Lincolnshire COUNTY COUNCIL
Working for a better future

**Open Report on behalf of Andrew Crookham,
Executive Director - Resources**

Report to:	**Councillor M J Hill, OBE, Leader of the Council (Executive Councillor: Resources and Communications**
Date:	**11 March 2021**
Subject:	**Treasury Management Strategy Statement and Annual Investment Strategy for Treasury Investments 2021/22**
Decision Reference:	**I021295**
Key decision?	**No**

Summary:

The Treasury Management Strategy Statement is an annual statement that sets out the expected treasury activities for the forthcoming year 2021/22. These activities include the Council's expected borrowing and treasury investments, cashflows and banking.

Annual strategies for the Council's borrowing and treasury investments are included as part of this Report, as well as the Council's Minimum Revenue Provision Policy Statement and the Annual Investment Strategy for Treasury Investments which sets out the Council's policies for investing its surplus cash for the year ahead taking into account the risks involved.

This report meets the requirements of the 2017 CIPFA Code of Practice for Treasury Management in the Public Sector, (adopted in the Council's Financial Regulations), and also the Local Government Act 2003 and MHCLG Government Guidance.

Approval for this Strategy Statement and Annual Investment Stategy is required by the Leader of the Council (Executive Councillor: Resources and Communications).

Recommendation(s):

That the Leader of the Council (Executive Councillor: Resources and Communications):

Approves the Treasury Management Strategy Statement for 2021/22, including the Annual Investment Strategy Statement for Treasury Investments 2021/22 and the Minimum Reveunue Provision Policy Statement contained within the Statement for the year ahead.

Alternatives Considered:	
1.	Not to approve the strategies or to approve amended strategies.

Reasons for Recommendation:

The Council's Financial Regulations require the Council to prepare annually a Treasury Management Strategy Statement (including an Annual Investment Strategy Statement for Treasury Investments and a Minimum Revenue Provision Policy Statement).

The strategies proposed in this Report have been developed with regard to relevant Guidance and in accordance with the Council's financial policies. They are alligned to the Council's Prudential Indicators. The advice of the Council's Treasury Management advisor has been taken during the course of developing the strategy and the proposals in this report are considered to be the most appropriate approach for the Council to adopt.

1. INTRODUCTION / BACKGROUND

1.1. <u>Background</u>

1.1.1. CIPFA defines treasury management as:

'the management of the Council's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks'

1.1.2. The main functions of treasury management are outlined in the table below.

• Cash Flow	Cash raised during the year meets cash expenditure as part of a balanced budget. This cash flow is planned and managed to ensure cash is available when needed. (Investing surplus cash or short term borrowing for predicted shortfalls).
• Investing Surplus Monies	Surplus monies are invested in accordance with the Council's low risk appetite and in line with its liquidity requirements. The Council outlines its investment policy and investment risk appetite within its **Annual Investment Strategy**. Risk appetite is low as security of investments is paramount over any returns made.
• Borrowing (Long Term) to fund Capital Plans.	The Council's capital plans provide a guide to the longer term borrowing need of the Council; essentially longer term cash flow planning. Both external and internal borrowing, (using long term cash surpluses), is done to manage this long term cash flow requirement.

1.1.3. These functions are critical to the Council, as the management of both debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due both in the short and long term for both revenue and capital projects. The minimisation of interest costs on borrowing and the maximisation of interest earned on investments, subject to the security of the sums invested, also play a significant role to the available resources of the Council.

1.2. Relevant Treasury Management Regulation / Legislation

1.2.1. The Council's treasury management activities are governed and meet the requirements of the following regulations, legislation and guidance.

- The Local Government Act 2003.
- CIPFA Prudential Code 2017.
- MHCLG MRP Guidance 2018.
- CIPFA Treasury Management Code 2017.
- MHCLG Investment Guidance 2018.

The Council has also adopted the key requirements of the CIPFA Treasury Management Code as part of its **Financial Regulations** within the **Constitution**.

1.3. Reporting Requirements: Treasury Management

1.3.1. The following reporting requirements of the CIPFA Treasury Management Code are met as follows:

- The Treasury Management Strategy, including the Annual Investment Strategy for Treasury Investments and the Council's Minimum Revenue Provision Policy Statement, is submitted to the **Executive Councillor for Resources and Communications** for approval prior to the start of the financial year. It is presented to the **Overview and Scrutiny Management Board** prior to this decision for scrutiny comment.

- **Quarterly update reports** will then be presented to the Overview and Scrutiny Management Board throughout the financial year which will monitor and report on actual treasury activity against the approved Strategy.

1.3.2. The aim of these reporting arrangements is to ensure that those with ultimate responsibility for the treasury management function appreciate fully the implications of treasury management policies and activities, and that those implementing policies and executing transactions have properly fulfilled their responsibilities with regard to delegation and reporting.

1.4. Treasury Management Training

1.4.1. The importance of ensuring that all staff involved in the treasury management function are fully equipped to undertake the duties and responsibilities allocated to them are recognised by the Council and it is the responsibility of the Section 151 Officer to implement the necessary arrangements to ensure this takes place.

1.4.2. The Council seeks to appoint individuals who are both capable and suitably experienced and also will provide training for staff to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills.

1.4.3. All treasury management staff are encouraged to take any suitable training in treasury management provided by CIPFA, Link Asset Services Ltd or other relevant market participant. The Treasury Manager, Treasury Officer and Corporate Head of Finance for the Council have all successfully gained the CIPFA/ACT qualification in International Treasury Management (Public Finance) (Cert ITM-PF).

1.4.4. The Section 151 Officer will ensure that elected members tasked with treasury management responsibilities, including those responsible for scrutiny, have access to training relevant to their needs and those responsibilities.

1.5. External Service Providers: Treasury Management

1.5.1. The Council currently uses **Link Asset Services Ltd** as its external treasury management advisers.

1.5.2. The Council recognises that responsibility for treasury management decisions remains with the Council at all times and will ensure that undue reliance is not placed upon our external service providers.

1.5.3. It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

1.6. Pension Fund Cash

In line with the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009, effective from 1st April 2010, an agreement is in place for the pooling of Pension Fund cash within the surplus Council cash balances for investment. This cash can include both day to day cash balances of the Pension Fund and also its Strategic Asset Allocation for Cash at any time.

1.7. Non-Treasury Investments

1.7.1. The CIPFA Codes and Government Guidance were revised in 2017/2018 to include requirements for **non-treasury investments**.

1.7.2. Non-treasury investments generally arise from capital expenditure, not from the Council's day to day cashflow activities, and comprise commercial financial assets and property, third party loans supporting service outcomes, investments in subsidiaries and investment in property portfolios.

1.7.3. Non-treasury investments held by the Council are therefore not covered within this Treasury Strategy but are reported within the Council's **Capital Strategy,** which will be presented to the County Council for approval on 19 February 2021 along with the County Council Budget for 2021/22. The risks of holding these types of investment and how the Council manages these risks are fully explained within the Capital Strategy as they differ to the risks relating to Treasury Investments as outlined in this document.

2. TREASURY MANAGEMENT STRATEGY STATEMENT 2021/2022

2.1. Introduction

2.1.1. The Treasury Management Strategy for 2021/22 is based upon the capital and revenue expenditure plans of the Council and the Treasury Officers' current views on interest rates for the year ahead.

2.1.2. Both capital and treasury management issues are covered in the following three areas of the Strategy as detailed below:

1- Prospect For Interest Rates 2021 to 2024 and Economic Commentary	
2- Borrowing	
- Borrowing Requirement 2021 to 2023/24	
- Associated Prudential Indicators (PI), including:	
▪ Capital Expenditure and Financing Plans.	PI 1
▪ Capital Financing Requirement & Internal Borrowing.	PI 2
▪ Affordable Borrowing Limit 2021/22 to 2023/24.	PI 4
▪ **Minimum Revenue Provision (MRP) Policy.**	**PI 5**
▪ Borrowing in Advance of Need Policy.	PI 11
▪ Interest Rate Exposure Re Borrowing.	PI 8

- Debt Rescheduling.	
- Borrowing Performance Benchmark.	
- Long Term Borrowing –Factors for Consideration 2021/22.	
- **Long Term Borrowing Strategy for 2021/22.**	
3- Investments	
- Annual Investment Strategy for Treasury Investments 2021/22	
- Interest Rate Exposure re Investments.	PI 8
- Short Term and Long Term Cash Flow Management. ▪ Liquidity of Investments.	PI 9
- Treasury Investment Performance Benchmark.	
- Treasury Investments – Factors for Consideration 2021/22.	
- Treasury Investment Strategy for 2021/22.	

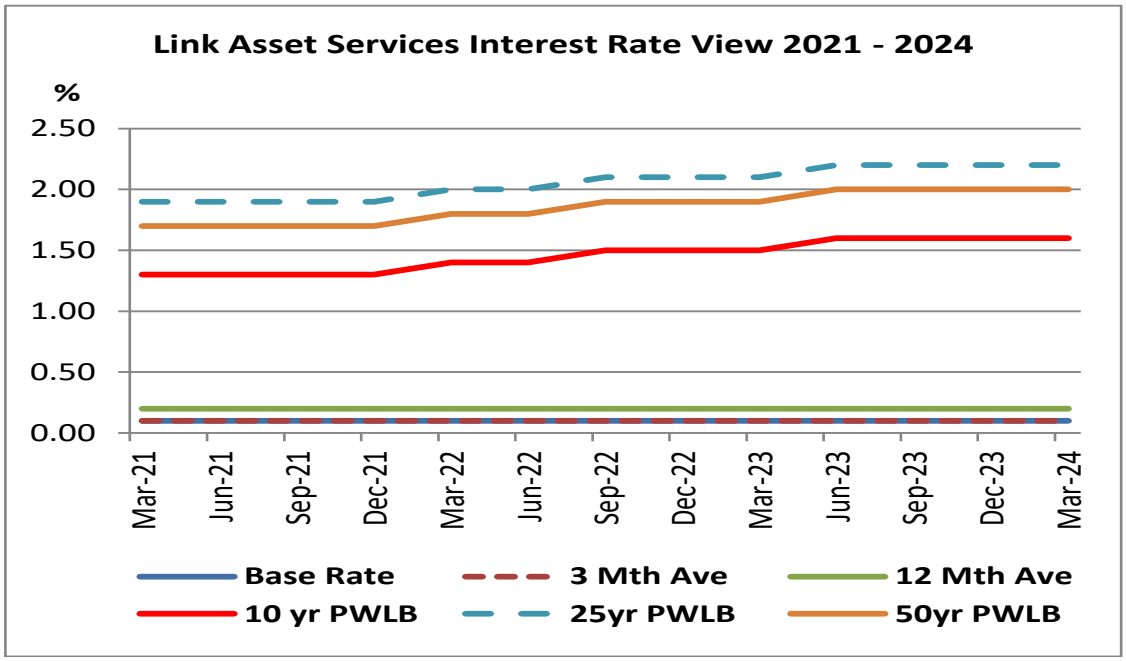
2.1.3. To place this Treasury Management Strategy in context, the table below shows the Council's net treasury portfolio position at 31 December 2020 compared to the start of the year, with associated average percentage costs/returns. It shows the net borrowing position of the Council as follows:

	1 Apr 2020		31 Dec 2020	
	Principal £m	Ave Rate %	Principal £m	Ave Rate %
PWLB Debt	**(481.540)**	**3.75%**	**(470.186)**	**3.74%**
LOBO Debt	**(20.000)**	**4.00%**	**(20.000)**	**4.00%**
Long Term Borrowing	**(501.540)**	**3.76%**	**(490.186)**	**3.75%**
Fixed Deposits	**160.000**	**1.04%**	**216.475**	**0.48%**
Bonds	**0.000**	**0.00%**	**0.000**	**0.00%**
Certificates of Deposit	**25.000**	**0.99%**	**7.000**	**0.42%**
Call & O/N	**40.000**	**0.54%**	**70.000**	**0.30%**
Money Market Funds	**63.105**	**0.41%**	**75.075**	**0.02%**
Treasury Investments*	**288.105**	**0.83%**	**368.550**	**0.35%**
Net Borrowing	**(213.435)**		**(121.636)**	

* Note: this balance excludes non-treasury investments but includes Pension Fund cash.

2.2. Prospect for Interest Rates 2021 to 2024 and Economic Commentary

2.2.1. Link Asset Services has provided their view for both short term and longer term interest rates for the following three years to March 2024, taking into account the current outlook for the UK Economy. This is summarised in the graph below.



2.2.2. The graph shows that short term rates are likely to **remain exceptionally low during 2021/22 with Bank Rate at 0.10%, with little increase in the following two years.** Long term rates have fallen to historically very low rates as a result of the Covid-19 crisis, quantitative easing (QE) operations of the Bank of England (BOE) and the 1.00% rate cut by the PWLB in 2020. **Although recently they have increased by around 0.50%, following a sell-off in the gilt market, as the BOE announced on 4 February 2021 that it intends to spread the current tranche of extra QE (£150bn) over the whole year. This sell off may be corrected by the BOE by future QE actions. Overall there is still expected to be little upward movement in long term rates over the next 3 years, by around 0.10% per year** as it will take economies, including the UK, a prolonged period to recover all the momentum they have lost in the sharp recession caused during the coronavirus shutdown period. Within this period however, **long term rates may be subject to exceptional levels of volatility** due to geo-political events, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. The interest rate forecast above does however take into account the agreed deal on the Brexit withdrawal that was signed before Christmas 2020.

A more detailed forecast for interest rates is shown in **Annex A** that also includes a view from Capital Economics, a leading city institution.

2.2.3. Link Asset Services has provided a list of risks that they feel may increase (upside risk) or decrease (downside risk) the interest rate forecast detailed above, which can be found in **Annex B**.

2.2.4. **Negative Interest Rates**

The Bank of England said in September 2020 that it is unlikely to introduce a negative Bank Rate, at least in the next 6 to 12 months, preferring to opt for quantitative easing as a monetary policy tool instead. However, there is an unprecedented level of money swilling around in the very short end of the market given the level of funding given to banks and local authorities to help deal with the Covid-19 crisis over the last year. This surplus cash supply has meant that some deposit accounts are already offering negative interest rates for shorter periods; Money Market Funds, offering instant access, are close to yielding 0.00%; and inter-local authority lending and borrowing rates have also declined sharply.

2.2.5. A detailed view of the current economic outlook from Link Asset Services is also shown in **Annex B**. A summary of this economic outlook, that will set the backdrop to the Council's treasury management activity in 2021/22, is detailed below:

- **GDP growth** - The economy ended 2020 8.6% lower than pre-Covid levels with recovery during the year hampered by the second National Lockdown. However, recent vaccine developments offer an improved outlook for the economy and analysts now believe it could regain pre-Covid levels by January-March 2022 provided that fiscal support from the Government is not withdrawn too quickly.

- The signing of the **Brexit withdrawal agreement** on 24 December 2020 removed the downside risks to the economy that a no deal threatened, however there is still plenty of work to do to secure agreement on the services sector during 2021.

- **Consumer spending** will be hit again by the second National Lockdown in November 2020 and consumer confidence has also weakened slightly. However, households have continued to pay off credit and that should leave them in a strong position to spend once restrictions are removed and this, alongside vaccine developments, offer hope of a consumer spending bounce in 2021.

- **CPI inflation** – Spare capacity in the economy is set to rise and so weaker inflationary pressures should ensure that inflation remains below 2% into 2022, with inflation staying sub 1% in the short term while restrictions continue.

- **Labour Market/Wage Growth** – Forecasters see the decline in employment surge to 5% or 1.6 million jobs in the coming months and vacancy levels are down 35% on pre-pandemic levels which points to the increase in jobless numbers. Economists see employment starting to rise again in Quarter 3 (July – September) 2021. Unemployment is currently at 4.8% but is forecast to peak at 7.5% in coming months,

although this has been pegged back from 9% due to the vaccine rollout. The second lockdown saw the furlough numbers spiking again to around 5 million. The current support scheme for furlough is due to expire in May 2021 when job losses are expected to increase at this time.

- **Fiscal Intervention -** The Chancellor continues to support the economy by extending loan and grant schemes and the furlough scheme. It is expected that the Budget on 3 March 2021 will lay out the next phase of the plan to tackle the virus and protect jobs. Tax cuts are not thought to be imminent at this stage.

- **Public Sector Borrowing** was forecast in November by the Office for Budget Responsibility (the OBR) to reach £394bn in 2021, the highest ever peace time deficit and equivalent to 19% of GDP, due to the support measures put in place to tackle the pandemic. Because long term debt interest has been kept low due to the amount of QE done by the Bank of England, this does mean that the cost of this Public Sector debt is manageable, despite the huge increase. The OBR was also forecasting that the budget deficit will come down to £102bn (3.9% of GDP) by 2025/26. The impact of the vaccines on the speed of economic recovery has been excluded from the above forecasts.

2.2.6. The economic outlook and structure of market interest rates have several key treasury management implications for the year ahead as follows:

- **Investment returns will remain exceptionally low during 2021/22,** as Base Rate is expected to stay at 0.10% throughout**,** with little increase expected for the foreseeable future.

- With short term returns at close to zero or negative, there may be a **cost to holding liquid investments** for cashflow purposes during 2021/22.

- **Borrowing interest rates** fell to historically very low rates as a result of the Covid-19 crisis, the QE operations of the Bank of England and the 1% cut in PWLB rates in November 2020, albeit they have since bounced back recently by around 0.50% due to gilt market activity. **Little movement in the rates is expected over 2021**, although rates will remain volatile as markets react to events as they occur.

- **There is still a gap of around 1% to 1.5%** between short term rates and long term rates and so any external borrowing undertaken will therefore incur a **cost of carry,** i.e. a revenue loss between borrowing costs and investment returns, in the medium term.

2.3. Borrowing

2.3.1. Borrowing Requirement 2020/21 to 2023/24

The **long term borrowing requirement** plans for the Council come from the Council's **capital expenditure and financing plans** which form part of the Council Budget each year.

The **affordability, prudence and sustainability** of the capital expenditure and financing plans are assessed / demonstrated by setting a series of **Prudential Indicators and Limits** each year, as required by the CIPFA Prudential Code 2017. **Annex C** shows these Prudential Indicators, actuals for 2019/20 and estimated for 2020/21 through to 2023/24. These are submitted with the Council Budget 2021/22 Report, due to be considered at the meeting of the County Council on 19 February 2021. A more detailed explanation of the Prudential Indicators linked to borrowing is provided in 2.3.2 below.

2.3.2. **Prudential Indicators Associated with Borrowing**

PI 1 - Capital Expenditure and Financing Plans

The table below shows the Council's **capital expenditure plans** for the reporting period and the element of this expenditure which is not to be financed straight away from cash resource or grants, hence to be financed at a future date by borrowing (**i.e. the borrowing requirement**). The table also shows the amount of external borrowing taken which is due to mature over the reporting period which impacts on the total indebtedness of the Council.

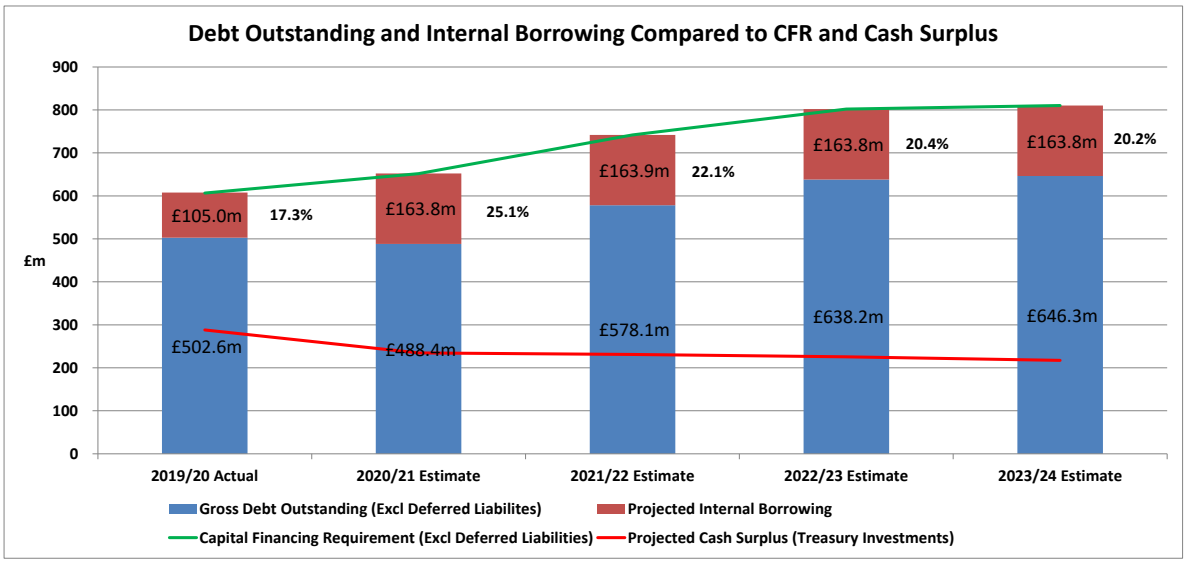
	Estimate 2020/21 £m	Estimate 2021/22 £m	Estimate 2022/23 £m	Estimate 2023/24 £m	Total £m
Capital Expenditure Plans (Gross)	203.502	208.655	111.933	39.682	**563.772**
New Borrowing Requirement	80.909	111.213	85.822	36.827	**314.771**
Maturing Borrowing Requirement	14.354	11.064	8.354	10.329	**44.101**

PI 2 - Capital Financing Requirement and Internal Borrowing

The Capital Financing Requirement (CFR) is a measure of the amount of capital expenditure that the Council has already spent that has yet to be funded from cash resources, i.e. the Council's total indebtedness or **need to borrow for capital financing purposes**. Credit arrangements (finance leases and private finance initiatives (PFI)) are also included in the CFR as they have the same practical impact as borrowing. The CFR is **increased** each year by the **new borrowing / credit arrangement** requirement, as highlighted in the table above, and **reduced** each year by the **Minimum Revenue Provision (MRP)**, or the Council's repayment of debt provision. The Council's policy for MRP is outlined in **Annex D**.

The graph below shows the actual CFR for 2019/20 and forward projections to 2023/24, **(the green line**), compared to the actual level of external debt the Council holds, (**the blue bars**). The difference between the CFR level and the external debt level is known as **Internal Borrowing (the red bars**). This represents the amount of borrowing requirement being met by the Council's **internal balances and cash flow** rather than by

taking external borrowing. This internal borrowing or 'under borrowed' strategy is a way of **managing risk** and has been prudent whilst investment returns are low and counterparty risk is high. The graph shows that this internal borrowing level has been increased to 25% of the CFR in 2020/21 and around 20% thereafter from a level of around 15% in previous years, after a decision not to take any external borrowing in 2020/21 was made. The predicted effect on the Council's cash resource by maintaining this level of internal borrowing is indicated by **the red line** on the graph below showing cash balances still falling to just over £200m for the forecasted period, a level the Council deems **sustainable**. This is despite increasing the internal borrowing level and reflects the extra cash resource being held by the Council at present due to Covid-19 funding received and yet to be expended. It should be noted however that the decision to turn internal borrowing into external debt can be made at any time, given the right market conditions, without affecting the level of the CFR.



The rising **green line** in the above graph indicates that the total CFR (or borrowing requirement) is increasing year on year which means new borrowing commitments are outstripping the minimum provision to repay debt (i.e. MRP) each year to 2023/24.

PI 4 - Affordable Borrowing Limit for 2021/2022 to 2023/2024

The Council has a statutory duty to determine and keep under review how much it can afford to borrow i.e. to determine its "**Affordable Borrowing Limit**" or the **Authorised Limit for External Borrowing** which is another Prudential Indicator.

The Borrowing Limit set must be affordable, prudent and sustainable so that the borrowing impact upon future council tax levels is acceptable and affordable to sustain a balanced budget. The limit includes both external borrowing and credit arrangements (finance leasing and PFI) and is set on a rolling basis for the forthcoming financial year and two successive financial years. Once set this limit should not be breached.

The Executive Director - Resources has responsibility to set the Authorised Borrowing Limit, to monitor the limit and to report to the **Executive Councillor for Resources and Communications**, if he is of the view that the limit is likely to be breached. The Executive Councillor has then to decide to take appropriate action for the limit not to be breached or to raise the limit if prudent to do so.

The Council's **Authorised Limit for External Debt for 2021/22 to 2023/24** is shown in the table below. The Council's actual external debt forecast as shown in the previous graph falls well within these limits set.

	2021/22 £million	2022/23 £million	2023/24 £million
Borrowing	681.075	726.394	731.411
Other Long Term Liabilities*	10.673	11.002	9.703
TOTAL	**691.748**	**737.396**	**741.114**

*Note: The above limit for Other Long Term Liabilities includes an allowance of £3.5m to cover those operating leases currently held off-balance sheet, to be transferred to the balance sheet and treated as finance leases in 2022/23, as per the requirements of International Financial Reporting Standard 16 (IFRS16). Actual figures will be reported as part of the 2022/23 closedown operation. This allowance has also been reflected in the CFR figures as shown in Annex C.

PI 5 – Minimum Revenue Provision (MRP) Policy

Financing capital expenditure by borrowing allows the Council to incur capital expenditure that it does not immediately fund from cash resources. Instead, the Council sets cash resource aside from the Revenue Budget each year to repay the borrowing. This practice is referred to as making **minimum revenue provision (or MRP) for the repayment of debt.**

Regulation and Statutory Guidance requires the Council to produce a **Minimum Revenue Provision (MRP) Policy Statement** in advance of each year, which sets out options followed to calculate, as a minimum, a **prudent MRP charge.** Voluntary Revenue Provision (VRP), over and above the statutory MRP, can be made if desired and this can be reclaimed if deemed necessary or prudent.

The Council's MRP Policy Statement for 2021/22 is detailed in **Annex D**. This policy uses the **average life** and **straight line repayment methods** to calculate the MRP charge, in accordance with the latest Guidance.

Following this policy, the MRP and VRP charge calculated for 2020/21 to 2023/24, based on the borrowing requirement above, is shown in the table below:

	Estimate 2020/21 £m	Estimate 2021/22 £m	Estimate 2022/23 £m	Estimate 2023/24 £m
Minimum Revenue Provision (MRP)	20.250	22.654	26.972	29.748
Voluntary Revenue Provision (VRP)	0.000	0.000	0.000	0.000

The Council's policy is to **actually repay** external debt at the MRP level, (not just make a provision against revenue balances), and as a measure of **affordability** the following voluntary Prudential Indicator (No 5) has been set:

MRP and Interest as a percentage of the Councils Income will not exceed 10%

Annex C shows that projected MRP and Interest to 2023/24 is well under this 10% limit – see PI 5.

In 2021/22, Link Asset Services will be contracted to review the Council's current MRP policy to see if any revisions can be made that may lead to savings in MRP charge going forward. This contract will be on a sliding fee scale depending on the level of savings identified and will also be on a no savings / no fee basis.

PI 11 – Policy for Borrowing in Advance of Need

The Council has set a Voluntary Prudential Indicator (No 11) which sets an upper limit for borrowing in advance of need to 25% of the expected increase in CFR over a 3 year budget period as shown in Annex C.

The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds. In determining whether borrowing will be undertaken in advance of need the Council will:

- ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need.
- ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered.
- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow.
- consider the merits and demerits of alternative forms of funding.

- consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use.

PI 8 - Interest Rate Exposure – Borrowing

Long term loans are usually secured at fixed rates of interest, to provide certainty over the cost of maintaining the loans over their lifetime. However up to **30%** of all borrowing could alternatively be secured at **variable rates of interest**. (This is a voluntary Prudential Indicator - Number 8 as shown in **Annex C**). This may be appropriate if, for example, funding is required for a relatively short period, or if the Council wishes to defer locking into fixed rate loans because the interest rate forecast indicates that interest rates will be lower than the prevailing rate in the near term.

2.3.3. **Debt Rescheduling**

Debt rescheduling involves repaying existing loans and replacing these with new loans at different terms for the prime objective of generating financial savings on interest paid.

The Council's Financial Strategy states that **'the Council will actively pursue debt rescheduling to the extent that it will generate financial savings without adding significantly to the overall debt burden'**.

Repaying debt early does incur a premium[1] or discount[2] depending on the current level of interest rates compared to the rate of interest on the debt repaid. The following strategy will be followed when undertaking any debt rescheduling:

- The timing of any rescheduling during the year will take place to minimise premium or maximise the discount available. This is achieved by repaying loans at a peak in current interest rate levels to reduce the amount of premium due and locking into replacement loans at a trough in current interest rates. This strategy can incur an interest cost due to the delay in replacing debt repaid or interest can be made by borrowing in advance of repaying debt. There is also a level of interest rate risk of any timing decision.

- Suitable loans will be selected for rescheduling that match out both premium and discounts, thereby eliminating the cash impact to the Council.

- Any positions taken via rescheduling will be in accordance with the borrowing strategy position outlined in 2.3.5 below.

- The appropriate timing of any rescheduling will be monitored throughout 2021/22 by the Council and Link Asset Services Ltd.

[1] A premium is incurred on repaying a loan early when the interest rate of the loan to be repaid is higher than the current rate available for the remaining duration of the existing loan.

[2] A discount is incurred on repaying a loan early when the interest rate of the loan to be repaid is lower than the current rate available for the remaining duration of the existing loan.

To date interest savings have been made by rescheduling existing PWLB EIP[3] loans into PWLB maturity[4] loans and some existing LOBO[5] debt has also been rescheduled into PWLB debt, at the request of the LOBO holder, to generate savings over the remaining term of the loan.

However, PWLB to PWLB debt restructuring is now much less attractive because of the large premiums that would be incurred due to the introduction by the PWLB in 2007 of a spread between the rates applied to new borrowing and repayment of debt.

2.3.4. **Borrowing Performance Benchmarks**

The performance of long term borrowing undertaken will be assessed against the relevant **PWLB rate for the year** for the relevant loan type and interest rate banding. **CIPFA Treasury Management benchmarking** will also be considered to compare with other councils average borrowing rates for the year. **Reducing or keeping increases to the average rate of the debt portfolio to a minimum** will also be a target indicator.

Short term borrowing will be assessed against the average **7 Day London Interbank Offer Rate (7Day LIBOR) or relevant equivalent** for the year or the current **yields on Money Market Funds/investments** for short term borrowing for cash flow purposes.

2.3.5. **Long Term Borrowing – Factors for Consideration for 2021/22**

- **Forecast for Long Term Interest Rates during 2021/22** – increase of no more than 0.10% during the year, with significant volatility over the period (see 2.2.1 and **Annex A**).
- **Target Rates for Borrowing (Source: Link Asset Services Ltd 26/11/2020) –** see below:

Period	Target Rate
50 Years	1.70%
25 Years	1.90%
10 Years	1.30%
5 Years	0.90%

[3] With EIP loans, an equal amount of principal is repaid on a half yearly basis throughout the term of the loan with interest calculated on the reducing balance, hence total payments reduce over the lifetime of the loan.

[4] With Maturity loans, only interest repayments are made during the life of the loan and repayment of principal is made in full at the end of the loan period.

[5] A LOBO is a 'Lender's Option, Borrowers Option' money market loan, whereby the Lender has the option to change the rate of a loan after a designated fixed period of time and the Borrower (LCC) has the option to accept this new rate or repay the loan. The fixed period of time is typically for 1 to 20 years and the total length of the LOBO is typically for 50 to 70 years.

- **The Council's Long Term Borrowing Maturity Profile** as at 25 February 2021 can be seen at **Annex E**. It shows actual maturities and also possible maturities from the LOBO debt taken. Any new borrowing taken should focus on the gaps in the maturity profile and taken at these lengths at prevailing rates of interest where possible.

- **Type of Debt**: An appropriate balance between PWLB and other types of fixed period debt from the market should be maintained in the debt portfolio. As such the following limits for **type of debt** against the total debt portfolio, should be followed:

Type of Debt	Limit
PWLB Debt	100%
Market Debt (Fixed term market institution debt).	20%
LOBO Debt	10%
Short Term (up to 10 years) Local Authority Debt	100%

2.3.6. **Long Term Borrowing Strategy 2021/22**

Given the factors detailed above, the following **borrowing strategy** will be adopted for 2021/22:

- **The Council will take new borrowing from the PWLB in all periods with the aim of achieving an even spread of maturity profile and keeping an increase in the average cost of the Council's debt to a minimum.**

- **Target levels will be monitored and timing of borrowing taken will coincide with any reduced rate opportunity below the target levels identified.**

- **Internal Borrowing will be considered to a level of around 20% of CFR, ensuring appropriate levels of cash are maintained.**

- **Consideration will be given to borrowing market loans or LOBOs, to fit into the above maturity strategy and limits, in order to take advantage of the lower rates offered on these loans.**

- **Short term borrowing from the money markets or other local authorities will be considered if appropriate.**

- **Borrowing in advance of need will be undertaken during the year if considered appropriate in accordance with the Council's policy as detailed in 2.3.2, PI 11 above.**

2.3.7. To support the above strategy, prevailing interest rates and market forecasts will be continually monitored throughout the year and appropriate borrowing actions, including debt rescheduling if appropriate, will be taken in response to any sharp rise or fall in long and short term interest rates occurring throughout the year.

2.4. Investments

2.4.1. Annual Investment Strategy for Treasury Investments 2021/22

Regulation and Statutory Guidance requires the Council to produce an **Annual Investment Strategy** in advance of each year which indicates the type of treasury and non-treasury investments permitted against a given level of risk adopted for each type. This is shown in **Annex F**.

(Note: The Investment Strategy for Non-Treasury Investments is reported separately within the Capital Strategy Report 2021/22, as Non-Treasury Investments have a different risk profile to that of Treasury Investments).

The Council's **risk level** adopted for its Treasury Investments is **low** to achieve the following investment priorities:

- **the security of capital and**
- **the liquidity of its investments**

The Council will aim to achieve the optimum return on its treasury investments commensurate with proper levels of security and liquidity.

The Treasury Investment Strategy outlines the **Specified** and **Non-Specified Investments** that the Council deems acceptable given the level of risk it has adopted. Authorised counterparties, lending limits and maturity limits are set using credit worthiness methodology from Link Asset Services Ltd and an approved **Counterparty Investment Lending List** is formulated from this methodology (**See Annex G**). All treasury investments will be made in accordance with the Annual Investment Strategy and Approved Lending List and any breaches during the year will be reported to the Executive Director - Resources.

Given the increased level of cash balances received in 2020 due to Covid-19 Grants received but not yet expended, the result of this is that Council Reserves have increased and the level of investments now average between £350m to £400m. To accommodate these increased levels, the maximum amount limits for individual Counterparties on the Council's Lending List, shown in the Annual Investment Strategy, have been extended to include the higher ranges. The Lending List shown in Annex G has been updated for these new maximum amounts which will be effective on 1 April 2021, subject to the Strategy being approved. Maturity Limits have not been changed.

2.4.2. **Interest Rate Exposure re Investments PI 8**

As a general guide, term deposits are usually at a **fixed rate** of interest, whereas amounts invested on call (to maintain sufficient liquidity in the investment portfolio) are usually at **variable rates** of interest. Fixed investments of up to two years are considered acceptable to good quality counterparties, limits permitting, where above market rates are achievable and sufficient liquidity is available, as a way of enhancing investment return. In a forecast rising interest rate scenario, fixed deposits should be pegged to coincide with the forecast increase periods at market levels. **There are no upper limits set to variable rate investments.**

2.4.3. **Short Term and Long Term Cash Flow Management**

Liquidity of Investments – PI 9

Liquidity is defined as having adequate, but not excessive, cash resources, borrowing arrangements and overdraft or standby facilities to ensure that funds are available, at all times, for the achievement of the Council's objectives.

The Council's investment level is forecast to be around **£350 million** net of Pension Fund cash in 2020/21, of which around **£160 million** can be identified as 'core' balances which will be available to invest for longer periods of investment. The remaining balance of cash is cash-flow driven.

The following measures and limits have been put in place to manage the liquidity of the Council:

- The Council will seek to maintain **liquid short-term deposits** of at least **£25m** available within a week's notice.
- **Prudential Indicator Number 9** has been set to place an upper limit to investments made over 365 days to **£40m.** (See Annex D).
- **Temporary Borrowing for Liquidity Purposes -** Temporary short term borrowing will be taken instead of drawing on investments, when cheaper to do so, in order to minimise the loss of interest from withdrawing funds at higher rate from call or deposit accounts to maintain liquidity.

2.4.4. **Treasury Investment Performance Benchmark**

The target investment return for investments for 2021/22 is the weighted **7 day/3 month LIBID** benchmark that reflects the low risk parameters of the investment portfolio. This is a relative benchmark which moves with the markets, but as an indication the benchmark rate at 31 December 2020 was **0.07%.**

Note: LIBOR and associated LIBID rates are expected to cease at the end of 2021. Work will be done with Link Asset Services to determine a

suitable replacement investment benchmark ahead of this cessation and this will be reported during the year to members accordingly.

The investment performance will also be compared against **benchmarking data provided by both CIPFA and Link Asset Services.**

2.4.5. **Investments – Factors for Consideration for 2021/22**

- **Forecast for Short Term Interest Rates during 2021/22** - Bank Rate is not expected to increase from 0.10% until March 2024 and some short term investments, including existing Money Market Funds, held for liquidity are close to 0.00% or negative.

- **Enhanced Money Market Funds** – A review of Enhanced Money Market Funds (VNAV) will be undertaken during 2021/22. These funds are Non Specified Investments within our Annual Investment Strategy and offer slightly higher yields than existing funds but have different risk parameters and access restrictions. The results of the review will be reported to members during the year accordingly, with approval sought from the Executive Councillor for Resources and Communications to open any new Funds if appropriate.

- **Annual Investment Strategy for Treasury Investments** – permitted counterparties, types of investments and all limits, as detailed in the Annual Investment Strategy, and amended when necessary, should be adhered to throughout the year.

- **ESG Investments** – Any Economic, Social and Governance (ESG) Investments will be considered, provided they meet the counterparty criteria and risk parameters as set out in the Annual Investment Strategy.

2.4.6. **Treasury Investment Strategy for 2021/22**

Given these factors above, the following **investment strategy** will be adopted for 2021/22:

- **For the element of the Council's investment portfolio that represents 'core' balances, investments will be made in all periods of 3 months to 2 years, to acceptable counterparties, to lock into rates in excess of the predicted base rate level.**

- **The Council will avoid locking into longer term deals (beyond 1 year) while investment rates are down at historically low levels and forecast to rise, unless exceptionally attractive rates are available which make longer term deals worthwhile.**

- **Extensive use of Bank Business Reserve Accounts and Money Market Funds[6] will be made, that offer returns close to or in excess of base rate level, for the Council's 'core' cash and cash flow generated balances.**

- **Investment in Certificates of Deposit[7], Treasury/LA Bills[8], Dated Bonds held to maturity[9] and Repo[10] will also be considered where appropriate.**

- **Short dated deposits (overnight to 1 month) will also be made for the Council's cash-flow generated balances in order to benefit from compounding of interest.**

In addition to the above strategy, prevailing interest rates and market forecasts will be continually monitored throughout the year and appropriate investment actions will be taken in response to any sharp rise or fall in long and short-term interest rates occurring throughout the year.

3. Legal Issues:

Equality Act 2010

Under section 149 of the Equality Act 2010, the Council must, in the exercise of its functions, have due regard to the need to:

- Eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by or under the Act.
- Advance equality of opportunity between persons who share a relevant protected characteristic and persons who do not share it.

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[6] Pooled investment vehicles offering returns equivalent of up to 1 month cash deposits whose assets comprise of cash type investments such as Certificates of Deposit, Commercial Paper and Cash Deposits.

[7] A bearer instrument which certifies that a sum of money has been deposited with the bank issuing the certificate at a fixed yield and on the stated maturity date the deposit is repaid with interest. The maturity length is typically from 1 month to 1 year.

[8] Short term securities issued by HM Treasury on a discounted basis i.e. issued below 100, with 100 being received on maturity with the difference equalling the interest return.

[9] A debt security instrument that governments, supranationals, and companies sell to investors (issue) to finance a variety of projects and activities. The investor buys the bond and receives fixed or variable coupons (interest) in return. Bonds can be dated (mature/repayable on a certain date) or non-dated (never mature). Bonds are tradeable (can be bought and sold) and hence the price of a bond fluctuates over its life. The total yield (return) on a bond for investor equals the npv of the cashflows (e.g. price paid, coupons received, nominal value received on maturity).

[10] A Repo is a form of securitised lending based on a Global Master Repo Agreement (GMRA 2000). Collateral is pledged against each loan made under a Repo Agreement, usually consisting of Gilts or Treasury Bills or acceptable Corporate Bonds. This collateral passes to the Lender in the case of a default of the loan with the original Counterparty.

- Foster good relations between persons who share a relevant protected characteristic and persons who do not share it.

The relevant protected characteristics are age; disability; gender reassignment; pregnancy and maternity; race; religion or belief; sex; and sexual orientation.

Having due regard to the need to advance equality of opportunity involves having due regard, in particular, to the need to:

- Remove or minimise disadvantages suffered by persons who share a relevant protected characteristic that are connected to that characteristic.
- Take steps to meet the needs of persons who share a relevant protected characteristic that are different from the needs of persons who do not share it.
- Encourage persons who share a relevant protected characteristic to participate in public life or in any other activity in which participation by such persons is disproportionately low.

The steps involved in meeting the needs of disabled persons that are different from the needs of persons who are not disabled include, in particular, steps to take account of disabled persons' disabilities.

Having due regard to the need to foster good relations between persons who share a relevant protected characteristic and persons who do not share it involves having due regard, in particular, to the need to tackle prejudice, and promote understanding.

Compliance with the duties in section 149 may involve treating some persons more favourably than others.

The duty cannot be delegated and must be discharged by the decision-maker. To discharge the statutory duty the decision-maker must analyse all the relevant material with the specific statutory obligations in mind. If a risk of adverse impact is identified consideration must be given to measures to avoid that impact as part of the decision making process.

The report details the Treasury Management Strategy for treasury investments and borrowing and the Council's policy for investing surplus cash for the year 2021/22. There are no equalities implications that need to be taken into account by the Executive Councillor.

Joint Strategic Needs Analysis (JSNA) and the Joint Health and Wellbeing Strategy (JHWS)

The Council must have regard to the Joint Strategic Needs Assessment (JSNA) and the Joint Health and Wellbeing Strategy (JHWS) in coming to a decision.

The report details the Treasury Management Strategy for treasury investments and borrowing and the Council's policy for investing surplus cash for the year 2021/22. There are no JSNA or JHWS implications that need to be taken into account by the Executive Councillor.

Crime and Disorder

Under section 17 of the Crime and Disorder Act 1998, the Council must exercise its various functions with due regard to the likely effect of the exercise of those functions on, and the need to do all that it reasonably can to prevent crime and disorder in its area (including anti-social and other behaviour adversely affecting the local environment), the misuse of drugs, alcohol and other substances in its area and re-offending in its area.

The report details the Treasury Management Strategy for treasury investments and borrowing and the Council's policy for investing surplus cash for the year 2021/22. There are no Crime and Disorder implications that need to be taken into account by the Executive Councillor.

4. Conclusion

The Treasury Management Strategy, determining appropriate borrowing and treasury investment decisions, and the Annual Investment Strategy, outlining the Council's policy for treasury investments, has been set for 2021/22 in light of the anticipated economic environment and movement of interest rates for the year ahead. There is no significant difference to strategy or risk appetite adopted from the previous year, except for the increase in Counterparty amount limits to accommodate the extra investment balances held as a result of Covid grant received but yet expended. Reviews taking place in 2021/22 in this area will include MRP Policy and Enhance Money Market Fund opportunities. These strategies reflect the requirements of the CIPFA Code of Treasury Management and MHCLG Guidance on Local Government Investments. Based on officer recommendation, this report is presented to the Leader of the Council (Executive Councillor: Resources and Communications) for approval in order to comply with Financial Regulations.

5. Legal Comments:

The Council's Financial Regulations require the Council to annually produce a Treasury Management Strategy setting out expected treasury activities in accordance with the requirements of the CIPFA Code of Practice. The strategy statement must be submitted to the Leader of the Council (Executive Councillor: Resources and Communications) for approval prior to the commencement of each financial year.

The Financial Regulations also require the production of an Annual Investment Strategy to ensure that Section 15 (1) of the Local Government Act 2003 is complied with, that is that all authorities must “have regard to guidance on investment issued by the Secretary of State” when investing their surplus cash. The strategy also must also be approved by the Leader of the Council (Executive Councillor: Resources and Communications).

This report enables the Council to meet its legal obligations in accordance with the Financial Regulations. The recommendations are lawful and within the remit of the Leader of the Council (Executive Councillor: Resources and Communications).

6. Resource Comments:

This report sets out the Council's Treasury Management Strategy and Investment Strategy for Treasury Investments for the year ahead. The Council requires a Treasury Management Strategy and Investment Strategy for Treasury Investments for the year ahead in order to comply with Financial Regulations.

7. Consultation

a) Has Local Member Been Consulted?

Not Applicable.

b) Has Executive Councillor Been Consulted?

Yes

c) Scrutiny Comments

The Overview and Scrutiny Management Board is responsibile for monitoring and scrutiny of the operation of the treasury management policies and practices and as such will consider this report at its meeting on 25 February 2021 and pass any comments to the Leader of the Council (Executive Councillor: Resources and Communications) prior to making a decision.

d) Risks and Impact Analysis

Risk and Impact Analysis for Treasury Management forms TMP1 of the Treasury Management Practices, as required by the CIPFA Code of Practice 2017. A Risk Register which details the main risks for Treasury Management has been completed and is reviewed annually. Both the TMPs and the Risk Register are held in the Treasury Files held in IMP at County Offices.

8. Appendices

These are listed below and attached at the back of the report	
Annex A	Interest Rate Forecasts 2021-2024
Annex B	Economic Outlook - Link Asset Services Ltd
Annex C	Prudential Indicator Table 2019/20 to 2023/24
Annex D	Minimum Revenue Provision Policy Statement for Repayment of Debt 2021/22
Annex E	Long Term Borrowing Maturity Profile at 25 February 2021
Annex F	Annual Investment Strategy for Treasury Investments 2021/22
Annex G	Authorised Lending List Effective 1 April 2021 and Definition of Credit Ratings and Credit Default Swaps

9. Background Papers

The following background papers as defined in the Local Government Act 1972 were relied upon in the writing of this report.

Document title	Where the document can be viewed
County Council Budget 2021/22 - 19 February 2021	https://lincolnshire.moderngov.co.uk/ieListDocuments.aspx?CId=120&MId=5729&Ver=4
LCC Treasury Management Policy Statement and Treasury Management Practices	Lincolnshire County Council, Resources

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