Northumberland
County Council

AUDIT COMMITTEE

22 JANUARY 2020

TREASURY MANAGEMENT STRATEGY STATEMENT FOR THE FINANCIAL YEAR 2020-21

Report of Chris Hand, Executive Director of Finance

Cabinet Member: Councillor Nicholas Oliver – Cabinet Secretary and Portfolio Holder for Corporate Services

Purpose of Report

The Local Government Act 2003 requires the Council to set out its Treasury Strategy for borrowing and to prepare an Annual Investment Strategy, which sets out the policies for managing investments and for giving priority to the security and liquidity of those investments. The Council nominates Audit Committee to be responsible for ensuring effective scrutiny of the Treasury Management Strategy and Policy.

This report sets out the Treasury Management Strategy, Treasury Management Policy Statement, the Annual Investment Strategy for the Financial Year 2020-21, Prudential Indicators 2020-21 to 2022-23 and the Minimum Revenue Provision Policy 2020-21.

Recommendations

- Members consider the report and recommend that County Council approve the Treasury Management Strategy Statement which includes the Treasury Management Policy Statement, the Annual Investment Strategy and Borrowing Strategy for the Financial Year 2020-21.
- Members recommend that County Council approve the Prudential Indicators (Appendix 4) for three years 2020-21 to 2022-23 to ensure that the Council's capital investment plans are affordable, prudent and sustainable.
- Members recommend that County Council approve the Minimum Revenue Provision Policy (Appendix 5) 2020-21.

Link to Corporate Plan

This report supports the "We want to be efficient, open and work for everyone" priority included in the Council's Corporate Plan 2018-21.

Key issues

The Local Government Act 2003 (the Act) and supporting regulations requires the Council to 'have regard to' the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code and the CIPFA Treasury Management Code of Practice (which were adopted by Northumberland County Council in February 2010), to set Prudential and Treasury Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

The Act requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act).

The Treasury Management Strategy Statement details the proposed activities of the Treasury Management function for the financial year 2020-21 and is based upon the treasury management officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury management advisors, Link Asset Services.

TREASURY MANAGEMENT STRATEGY STATEMENT 2020-21

1. INTRODUCTION

1.1. Background

This Treasury Management Strategy Statement details the expected activities of the Treasury Management function for the financial year 2020-21. Its production and submission to full Council is a requirement of the CIPFA Code of Practice on Treasury Management.

Part of the treasury management operation is to ensure that cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council; essentially the longer-term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans, or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.

The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue expenditure or for larger capital projects. The financial cost of these activities - i.e. the balance between interest costs of debt and the investment income arising from cash deposits - has a significant impact on the overall revenue budget. In addition, since cash balances are mostly generated from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will result in a loss to the General Fund Balance.

Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities, (arising usually from capital expenditure), and are separate from the day to day treasury management activities.

CIPFA defines treasury management as:

"The management of the local authority'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."

1.2. Statutory and Regulatory Requirements

The Local Government Act 2003 (the Act) and supporting Regulations requires the Council to 'have regard to' the Chartered Institute of Public Finance and

Accountancy's (CIPFA) Prudential Code 2017, and the CIPFA Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes 2017.

The codes define the manner in which capital spending plans are to be considered and approved, and require the Council to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable. In conjunction with this, they also require the Council to set out its Treasury Strategy for borrowing and to prepare an Annual Investment Strategy, as required by the (revised) Investment Guidance issued by The Ministry of Housing, Communities and Local Government (MHCLG) which came into effect 1 April 2018.

With effect from 2019-20 there was a requirement that the report included a Capital Strategy, to provide a longer-term focus to the capital plans, and an extension of the meaning of 'investments' to include both financial and non-financial investments or commercial activity undertaken under the Localism Act 2011. The Capital Strategy is reported to County Council for approval with the annual budget report and Medium Term Financial Plan in February each year.

Non-financial investments, especially in property, do not generally form part of treasury management activities carried out by the treasury management team of a local authority.

Treasury management investments represent the placement of cash in relation to the s12 Local Government Act 2003 Act investment powers; namely residual cash resulting from the authority's day to day activities.

Non-financial, or non-treasury investments tend to relate to s1 expenditure powers under the Act and be either of the following:

- Policy type investments, whereby capital or revenue cash is advanced for a specific council objective. This may be an advance to a third party for economic regeneration, or to enable care facilities etc.
- Commercial type investments, whereby the objective is primarily to generate capital or revenue resources. The resources generated would then help facilitate Council services.

This report deals solely with financial investments. Non-financial investments, which from the Council's perspective relate to the loans provided to third parties, are covered in the Capital Strategy report.

1.3. Basis and Content of Treasury Management Strategy for 2020-21

The proposed strategy for 2020-21 in respect of the following aspects of the treasury management function is based upon officers' views on interest rates, supplemented by leading market forecasts provided by the Council's treasury advisors, Link Asset Services. The strategy covers:

- Current portfolio position;
- Economic outlook and prospects for interest rates;

- Borrowing Strategy for 2020-21;
- Annual Investment Strategy for 2020-21;
- Housing Revenue Account (HRA) treasury costs;
- Treasury management limits and Prudential Indicators;
- Minimum Revenue Provision Policy Statement;
- Policy on use of external service providers, and;
- Implementation of the Treasury Management Strategy, scheme of delegation, reporting and training requirements.

1.4. Balanced Budget Requirement

It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, revised under Section 31 of the Localism Bill 2011, for the Council to produce a balanced budget. In particular, Section 31 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This means that the impact of increases in capital expenditure, such as interest charges associated with any new borrowing, and any increases in running costs from these capital projects, must be limited to a level which is affordable within the projected income of the Council for the foreseeable future.

The Council also has a statutory duty under S.3 of the Local Government Act 2003, and supporting regulations, to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Affordable Borrowing Limit". The Council must have regard to the Prudential Code when setting its Affordable Borrowing Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits.

The Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving best value in treasury management within the context of effective risk management, and to employing suitable performance measurement techniques, for example comparison with other members of the CIPFA and Link benchmarking clubs.

2. THE PORTFOLIO POSITION AT 30 NOVEMBER 2019

2.1. Current Borrowing

The Council's borrowing at 30 November 2019 is shown below:

	General Fund £m	HRA £m	Total Principal 30 Nov 2019 £m	Weighted Average Rate %
Public Works Loan Board Loans	410.904	40.704	451.608	2.67

LOBOs	153.500	23.000	176.500	3.95
Market / Local Authority (>1yr)*	173.000	8.100	181.100	2.17
Salix	0.041	0.000	0.041	0.00
Short Term loans* (<1yr)	2.000	0.000	2.000	1.10
TOTAL EXT BORROWING	**739.445**	**71.804**	**811.249**	**2.83**

* Note: above figures are based on the term of loans at their inception

Total external borrowing has increased by £79.727 million from £731.522 million at the start of year to £811.249 million at 30 November 2019. Following further repayments the year end figure is expected to be around £783.981 million.

2.2. Current Investments

The table below summarises the investment position at 30 November 2019:

	Total Principal 30 Nov 2019 £m	**Weighted Average Rate %**
Money Market Funds and Call Accounts	81.300	0.85
Fixed Term Investments – Short Term (<1yr)*	72.000	0.79
Fixed Term Investments – Long Term (>1yr)*	33.250	3.24
TOTAL EXTERNAL INVESTMENTS	**186.550**	**1.25**

* Note: above figures are based on the term of investments at their inception

3. FORECAST FOR INTEREST RATES AND ECONOMIC OUTLOOK

The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives Link's central view of rates for 2020-21 (at 11 November 2019). A longer view and more detailed forecast are included at Annex 1.

	Qtr 1 (Q/E Jun 2020)	**Qtr 2 (Q/E Sep 2020)**	**Qtr 3 (Q/E Dec 2020)**	**Qtr 4 (Q/E Mar 2021)**
Bank Rate	0.75%	0.75%	0.75%	1.00%
5yr PWLB	2.40%	2.50%	2.50%	2.60%
10yr PWLB	2.70%	2.70%	2.80%	2.90%
25yr PWLB	3.40%	3.40%	3.50%	3.60%
50yr PWLB	3.30%	3.30%	3.40%	3.50%

3.1. Economic Outlook (at November 2019)

It has been no surprise that the Monetary Policy Committee (MPC) has left Bank Rate unchanged at 0.75% so far in 2019 due to the ongoing uncertainty over Brexit. In its meeting on 01 August 2019 the MPC became more dovish, due to its concern about the outlook for both the global and domestic economies. This was reflected in their policy statement which, based on an assumption that there is an agreed deal on Brexit, suggested that rates would only rise at a "gradual pace and to a limited extent" and that this would be conditional on "some recovery in global growth". Brexit uncertainty has had a dampening effect on UK GDP growth in 2019, especially around mid-year. If there is a no deal Brexit, then it is likely that there will be a cut or cuts in Bank Rate to help support economic growth. The September MPC meeting expressed concern about world growth and the effect that prolonged Brexit uncertainty is likely to have on growth.

Until recent years, world growth has been boosted by increasing globalisation i.e. countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth, and by lowering costs has also depressed inflation. However, the rise of China as an economic superpower over the last thirty years has unbalanced the world economy. The Chinese government has targeted achieving major world positions in specific key sectors and products, and facilitated this by providing massive financial support (such as subsidies) to state owned firms; as well as enforcing government directions on other firms and restrictions on market access by foreign firms. This is viewed as being unfair competition that is putting western firms at an unfair disadvantage or even putting some out of business. China is also regarded with suspicion on the political front as a country that is not averse to using economic and military power for political advantage. The current trade war between the US and China therefore needs to be seen against that backdrop.

It is, therefore, likely that we are heading into a period where there will be a reversal of world globalisation and a decoupling of western countries from dependence on China to supply products. This is likely to produce an environment in the coming years of weak global growth and so weak inflation. As a result, central banks are likely to come under more pressure to support growth by looser monetary policy measures and this will militate against central banks increasing interest rates.

The trade war between the US and China is a major concern to financial markets due to the synchronised general weakening of growth in the major economies of the world, compounded by fears that there could even be a recession looming up in the US, though this is probably overblown. These concerns resulted in government bond yields in the developed world falling significantly during 2019. If there were a major worldwide downturn in growth, central banks in most of the major economies will have limited ammunition available, in terms of monetary policy measures, when rates are already very low in most countries (apart from the US).

Bond Yields / PWLB Rates

There has been much speculation recently that we are currently in a bond market bubble – where bonds are trading above their true worth (fuelled by a belief that no matter how high prices go, someone is likely to pay an even higher price), and that, eventually, this must come to an end. However, given the context that there are heightened expectations the US could be heading for a recession, and a general background of a downturn in world economic growth, together with inflation generally at low levels in most countries and expected to remain subdued, conditions are ripe for low bond yields. While inflation targeting by the major central banks has been successful over the last thirty years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers. This means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last thirty years. Over the last year we have seen many bond yields up to ten years in the Eurozone actually turn negative. In addition, there has at times been an inversion of bond yields in the US whereby ten year yields have fallen below shorter term yields. In the past, this has been a precursor to a recession. The other side of this coin is that bond prices are elevated as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities. However, stock markets are also currently at high levels as some investors have focused on chasing returns in the context of dismal ultra-low interest rates on cash deposits.

In line with bond yield movements, during the last half year there has been a near halving of longer term PWLB rates to completely unprecedented historic low levels. There is however a feeling that financial markets may have gone too far in their fears about the degree of the downturn in US and world growth. If the US only suffers a mild downturn in growth, bond markets in the US are likely to sell off and that would be expected to put upward pressure on bond yields - not only in the US but, due to a correlation between US treasuries and UK gilts, also in the UK. However, forecasting the timing of this and how strong the correlation is likely to be is very difficult to forecast with any degree of confidence.

The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.

In addition, PWLB rates are subject to ad hoc decisions by HM Treasury to change the margin over gilt yields charged in PWLB rates. These changes could be up or down. It is not clear whether, if gilt yields were to rise back up again by over 100bps within the next year or so, if HM Treasury would remove the extra 100 bps margin implemented on 09 October 2019.

Economic and interest rate forecasting remains difficult with so many influences weighing on UK gilt yields and PWLB rates. The above forecasts, (and MPC

decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

3.2. Downside Economic Risks

Apart from the above uncertainties, downside risks to current forecasts for UK gilt yields and therefore PWLB borrowing rates currently include:

- Brexit- if it were to cause significant economic disruption and a major downturn in the rate of growth.
- Bank of England takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the Eurozone sovereign debt crisis. In 2018, Italy was a major concern due to having a populist coalition government which made a lot of anti-austerity and anti-EU noise. However, in September 2019 there was a major change in the coalition governing Italy which has brought to power a much more EU friendly government; this has eased the pressure on Italian bonds. Only time will tell whether this new coalition based on an unlikely alliance of two very different parties will endure.
- Weak capitalisation of some European banks, particularly Italian banks.
- German minority government. In the last German general election, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party. The SPD has done particularly badly in state elections since then which has raised a major question mark over continuing to support the CDU.
- Other minority EU governments. Austria, Sweden, Spain, Portugal, Netherlands and Belgium also have vulnerable minority governments dependent on coalitions which could prove fragile.
- Austria, the Czech Republic, Poland and Hungary now form a strongly anti-immigration bloc within the EU. There has also been rising anti-immigration sentiment in Germany and France.
- In October 2019, the IMF issued a report on the World Economic Outlook which flagged up a synchronised slowdown in world growth. However, it also flagged up that there was potential for a rerun of the 2008 financial crisis, but his time centred on the huge debt binge accumulated by corporations during the decade of low interest rates. This debt is mainly held by the shadow banking sector i.e. pension funds, insurers, hedge funds, asset managers etc., who, faced with corporate and government debt now yielding negative interest rates, have been searching for higher returns in riskier assets. Much of this debt is only marginally

above investment grade so any rating downgrade could force some holders into a fire sale, which would then depress prices further and so set off a downward spiral. The IMF's answer is to suggest imposing higher capital charges on lending to corporates and for central banks to regulate the investment operations of the shadow banking sector. In October 2019, the deputy Governor of the Bank of England also flagged up the dangers of banks and the shadow banking sector lending to corporates, especially highly leveraged corporates, which had risen back up to near pre-2008 levels.

- Geopolitical risks, for example in North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

3.3. Upside Economic Risks

The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates, include:

- Brexit. If agreement was reached all round that removed all threats of economic and political disruption between the EU and the UK.
- The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- UK inflation, whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

4. THE BORROWING STRATEGY 2020-21

4.1. Introduction

The Council borrows to fund the Capital programme, including loans to third parties for policy reasons (such as those to Advance Northumberland and Northumbria Healthcare NHS Foundation Trust etc.). Its capital expenditure plans are therefore the key driver of treasury management activity.

The output of capital expenditure plans is reflected in the Prudential Indicators, as set out in Appendix 13.

4.2. Borrowing Need – Capital Financing Requirement

The Council's long-term borrowing requirement is measured by the Capital Financing Requirement ("CFR"). The CFR represents total historic outstanding capital expenditure which has not yet been paid for from either revenue or cash-backed capital resources (such as grants and capital receipts). The CFR is repaid over time by an annual charge to revenue, known as the Minimum Revenue Provision (MRP). This charge, which is equivalent to depreciation, effectively spreads the cost of debt associated with capital expenditure over the useful economic life of the underlying assets.

At the same time the Council has significant levels of 'cash-backed' balances that are available for investment. Accordingly, the capital financing requirement (or borrowing requirement) need not always be met or funded externally from physical loans: At least in the short term, investment balances can be 'used' in lieu of borrowing externally; by withdrawing investments (in turn foregoing investment income) and instead using the cash to fund part of the borrowing requirement. This is often referred to as 'internal' or 'under' borrowing. Such an approach also has the added benefit of reducing 'counter-party' credit risk in terms of investments; because it reduces the need to place investments with external institutions.

The following tables summarises the forecast CFR movements for the next three financial years (based on the latest capital expenditure plans) along with the anticipated external borrowing over this period; assuming a significant degree on internal borrowing as proposed further below:

CFR Forecast (exc. PFI)	**2020-21 £m**	**2021-22 £m**	**2022-23 £m**
Opening CFR (exc. PFI)	947.762	1,063.141	1,209.002
Increase in CFR (exc. PFI)	115.379	145.861	37.047
Closing CFR (exc. PFI) [Need to Borrow]	**1,063.141**	**1,209.002**	**1,246.049**

External Borrowing Forecast (exc. PFI)	**2020-21 £m**	**2021-22 £m**	**2022-23 £m**
Opening External Borrowing (exc. PFI)	783.981	915.438	1,061.893
Increase in External Borrowing (exc. PFI)	131.457	146.455	38.456
Closing in External Borrowing (exc. PFI)	**915.438**	**1,061.893**	**1,100.349**
Under / (Over) Borrowing	147.703	147.109	145.700

4.3. Proposed Borrowing Strategy

With investment returns anticipated to remain low (at least in the short term), it is proposed to continue with the practise adopted in recent years of wherever possible using investments in lieu of external borrowing – i.e. operating an under-borrowing position.

Whilst the principal strategy of maintaining an under-borrowing position will reduce short term revenue costs, consideration will also be given to weighing the short term advantage of internal borrowing against potential long term costs.

As identified above, by the end of 2020-21 13.89% (£147.703 million) of the Council's borrowing requirement is proposed to be covered by internal borrowing. The effective cost of this 'borrowing' is the foregone investment income. For 2020-21 this is estimated at 0.75% or around £1.168 million (based on the average mid-year internal borrowing position). Taking into consideration the forecast average cost for external borrowing (i.e. average interest rate on actual loans) for 2020-21 of 3.02%, this

equates to a notional saving of 2.27% or around £3.540 million (or alternatively the notional cost of externalisation).

However, it is important to point out that this element of the borrowing requirement is subject to interest rate movements and therefore not without risk. Clearly if investment returns were to increase, or the borrowing had to instead be externalised (and funded by actual loans), the costs associated with this would increase accordingly. In order to identify and quantify this risk a local indicator is included in the Council's Prudential Indicators (see Appendix 13), identifying the level of internal borrowing and the impact of interest rate movements on this proportion of the borrowing requirement.

Despite utilising investments balances to support the borrowing need, as identified above a significant amount of external borrowing will still be required during 2020-21 (estimated at around £225.000 million, after taking into consideration maturing loans of £93.543 million) and going forward to fund the proposed capital programme. Against the above backdrop and the risks within the economic forecast, it is envisaged this requirement will be met primarily from medium to longer term borrowing, whilst interest rates are lower than they are projected to be in the next few years. However, some shorter term/temporary borrowing may also be considered, particularly if the anticipated rates increases do not materialise as quickly as projected.

The Section 151 Officer will however continue to monitor the interest rate market and scrutinise all lending opportunities to ensure borrowing is taken at the most advantageous time and limit the risk of exposure to increased borrowing costs in the future.

For example, if it was felt that there was a significant risk of a sharp rise in long rates than that currently forecast (perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK), then the portfolio position will be re-appraised and consideration given to increased long-term borrowing being drawn down whilst interest rates remain low.

Conversely, if it was felt that there was a significant risk of a sharp fall in rates (perhaps due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowing may be postponed and the potential for rescheduling from fixed rate funding into short term borrowing perhaps considered.

In line with the scheme of delegation set out in the Treasury Management Practices (TMP's, section 10), The Section 151 Officer will continue to approve all borrowing.

4.4. Policy on borrowing in advance of need

While not expected to happen due to the internal/under borrowing policy, the Council does have flexibility to borrow funds this year for use in future years. Where there is a clear business case for doing so, borrowing may be undertaken to fund the approved capital programme or to fund future debt maturities. The Section 151 Officer may do this under delegated power where, for instance, a sharp rise in interest rates is expected, and so borrowing early at fixed interest rates will be economically beneficial.

Risks associated with any advance borrowing activity will be subject to appraisal in advance and subsequent reporting through the mid-year or annual reporting mechanism.

4.5. Debt Rescheduling

As short term borrowing rates are forecast to be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment and in particular the premiums incurred.

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy; and,
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

The Council will monitor the situation and seek advice from Link Asset Services before any rescheduling of debt. All rescheduling will be reported to the Council as part of the in-year treasury management updates.

4.6. Municipal Bond Agency and European Investment Bank

The Municipal Bond Agency, which is currently in the process of being set up, may be in a position to offer loans to local authorities in the near future; perhaps at rates lower than those offered by the PWLB. Consideration may therefore be given to making use of this new source of borrowing as and when appropriate.

Consideration will also be given to borrowing from the European Investment Bank (EIB), where rates can be forward fixed, if this represents better value of money.

5. ANNUAL INVESTMENT STRATEGY 2020-21

5.1. Introduction – Investment Policy

The Council has significant levels of ‘cash-backed’ balances that are available for investment, in the form of General Fund and HRA balances, and the numerous earmarked reserves and provisions.

5.2. Investment Returns Expectations

As outlined in section 3 above and Annex 1, Bank Rate is forecast to increase steadily but slowly over the next few years to reach 1.25% by quarter 1 2023. Against this background, Link Asset Services suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows:

	2020-21	2021-22	2022-23	2023-24	2024-25
Budgeted Rate	0.75%	1.00%	1.25%	1.50%	1.75%

5.3. Investment Strategy

As proposed in section 4 above, it is expected that during 2020-21 a significant proportion of available investment balances will be used as 'internal borrowing' to support the financing of the CFR. As a result, external investments will be limited and may decrease further during the year.

All remaining funds will be invested in-line with the following Investment Policy, which has regard to the MHCLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code").

The overall aim of the Investment Strategy is to provide security of capital and minimise risk while ensuring the Council has sufficient liquidity.

The Council will also aim to achieve the optimum return on its investments commensurate with desired levels of security and liquidity. The risk appetite of the Council is medium, therefore specified and unspecified investments (see below) will be considered. However, security and liquidity will continue to take precedence over yield. All investments will be placed only with organisations which meet the criteria and will always be scrutinised and approved in line with approved Treasury Management Practices (Annex 3).

5.4. Investment objectives

The general policy objective for this Council is the prudent investment of its surplus cash balances, which includes monies borrowed for the purpose of expenditure in the reasonably near future (i.e. over the 3 year medium term planning cycle). The Council's investment priorities are:

- the security of capital;
- the liquidity of its investments; and,
- the achievement of optimum yield.

Security and liquidity of principal have always been the priority, and will continue to be so. In CIPFA's view "The priority is to protect capital rather than maximise return. However, the avoidance of all risk is neither appropriate nor possible and a balance must be struck with a keen responsibility for public money." In times of budget constraints, making the Council's funds work and generate increased returns is becoming increasingly important. CIPFA encourages Local Authorities to look carefully at their Counterparty Lists to ensure return on investments is achieved.

CIPFA recommends that "Responsibility for local authorities investment decisions lies, and must continue to lie with the local authorities themselves". The best authorities:

- explicitly balance risk and reward;
- review and scrutinise policies and procedures regularly;
- have well trained staff and engaged elected members; and,

- use a wide variety of information.

The Credit and Counterparty Criteria List (Annex 2), which has not changed from last year, offers diverse counterparties and takes into account country, sector and group limits.

This list clearly sets out the minimum acceptable credit criteria for organisations with which the Council will place funds.

All investments will be placed only with organisations which meet the criteria and will always be scrutinised and approved in line with approved Treasury Management Practices (Annex 3).

The borrowing of monies purely to invest or lend-on and make a return is unlawful and this Council will not engage in such activity.

5.5. Security of Capital and Creditworthiness (Credit and Counterparty Policy)

In accordance with the above guidance from the MHCLG and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria when determining which organisations it can place investments with. The criteria are set out in Credit and Counterparty Policy which is attached at Annex 2.

The Council regards a key objective of its treasury management activities to be the security of the principal sums it invests. Accordingly, it will ensure that its counterparty policy and limits reflect a prudent attitude towards organisations with which funds may be deposited.

The Council applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from Fitch and Moody's. The credit ratings of counterparties are supplemented with the following overlays:

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

* Credit default swaps (CDS) are a type of insurance against default risk by a particular company/financial institution. In the event of a default, the buyer receives the face value of the bond or loan from the insurer.

The Council is alerted daily of changes to ratings of all three agencies. If a downgrade results in the counterparty no longer meeting the Council's minimum criteria, no new investment will be made. Consideration will also be given to whether or not existing investments will be withdrawn, which is dependent on whether the bank concerned is agreeable.

As with previous practice, ratings and the use of this external service will not be the sole determinant of the quality of an institution. It is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the

economic and political environments in which institutions operate. In addition, the Council will also use market data and market information, information on government support for banks and the credit ratings of that government support.

The assessment will also take account of information that reflects the opinion of the markets. Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

5.6. Types of investments the Council may use

The Council may use various financial instruments for the prudent management of its treasury balances (as listed in the Credit and Counterparty Policy).

The Credit and Counterparty Policy does not identify individual counterparty names in order to ensure that the Section 151 Officer has the flexibility to place investments with the most suitable organisations, which meet the agreed criteria, in a timely manner.

Treasury staff investigates various products and instruments as they become available to see if they meet the Council's investment priorities and criteria list.

In line with the MHCLG Guidance, the Credit and Counterparty Policy categorises investments instruments between 'Specified' and 'Non-Specified' investments:

Specified Investments offer high security and high liquidity. All such investments are:

- in pounds sterling;
- due to be repaid within 12 months or which may be required to be repaid within 12 months;
- not capital expenditure;
- made with high credit quality organisations, (for the purpose of this strategy high credit ratings are "A-" and above for long term and "F2/P-2" and above for short term investments); or,
- made with the United Kingdom Government or local authority (including the North East Combined Authority), parish council or community council.

Non-Specified Investments are those which do not meet the criteria for specified investments and give greater potential risk. The MHCLG does not discourage the use of non-specified investments but states that there is a need for these to be dealt with in more detail.

As in previous years, it is anticipated that the majority of investments will be specified but it is proposed to maintain a maximum of 25% of total Council investments being held in non-specified investments at any one time during the year. This is primarily to allow the use of large, non-rated, building societies as well investments beyond 1 year with other local authorities.

Investments will only be placed with organisations which meet the criteria set out in the approved Credit and Counterparty Policy. Individual investments or aggregate of

investments to one organisation should comply with the monetary limits set out in Credit and Counterparty Criteria List.

Nationalised/part-nationalised banks in the UK have credit ratings which do not comply with the credit criteria used by the Council. However, due to significant Government ownership the Council feels more comfortable applying higher limits for investments.

Investments are to be arranged in line with Treasury Management Practices (Annex 3) and all investments with new counterparties must be approved by the Section 151 Officer or in their absence the Deputy Section 151 Officer or Finance Managers. There is currently no proposed change to this practice.

5.7. Forecast Investment Balances and Liquidity

Based on current reserves and balances forecast, and allowing for the proposed strategy of using some of the investable balances as 'internal borrowing' to support the financing of the CFR (see Section 4), it is anticipated that in 2020-21 the Council's external investment balances will fluctuate throughout the year within a range between £47.000 million and £109.000 million.

To ensure liquidity a minimum of 20% of its overall investments, or £5.000 million, whichever is lower, will be held in liquid accounts. For cash flow generated balances, the Council will seek to utilise its money market funds, call accounts and short-dated deposits (overnight to six months).

As investment rates are forecast to remain low and there is a requirement for liquid funds to support the under-borrowing position, it is envisaged the Council will avoid locking into longer term deals. However, if exceptionally attractive rates are available then they will be considered. Close contact will be maintained with the money market to ascertain the most favourable interest rates on offer to achieve best value from the return on surplus monies available.

Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates.

5.8. Non Treasury Management Investments Defined as Capital Expenditure

In addition to the above standard treasury management activity, the Council also receives interest from two other 'non-treasury' activities; namely the investment shares NIAL Holdings (Newcastle Airport) [£13.527 million] and Advance Northumberland [£4.338 million], and the loans to Newcastle Airport, Northumbria Healthcare NHS Foundation Trust, Advance Northumberland and other organisations.

These non-treasury activities are deemed by Statutory Regulations as capital expenditure and are provided to support Council service objectives and corporate priorities. They are not made or regarded as part of the 'core' treasury management activity - i.e. the investment of surplus cash flow balances, as made under the power to invest inferred by s12 of the Local Government Act 2003. As a result these activities were previously outside of the scope of the Investment Strategy.

The MHCLG's investment guidance recommend that these non-financial or non-core investments should be included within the Annual Investment Strategy.

Whilst it is entirely appropriate to highlight the scope of these activities, there is a view amongst some practitioners that it may be misleading to refer to items of expenditure in the context of an investment strategy, and that a more suitable mechanism to explain and cover these activities would be within the newly re-introduced Capital Strategy.

Due to their nature, it is difficult to assess and consider non-financial or non-core investments in the context of liquidity and security, which arguably does not apply to these activities, at least not in the same way as it does for standard cash investments. Beyond the terms of the underlying agreement, loans to third parties are not liquid and have no need to be. The expenditure is incurred in the support of service objectives and funded from capital resources, which is different to the requirements and policies surrounding management of the Council's investments and cash flows. Similarly, whilst the return of the funds advanced is key, security for third party loans may need to be considered differently to the credit ratings modelling approach utilised for core-treasury investments.

For these reasons, the Council's policy on non-financial or non-core investments, specifically the loans to third parties, is covered separately within the Capital Strategy document which is considered and approved by Council at its budget setting meeting in February, and is attached at Appendix 11.

A summary of value of loans to third parties and the interest expected to be received is summarised below:

Borrower	**Estimated Balance at 1 Apr 2020 £m**	**Weighted Average Interest Rate**	**Forecast Interest Income 2020-21* £m**
Northumbria Healthcare NHS Foundation Trust	117.980	3.8%	4.229
Advance Northumberland Group	287.118	5.0%	14.531
Newcastle Airport	11.916	8.6%	1.025
North East Local Enterprise Partnership	8.374	2.1%	0.190
Northumberland College	6.890	4.4%	0.303
Northumberland Aged Miners	1.719	3.5%	0.060
Cramlington Town Council	0.316	4.0%	0.012
Active Northumberland	0.298	3.3%	0.009
Newcastle City Council	0.223	5.0%	0.011
Alnwick Juniors	0.184	1.5%	0.003
Arts Groups (The Maltings, Alnwick Playhouse, Queen's Hall)	0.139	3.8%	0.005
Calvert Trust	0.098	2.1%	0.002

Alnwick Youth Hostel	0.097	2.1%	0.002
Haltwhistle Pool	0.096	2.1%	0.002
Other Parish/Town Councils and Housing Associations	0.070	11.9%	0.008
Alexa's Animal Charity	0.148	2.4%	0.004
Total	**435.666**	**4.7%**	**20.396**

*Note: the above includes forecast advances to be made.

The Medium Term Capital Programme for 2020-21 to 2022-23 includes a provision of £53.264 million for further loans to Advance Northumberland and other third parties, plus an additional £7.339 million for loans to the North East Local Enterprise Partnership in respect of Enterprise Zone investments (which will ultimately be repaid by future business rate increases).

Whilst the income from these advances is significant, the intention is largely only to cover the associated underlying borrowing costs to the Council. The loans are considered and approved to support the Council's service and policy objectives not to generate a financial return for the Council.

5.9. Provision for credit related losses

If any of the Council's investments appear at risk of loss due to default (i.e. a credit-related loss, and not one resulting from a fall in price due to movements in interest rates) the Council will make revenue provision of an appropriate amount.

6. HOUSING REVENUE ACCOUNT (HRA) TREASURY MANAGEMENT COSTS

6.1. Overview

Following implementation of the HRA self-financing reforms in April 2012, a separate pool of specific loans is now maintained for the HRA. The interest costs associated with these loans are charged direct to the HRA. This arguably negates the need for the former HRA Item 8 charge; which allocated a share of the Authority's overall borrowing costs to the HRA.

For the most part, the HRA will aim to ensure that new loans are taken out (or repaid) to match any anticipated movement in its borrowing requirement - known as the HRA Capital Financing Requirement (HRA CFR). There will however be instances during the year when the balance of the HRA loan pool - i.e. actual external borrowing charged to the HRA does not equate exactly to the HRA CFR. In such circumstances the HRA is borrowing from (or lending to) the General Fund and an additional charge (or credit) is necessary in order to reflect the notional cost of this imbalance. The Council's proposed policy for this arrangement is as follows, the policy remains unchanged from the previous year:

6.2. Policy for HRA Under and Over Borrowing

HRA Under-Borrowing

Where the weighted average balance of the HRA (external) loans pool is less than the weighted average HRA CFR for the same period, notional interest will be charged to the HRA at the average rate of interest for 30 year PWLB borrowing for the period.

HRA Over-Borrowing

Where the weighted average balance of the HRA (external) loans pool is greater than the weighted average HRA CFR for the same period, notional interest will be paid to the HRA at the average 3 month London Interbank Bid (LIBID) rate for the period.

6.3. Other Treasury Management Charges to HRA

As under the former Item 8 arrangements, the HRA will continue to receive interest (or investment income) on its weighted average balances for the year, based on the Council's overall average investment rate.

The HRA will also continue to be charged a proportion of the authority's overall debt management expenses (based on the CFR proportions), as well its share of any historic premiums or discounts associated with the premature repayment of borrowing. Any future/new premiums or discounts will be met fully by the relevant fund of the underlying loan – i.e. premiums or discounts related to loans within the HRA loan pool will be charged fully to the HRA, and vice versa.

7. PRUDENTIAL INDICATORS and TREASURY LIMITS 2020-21 to 2022-23

The Council's capital expenditure plans are the key driver for treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members to overview and confirm capital expenditure plans.

Councils are required to approve a set of Prudential Indicators for the new financial year and adhere to these indicators during the course of that year. The indicators are to be set on a rolling basis, for the forthcoming financial year and two successive financial years. Prudential Indicators for 2020-21 to 2022-23 are set out in Appendix 13.

8. THE ANNUAL MINIMUM REVENUE PROVISION POLICY STATEMENT

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision (MRP)), although it is also allowed to make additional voluntary payments if required.

MHCLG Regulations have been issued which requires Full Council to approve an MRP policy in advance of each year. A variety of options are provided to councils, with an overarching requirement there is a prudent provision.

MHCLG revised their MRP guidance in 2018. However, none of the amendments impact on the Council's current or proposed policy.

The 2020-21 policy is unchanged from that approved for 2019-20.

The Council is recommended to approve the Annual Minimum Revenue Provision Policy Statement including Additional Voluntary Provision as detailed within Appendix 14.

9. POLICY ON USE OF EXTERNAL SERVICE PROVIDERS

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon the services of our external service providers. All decisions will be undertaken with regard to all available information, including, but not solely, the Council's treasury advisers.

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 the appointment and the methods by which their value will be assessed are properly agreed and documented, and subject to regular review.

The Council uses Link Asset Services Ltd as its treasury management consultant. The company provides a range of services which include:

- Technical support on treasury matters, capital finance issues and templates of Member reports;
- Economic and interest rate analysis;
- Debt services which include advice on the timing of borrowing;
- Debt rescheduling advice surrounding the existing portfolio;
- Generic investment advice on interest rates, timing and investment instruments; and,
- On line up to date credit ratings.

10. IMPLEMENTATION OF THE TREASURY MANAGEMENT STRATEGY, SCHEME OF DELEGATION, TRAINING AND REPORTING REQUIREMENTS

10.1. Implementation of the Treasury Management Strategy

The continued implementation of the above strategy and procedures is the responsibility of the Section 151 Officer, who is authorised to arrange the necessary borrowings within the limits set out in the Prudential Indicators, and necessary investments as set out in the investment strategy.

Northumberland County Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to Cabinet.

The Council nominates Audit Committee to be responsible for ensuring effective scrutiny of the Treasury Management Strategy and policies.

There are no proposed changes to this methodology.

10.2. Treasury Management Practices (TMPs)

Treasury Management Practices (Annex 3) set out the manner in which the Council will seek to achieve the treasury management policies and objectives. The Council has adopted the recommended form of words defining the Council's treasury management practices (TMPs), in compliance with CIPFA's Treasury Management in the Public Services: Code of Practice and the Prudential Code for Capital Finance in Local Authorities. These set out the specific details of the systems to be employed and the records to be maintained.

These practices are as follows:

TMP1 Credit and Counterparty Risk management;

TMP2 Best value and performance measurement;

TMP3 Decision-making and analysis;

TMP4 Approved instruments, methods and techniques;

TMP5 Organisation, clarity and segregation of responsibilities, and dealing arrangements;

TMP6 Reporting requirements and management information;

TMP7 Budgeting, accounting and audit arrangements;

TMP8 Cash and cash flow management;

TMP9 Money laundering;

TMP10 Training and qualifications;

TMP11 Use of external service providers; and,

TMP12 Corporate governance.

There are no proposed changes to these practices.

10.3. Responsible Officers

Daily treasury management activities will be undertaken by a Senior Accountant within the Corporate Finance team, as set out in TMP5. If they are absent a Principal Accountant within the Corporate Finance team will undertake these activities.

The three annual Treasury Management reports submitted to Cabinet and Council will be produced by the Technical Accountant.

The Finance Manager will ensure all treasury management activities are made in accordance with agreed policies and practices.

10.4. Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. Members received training in October 2018 and further training will be arranged as required.

The training needs of treasury management officers are periodically reviewed. Each officer concerned will receive appropriate training and guidance on their duties and the constraints within which they operate.

10.5. Reports and Monitoring

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, reports need to be submitted to full Council which need to be reviewed by Members of the Council in both Cabinet and Scrutiny functions.

The adequacy of the strategy statement will be monitored and reports requesting amendments to the statement will be produced when changes are thought to be necessary. The changes will be made in consultation with the Cabinet Portfolio holder for Corporate Services, whose role relates to the strategy and associated risks. Any strategy changes will be reported to the Audit Committee.

The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of polices, estimates and actuals. The following reports are required to be adequately scrutinised by Audit Committee before being recommended to the Council.

Treasury Management Strategy Statement

The first, and most important report covers:

- the capital plans (including prudential indicators);
- a Minimum Revenue Provision Policy (how residual capital expenditure is charged to revenue over time);
- the Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury indicators; and,
- an investment strategy (the parameters on how investments are to be managed).

A Mid-Year Treasury Management Report

This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury activity is meeting the strategy or whether any policies require revision.

An Annual Treasury Report

This provides details of prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

It is proposed that the Council follow reporting arrangements in accordance with the requirements of the revised Treasury Management Code of Practice.

Area of Responsibility	Council/ Committee/ Officer	Frequency

Scrutiny of treasury management strategy	Audit Committee or Risk Appraisal Panel	Annually before the start of the year
Treasury Management Strategy / Annual Investment Strategy / MRP policy and Treasury Management Practices	Cabinet / Full Council	Annually before the start of the year
Annual Treasury Outturn Report	Cabinet / Full Council	Annually by 31 July after the end of the year
Treasury Management Budget Monitoring Reports	Incorporated within the Budget Monitoring report and reported separately to Scrutiny Committee	Quarterly
Scrutiny of treasury management performance	Audit Committee	As required
Updates or revisions to Treasury Management Strategy / Annual Investment Strategy / MRP policy	Cabinet / Full Council	Ad- hoc

The policies and strategies set out in this document will ensure that the management and administration of treasury management will be robust, rigorous and disciplined.

The procedures for monitoring treasury management activities through audit, scrutiny and inspection will be applied with an openness of access to information and provide well-defined arrangements for review and implementation of changes.

Implications

Policy	The report sets out the Treasury Management Policy Statement for 2020-21, and is consistent with "We want to be efficient, open and work for everyone" priority included in the Council's Corporate Plan 2018-21.
Finance and value for money	The financial implications of the 2020-21 investment and borrowing transactions have been taken into account within the revenue budget for 2020-21 and Medium Term financial Plan 2020-22. Northumberland County Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving best value in treasury management within the context of effective risk management, and to employing suitable performance measurement techniques, for example comparison with other members of the CIPFA and Link benchmarking clubs.
Legal	The Local Government Act 2003 (the Act) and supporting regulations requires the Council to 'have regard to' the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code and the CIPFA Treasury Management Code of Practice, 2017.
Procurement	There are no direct procurement implications for the County Council.
Human Resources	There are no direct staffing implications for the County Council.
Property	There are no direct property implications for the County Council.
Equalities (Impact Assessment attached) Yes ☐ No ☐ N/A ☐	Not applicable for the County Council.

Risk Assessment	The report highlights the principal financial risks within the Treasury Management function. The identification, monitoring and control of risk are the prime criteria by which the effectiveness of the County Council's Treasury Management activities will be measured. Accordingly, the analysis and reporting of Treasury Management activities will focus on their risk implications for the Council. The investment priority is security and liquidity rather than yield, which is a secondary aim.
Crime & Disorder	There are no Crime and Disorder implications for the County Council.
Customer Consideration	There are no Customer Considerations for the County Council.
Carbon reduction	There are no specific Carbon Reduction implications within this report.
Health and Wellbeing	There are no Health and Wellbeing implications for the County Council.
Wards	All divisions.

Background Papers:

CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance notes 2017.

CIPFA Prudential Code for Capital Finance in Local Authorities 2017.

Guidance on Local Government Investments The Local Government Act 2003,

Local Authorities (Capital Finance and Accounting) Regulations 2012 (S.I.2012/265)

List of Appendices

Appendix 1 – Economic Forecasts

Appendix 2 – Credit and Counterparty Criteria Policy

Appendix 3 – Treasury Management Practices

Appendix 4 – Prudential Indicators

Appendix 5 – Minimum Revenue Provision Policy

Appendix 6 – Capital Strategy

Report sign off:

	Name
Monitoring Officer/Legal	Liam Henry
Executive Director of Finance and S151 Officer	Chris Hand
Relevant Executive Director	Alison Elsdon
Chief Executive	Daljit Lally
Portfolio Holder(s)	Nick Oliver

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