Supplementary Committee Agenda

Epping Forest District Council

Audit & Governance Committee
Monday, 22nd March, 2021

Place: Virtual Meeting on Zoom

Time: 7.00 pm

Democratic Services: Laura Kirman
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12. DRAFT TREASURY MANAGEMENT STRATEGY (INCLUDING INVESTMENT STRATEGY) 2021/22 (Pages 117 - 138)

(Section 151 Officer) To consider the Draft Treasury Management Strategy.

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Report to the Audit & Governance Committee

Report reference:
Date of meeting: 22 March 2021

Epping Forest District Council

Portfolio: **Finance & Economic Development**

Subject: **Treasury Management Strategy (including Investment Strategy) 2021/22**

Responsible Officer: **Andrew Small** **(01992 564278)**

Democratic Services: **Laura Kirman** **(01992 564243)**

Recommendations/Decisions Required:

(1) To consider and recommend for approval by full Council, the draft Treasury Management Strategy 2021/22 (including the MRP Policy) attached at ***Appendix A***; and

(2) To consider and recommend for approval by full Council, the draft Investment Strategy 2021/22 attached at ***Appendix B.***

Executive Summary:

The preparation of an annual Treasury Management Strategy is a requirement of CIPFA's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) and generally accepted good practice. It covers planned treasury activity for the financial year 2021/22 and is attached at ***Appendix A***.

In addition, following the issue of (MHCLG) statutory guidance on Local Government Investments in 2018, the Council is now recommended to produce an annual Investment Strategy, covering the Council's wider investment activities. The 2021/22 Strategy is attached at ***Appendix B.***

The overriding position that this report presents in the year ahead is a further rise in Borrowing activity as the Council continues to roll out its capital investment plans. Conversely Investment activity is expected to be very limited.

Both Borrowing and Investing is taking place against a backdrop of historically low interest rates, which are set to continue for some time.

This purpose of this report is to allow the Audit and Governance Committee to consider and comment on both strategies, before making appropriate recommendations to full Council on 29th April 2021.

Reasons for Proposed Decision:

To provide assurance to full Council that the risks associated with treasury management and investments are being appropriately managed.

Legal and Governance Implications:

CIPFA's the CIPFA Code) requires the Council to prepare for approval by full Council, an annual Treasury Management Strategy.

The Government (MHCLG) issued Investment Guidance in 2018, recommending the preparation (at least annually) of an Investment Strategy for approval by full Council.

The role of the Audit and Governance Committee is to consider this report – covering both the Treasury Management and Investment strategies – and make recommendations to full Council.

Safer, Cleaner and Greener (SCG) Implications:

None.

Background Papers:

Treasury Management in the Public Services: Code of Practice 2017 Edition published by CIPFA.

(MHCLG) Statutory Guidance on Local Government Investments (3rd Edition). Issued under section 15(1)(a) of the Local Government Act 2003 and effective for financial years commencing on or after 1st April 2018.

Risk Management:

There are a range of inherent financial risks associated with Treasury Management activity; not least the potential for loss of interest and/or deposits. The Council therefore engages the services of external Treasury Management advisors, Arlingclose Ltd.

Borrowing and Investment decisions are made in accordance with the Council's formally adopted Treasury Management Strategy. The Strategy includes several Risk Management features, including – for example – the overriding priority that security of deposit takes precedence over return on investment.

Appendix A

Treasury Management Strategy 2021/22

DRAFT

Introduction

Treasury management is the management of the Council's cash flows, borrowing and investments, and the associated risks. 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. The successful identification, monitoring and control of financial risk are therefore central to the Council's prudent financial management.

Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition* (the CIPFA Code) which requires the Council to approve a Treasury Management Strategy before the start of each financial year. This report fulfils the Council's legal obligation under the *Local Government Act 2003* to have regard to the CIPFA Code.

Investments held for service purposes or for commercial profit are considered in a different report, the Investment Strategy ***(Appendix B).***

External Context

The medium-term global economic outlook has improved with the rollout of vaccination programmes, of which the UK is at the forefront. However, the current imposition of lockdowns and ongoing social distancing measures will increase the economic damage caused by the pandemic.

Signs of a slowing UK economic recovery were already evident towards the end of 2020 and there will be a further sharp fall in activity in Quarter 1 2021. Employment is falling despite an extension to support packages and may be lower than suggested by the official measure.

Whilst restrictive measures are likely to continue in the UK and Europe until most of the population is vaccinated by the second half of 2021, the end of lockdowns in Quarter 2 will prompt a sharp increase in GDP.

The combined effect of Brexit and the after-effects of the Pandemic will dampen subsequent economic growth relative to peers, maintain spare capacity and limit domestically generated inflation. The Bank of England will therefore maintain loose monetary conditions for the foreseeable future.

The UK central bank stance will be mirrored across most developed economies, albeit some, like the Federal Reserve, are closer to monetary tightening than others.

Longer-term yields will also remain at low levels, anchored by low central bank policy rates and insipid longer-term inflation expectations. Some upward movement is likely as the global economy returns to a firmer footing, with gilt yields facing upside risks from possible significant US fiscal stimulus. However, there are risks to the downside too, particularly in relation to further virus outbreaks.

As the rollout of vaccinations continue, the Monetary Policy Committee (MPC) expects GDP to rapidly recover towards pre-Covid levels toward the end of 2021. This rebound in activity is supported by the substantial fiscal and monetary policies put in place by Government. As these policies are phased out, the pace of recovery in GDP is likely to slow but the MPC forecasts the spare capacity in the economy being eliminated as activity picks up throughout the year.

Although the Covid pandemic has caused weak inflation throughout 2020, the MPC expects the CPI rate to rise quite sharply towards the 2% target due to the reversal of the VAT cut for certain services and a rise in energy prices. The central projection sees inflation rise to near 2% over the second and third years of the forecast period provided interests rates stick to the market path.

The unemployment rate rose to 5% in the three months to November 2020. Other indicators suggest that the slack in the labour market could be even higher. Although the employee support schemes have helped to largely mitigate the rise in unemployment, the MPC forecasts further increases in unemployment over the rest of 2021.

Local Context

At close of business on 28th February 2021, the Council held £250.206 million Borrowing and £11.039 million in Treasury Investments. This is set out in further detail at ***Appendix B.*** Forecast changes in these sums are shown in the Balance Sheet analysis in Table 1 below.

Table 1: Balance Sheet Summary and Forecast

	31/03/20 Actual £m	31/03/21 Estimate £m	31/03/22 Forecast £m	31/03/23 Forecast £m	31/03/24 Forecast £m
General Fund CFR	95.8	162.3	169.6	223.1	255.7
HRA CFR	154.4	155.6	174.1	214.6	219.0
Total CFR	**250.2**	**317.9**	**343.7**	**437.7**	**474.7**
Less: Other debt liabilities*	0	0	0	0	0
Less: External borrowing	**224.5**	**247.7**	**193.1**	**192.9**	**192.6**
Internal borrowing	**25.8**	**70.3**	**150.6**	**224.8**	**282.1**
Less: Usable reserves	(47.5)	(47.5)	(47.5)	(47.5)	(47.5)
Less: Working capital surplus	(0.4)	(0.4)	(0.4)	(0.4)	(0.4)
Investments/(New borrowing)	**22.1**	**(22.4)**	**(102.7)**	**(196.9)**	**(234.2)**

** leases and PFI liabilities that form part of the Council's total debt*

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

The Council has an increasing CFR due to the Capital Programme (including Qualis Investments), and will therefore be required to borrow up to a further £234.2 million over the forecast period (2021/22 to 2023/24).

CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Council expects to comply with this recommendation during 2021/22.

Liability Benchmark

To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as Table 1 above, but that cash and investment balances are kept to a minimum level of £12.0 million at each year-end to maintain adequate liquidity but minimise credit risk.

Table 2: Liability Benchmark

	31/03/20 Actual £m	31/03/21 Estimate £m	31/03/22 Forecast £m	31/03/23 Forecast £m	31/03/24 Forecast £m
Total CFR	250.2	317.9	343.7	437.7	474.7
Less: Usable reserves	(47.5)	(47.5)	(47.5)	(47.5)	(47.5)
Less: Working capital	(0.4)	(0.4)	(0.4)	(0.4)	(0.4)
Plus: Minimum investments	12.0	12.0	12.0	12.0	12.0
Liability benchmark	**214.3**	**282.0**	**307.8**	**401.8**	**438.8**

Borrowing Strategy

The Council currently (@ 28th February 2021) holds £250.206 million of loans, an increase of £25.75 million compared to 31st March 2020, as part of its strategy for funding previous years' Capital Programmes. The Balance Sheet forecast in Table 1 shows that the Council expects to borrow up to £307.8 million in 2021/22 (if minimum Investment balance of £12.0 million illustrated in Table 2 is achieved). The Council may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the Authorised Limit for Borrowing of £363.7 million is not exceeded.

Objectives

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

Strategy

Given the significant cuts 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 much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

By doing so, the Council reduces its net borrowing costs (despite foregone investment income) and reduces overall treasury risk. The benefits of internal and short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when 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 cost in the short-term.

The Council has previously raised all of its long-term borrowing from the PWLB but will consider long-term loans from other sources including banks, pension funds and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Council 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 take out further short-term loans to cover unplanned cash flow shortages.

Sources of Borrowing

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

- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
- Any institution approved for investments (see below)
- 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 Essex County Pension Fund)
- Capital market bond investors; and
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues.

Other sources of Debt Finance

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; and
- Sale and leaseback.

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 would therefore be the subject of a separate report to full Council.

Short-Term and Variable Rate Loans

These loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the Treasury Management indicators below.

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.

Treasury Investment Strategy

The Council holds significant invested funds, representing income received in advance of expenditure, plus balances and reserves held. During 2020/21, the Council's Treasury Investment balance has ranged between £1.2 million and £70.5 million. However, the cash flows were highly exceptional and predominantly the result of the Government advancing the Council large sums of money (at very short notice) for distribution to local businesses as part of its Coronavirus support measures. Volatility is expected to greatly reduce in 2021/22, especially from July (Quarter 2) onwards, with balances expected to oscillate much closer to a target liquidity level of £12.0 million.

Objectives

The CIPFA Code requires 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. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

Negative Interest Rates

The COVID-19 pandemic has increased the risk that the Bank of England could set its Bank Rate at or below zero, which – if it happened – would be likely to feed through to negative interest rates on low risk, short-term investment options. Since investments cannot pay negative income, negative rates would be applied by reducing the value of investments. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

Strategy

Given the risk and very low returns from short-term unsecured bank investments, the Council may consider diversifying into more secure and/or higher yielding asset classes during 2021/22.

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 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.

Approved Counterparties

The Council may invest its surplus funds with any of the counterparty types in Table 3 below, subject to the limits shown.

Table 3: Treasury Investment Counterparties and Limits

Sector	Time limit	Counterparty limit	Sector limit
The UK Government	50 years	Unlimited	N/A
Local authorities & other government entities	25 years	£10 million	Unlimited
Banks (unsecured)*	13 months	£5.0 million	£20.0 million
Building Societies* (unsecured)	13 months	£2.0 million	£2.0 million
Registered Providers* (unsecured)	5 years	£3.0 million	£3.0 million
Money Market Funds*	N/A	£10.0 million	Maximum of 3 Funds (see below)

Note - this table must be read in conjunction with the notes below.

__ 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 account of.

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.

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.

If operational need requires the use of more than three funds, the S151 officer can authorise this in consultation with the Portfolio Holder for Finance and Economic Development, provided this is reported to the Chair of the Audit and Governance Committee, and a report is submitted to the next available meeting of the Audit and Governance Committee.

Operational Bank Accounts

The Council may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £5.0 million per bank. 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 Council maintaining operational continuity.

Risk Assessment and Credit Ratings

Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- No new investments will be made,
- Any existing investments that can be recalled or sold at no cost, will be; and
- Full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "negative watch") so that it may fall below the approved rating criteria, then only investments that can be withdrawn [on the next working day] will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

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 happened in 2008 and 2020, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government, or with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

Investment Limits

The Council had £27.341 million in reserves on its (draft) Balance Sheet as at 31st March 2020 to cover unexpected credit losses in an emergency. A reasonable level of risk to carry in a single institution would be 15% (based on current market conditions). An Investment Limit for a single institution of £4.0 million will therefore be applied (rounded down for prudence).

Liquidity Management

The Council uses cash flow forecasting to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's Medium-Term Financial Plan and Cash Flow Forecast.

Treasury Management Indicators

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

Security

The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

Credit Risk Indicator	Target
Portfolio average credit rating	A-

Liquidity

The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling [three] month period, without additional borrowing.

Liquidity Risk Indicator	Target
Total cash available within 3 months	£3.0 million

Interest Rate Exposure

This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates will be:

Interest Rate Risk Indicator	**Limit**
Upper limit on one-year revenue impact of a 1% rise in interest rates	£318,000
Upper limit on one-year revenue impact of a 1% fall in interest rates	£120,000

The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.

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 Borrowing will be:

Refinancing Rate Risk Indicator	**Upper Limit**	**Lower Limit**
Under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	50%	0%
10 years and within 15 years	50%	0%
15 years and within 20 years	50%	0%
25 years and above	50%	0%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Principal Sums Invested for Periods Longer than a Year

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:

Price Risk Indicator	**2021/22**	**2022/23**	**2023/24**
Limit on principal invested beyond year end	£15.0 million	£10.0 million	£5.0 million

Related Matters

Housing Revenue Account

On 1st April 2012, the Council notionally split each of its existing long-term loans into General Fund and HRA pools. In future, new long-term loans borrowed will be assigned in their entirety to one pool or the other. Interest payable and other costs/income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged/ credited to the respective revenue account. Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. This balance will be measured, with interest transferred between the General Fund and HRA at the Council's average interest rate on investments, adjusted for credit risk.

Markets in Financial Instruments Directive (MIFID)

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

Financial Implications

In 2021/22, the budgets for General Fund and HRA investment income are £25,000 and £36,000 respectively. If investment levels and borrowing, or interest rates, differ from expectations, performance against budget will be correspondingly different.

Other Options Considered

The CIPFA Code does not prescribe any specific Treasury Management Strategy for local authorities to adopt. The Section 151 Officer, having consulted the Portfolio Holder for Finance and Economic Development, 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 below.

Alternative	Impact on Income and Expenditure	Impact on Risk Management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller

Alternative	Impact on Income and Expenditure	Impact on Risk Management
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

Annex 1

Arlingclose Interest Rate Forecast - February 2021

- Arlingclose expects the Bank Rate to remain at the current 0.10% level. The risks of a Bank Rate cut over the medium-term have recently reduced.
- Gilt yields will remain low in the medium-term. Shorter term gilt yields may rise marginally as it becomes apparent that the Bank is not likely to reduce Bank Rate further.
- Longer term yields may face upward pressure due to rising short term inflation, but Arlinclose expect yields to remain at low levels due to contained long-term inflation expectations.
- Downside risks remain – the damage from the pandemic will have lasting effects and there is the risk of further mutations due to the uneven global rollout of vaccines.

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

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

Annex 2

Existing Investment & Debt Portfolio

	28/02/21 Actual Portfolio £m	28/02/21 Average Rate %
External Borrowing		
Public Works Loan Board	235.206	
Local authorities	15.0	
Other loans	0	
Total External Borrowing	**250.206**	**2.63%**
Other Long-Term Liabilities:		
Leases	0	
Total Other Long-Term Liabilities	**0**	
Total gross external debt	**250.206**	
Treasury Investments		
The UK Government	0	
Local authorities	0	
Banks (unsecured)	3.039	
Money market funds	8.0	
Other investments	0	
Total Treasury Investments	**11.039**	**0.015%**
Net Debt	**239.167**	

Appendix B

Investment Strategy Report 2021/22

Introduction

The Council invests its money for three broad purposes:

- Because it has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure (known as **Treasury Management Investments**)
- To support local public services by lending to or buying shares in other organisations (**Service Investments**); and
- to earn investment income (known as **Commercial Investments** where this is the main purpose).

This Investment Strategy meets the requirements of statutory guidance issued by the Government in January 2018 and focuses on the second and third of these categories.

Treasury Management Investments

The Council typically receives its income in cash (e.g. from taxes and grants) before it pays for its expenditure in cash (e.g. through payroll and invoices). It also holds reserves for future expenditure and collects local taxes on behalf of other local authorities and the Government. These activities, plus the timing of borrowing decisions, lead to a cash surplus which is invested in accordance with guidance from the Chartered Institute of Public Finance and Accountancy (CIPFA). The balance of Treasury Management investments is expected to fluctuate between £10.0 million and £30.0 million during the 2021/22 financial year.

Contribution

The contribution that these investments make to the objectives of the Council is to support effective Treasury Management activities.

Full details of the Council's policies and its plan for 2021/22 for Treasury Management investments are covered in a separate document, the Treasury Management Strategy (***Appendix A*** of this report).

Service Investments: Loans

Contribution

The Council will sometimes make investments to support service delivery objectives where there is a strategic case for doing so. This is an approach that has been adopted for the delivery of a package of services including Refuse Collection and Leisure. For example, the Council has previously invested in contractor loans for the procurement of Refuse Vehicles, which has realised a return for the Council in the form of lower contract payments, whilst protecting the local Waste Collection service.

See separate discussions below re Qualis loans (under Commercial Investments).

Security

The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to limit this risk, and ensure that exposure to service loans remains proportionate, the Council will – wherever possibly – look to securitise loans against physical assets (Property, Plant and Equipment).

Accounting standards require the Council to set aside a loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Council's Statement of Accounts are shown net of this loss allowance. However, the Council makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments.

Risk Assessment

The Council assesses the risk of loss before committing to, and whilst holding, service loans. The approach taken is tailored to individual circumstances and will often include the engagement of professional advisors, the undertaking of credit checks etc.

Service Investments: Shares

Contribution

The Council will sometimes invest in shares to support local public services and stimulate local economic growth. Most notably the Council has 1 Ordinary Share in, and is the sole shareholder of, the Qualis Group, which has been set up to help create more jobs, grow the local economy, and improve housing and public amenities in the district.

Security

One of the risks of investing in shares is that they fall in value meaning that the initial outlay may not be recovered. However, in the case of the Qualis Group, (other than for service purposes) the Council has invested with a view to realising a significant financial return through the receipt of dividends and, despite limited liability status, the Council carries significant risk in the event of the financial failure of Qualis (e.g. through a guarantee to the Pension Fund as part of the transfer of staff from the former in-house Housing Repairs service).

The Qualis Business Plan therefore requires the approval of the Council, and forms part of a wider Governance Framework purposely set-up to protect the interests of the Council.

Risk Assessment

The Council assesses the risk of loss before committing to, and whilst holding, shares. The approach taken is tailored to individual circumstances, although in the case of Qualis, extensive use of professional advisors was made.

Non-Specified Investments

Shares are the only investment type that the Council has identified that meets the definition of a non-specified investment in Government guidance.

Commercial Investments: Property

Contribution

The Council invests in the acquisition of commercial property in a range of locations across the district. The value of the overall portfolio rose from £117.011 million to £138.026 million in 2019/20, with net income of £6.216 million achieved. Shops and Industrial Units have been two areas of emphasis and the returns achieved have been a key enabler in maintaining a low Council Tax charge in the district (now the lowest district Council Tax in Essex) as well as helping to shape the district through the protection and promotion of local business and employment opportunities.

Portfolio Category	Balance Sheet Value	
	31/03/19	31/03/20
	£000's	£000's
Shops	81,133	94,765
Industrial Units	24,547	32,011
Other	11,331	11,250
Total Portfolio	**117,011**	**138,026**

Security

In accordance with government guidance, the Council considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs.

A fair value assessment of the Council's investment property portfolio has been made within the past twelve months, and the underlying assets provide security for capital investment.

Risk Assessment

The Council assesses the risk of loss before committing to, and whilst holding, shares. In the case of commercial property, the 'strength of the covenant' is of primary interest.

Commercial Investments: Qualis

Contribution

As well as the shareholding in Qualis noted above within Service Investments, the Council also makes a margin on the capital loans that it has made to the "Qualis Group". Access to affordable finance is a key enabler in the Qualis Business Plan which underpins the ambition to create more jobs, grow the local economy, and improve housing and public amenities in the district.

Description	Type/Terms	2020/21	2021/22	2022/23	Totals
		£000's	£000's	£000's	£000's
Investment Loan	10-Year Maturity/4.0%	30,000	0	0	**30,000**
Regeneration Finance Loans	TBC	6,000	10,000	47,000	**63,000**
Totals		**36,000**	**10,000**	**47,000**	**93,000**

In addition to the capital loans presented above, the Council has also provided Qualis with a Working Capital (revenue) Loans totalling £6.0 million in a series of seven tranches as follows:

- 2019/20 (Tranche 1) - £500,000 (5-Year EIP @ 7.80%); and
- 2020/21 (Tranches 2 - 7) - £5,500,000 (5-Year EIP @ 3.80%).

Accounting standards require the Council to set aside a loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Council's Statement of Accounts are shown net of this loss allowance. However, the Council makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments.

Security

The Qualis Business Plan requires the approval of the Council, and forms part of a wider Governance Framework purposely set-up to protect the interests of the Council.

Risk Assessment

The Council assesses the risk of loss before committing to, and whilst holding, Qualis loans. For example, detailed consideration was given to the Business Plan before the Council committed to the Working Capital Loan in recognition of the higher level of risk i.e. the arrangement is not 'asset backed' (contrast the Investment Loan, which Qualis applied to the purchase of commercial property).

Loan Commitments and Financial Guarantees

Although not strictly counted as investments, since no money has exchanged hands yet, loan commitments and financial guarantees carry similar risks to the Council and are included here for completeness.

The Council became "self-financing" in respect of its retained housing stock from April 2012. The self-financing regime applied to all authorities and replaced the former Housing Subsidy system whereby the Council made annual payments to the Government funded from its HRA. Its introduction entailed a one-off redistribution of 'debt' between local authorities, and locally this resulted in the Council taking on PWLB loans, which it is required to service (instead of making Housing Subsidy payments).

If the HRA is unable to repay the debt at any point in the future, the Council (through its General Fund) is liable to repay any remaining balance. The remaining balance on the HRA debt as 31st March 2020 was £185.456 million.

The Council has also provided a guarantee (to the Essex County Pension Fund) on pension costs for 38 'TUPE protected' employees that transferred to Qualis in October 2020, as part of the transfer of the Housing Repairs service. If Qualis is unable to meet its liabilities incurred, through its participation in the Local Government Pension Scheme (LGPS), the Council is obliged to meet those costs on its behalf.

Capacity, Skills and Culture

Statutory Officers and Elected Members

The Council employs professionally qualified and experienced staff in senior positions with responsibility for making investment decisions. In particular, the Section 151 Officer, who is the strategic lead on the Council's finances, is a qualified (CIPFA) accountant with many years of experience, whereas the Deputy Section 151 Officer, who leads on operational matters, is also a qualified (ACCA) accountant, also with many years of experience. The Council is committed to the ongoing professional development of the other officers within the Finance function, which includes a commitment towards general professional development (e.g. through CIPFA, ACCA and AAT), as well focussed professional training in specialist areas including Treasury Management.

The Council also acknowledges the importance of ensuring that Members have appropriate capacity, skills and information to effectively undertake their role on the Audit and Governance Committee and have arranged training in the past from the Council's Treasury Management advisors, Arlingclose.

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