                 | 1.73                 | 1.50                 |
| Proportion            | 0.63%                | 0.64%                | 0.52                 |