Treasury Management Strategy 2021 to 2022

CHELTENHAM
BOROUGH COUNCIL

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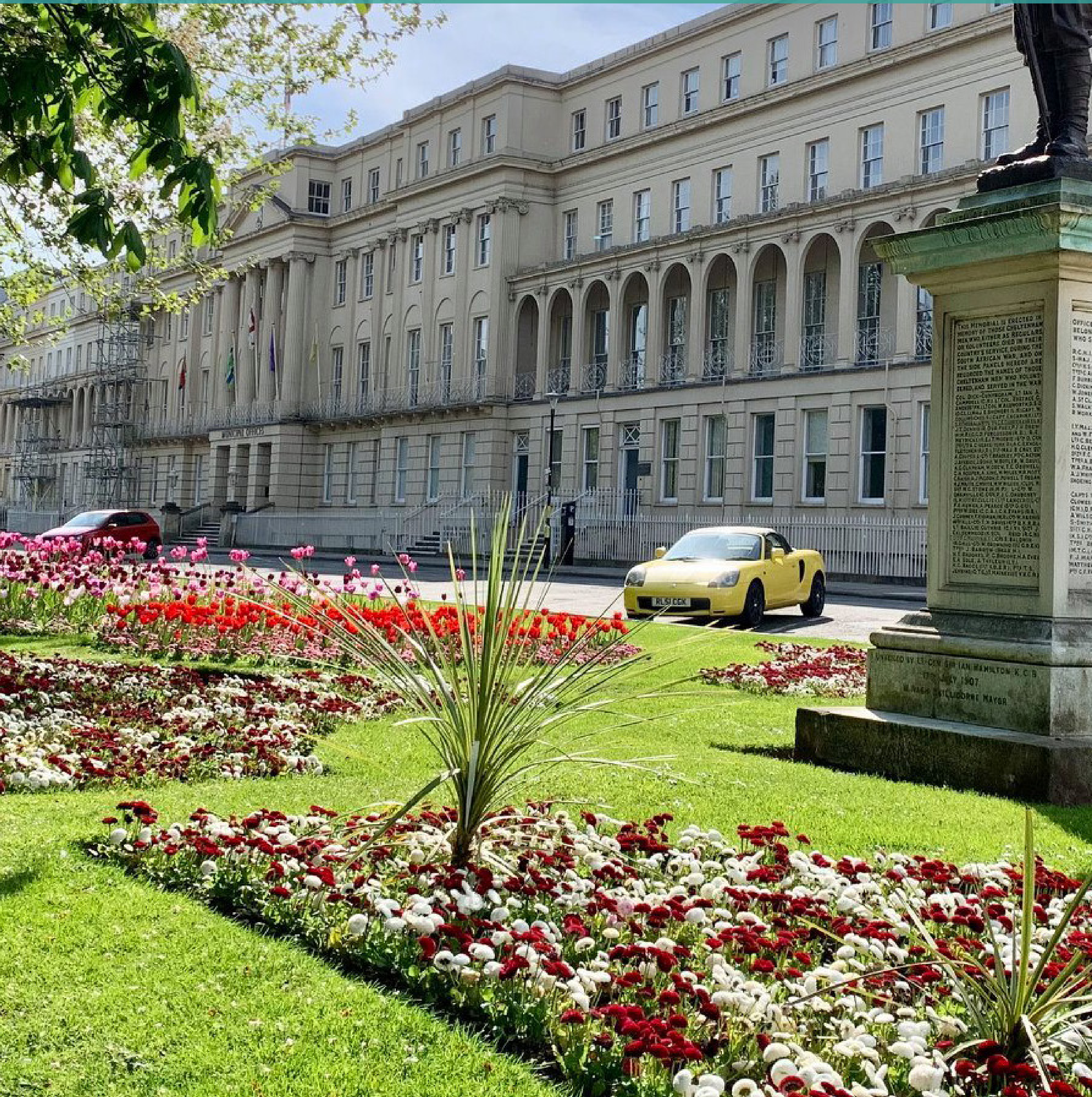

1. Introduction

1.1 - Treasury management is the management of the Authority's cash flows, borrowing and investments, and the associated risks. Treasury risk management at the Authority 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 Authority to approve a treasury management strategy before the start of each financial year. This report fulfils the Authority's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

1.2 - The Council's Treasury Management Strategy forms a key part of our overall Corporate Planning Framework. It provides a mechanism by which our treasury management decisions can be aligned with our over-arching corporate priorities and objectives over a medium term planning horizon.

1.3 - The Strategy has direct links to the Council's Asset Management Strategy, Commercial Strategy, Capital Strategy and Investment Strategy and forms a key part of the Council's Medium Term Financial Strategy (MTFS) as presented below:

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2. Purpose of this Strategy

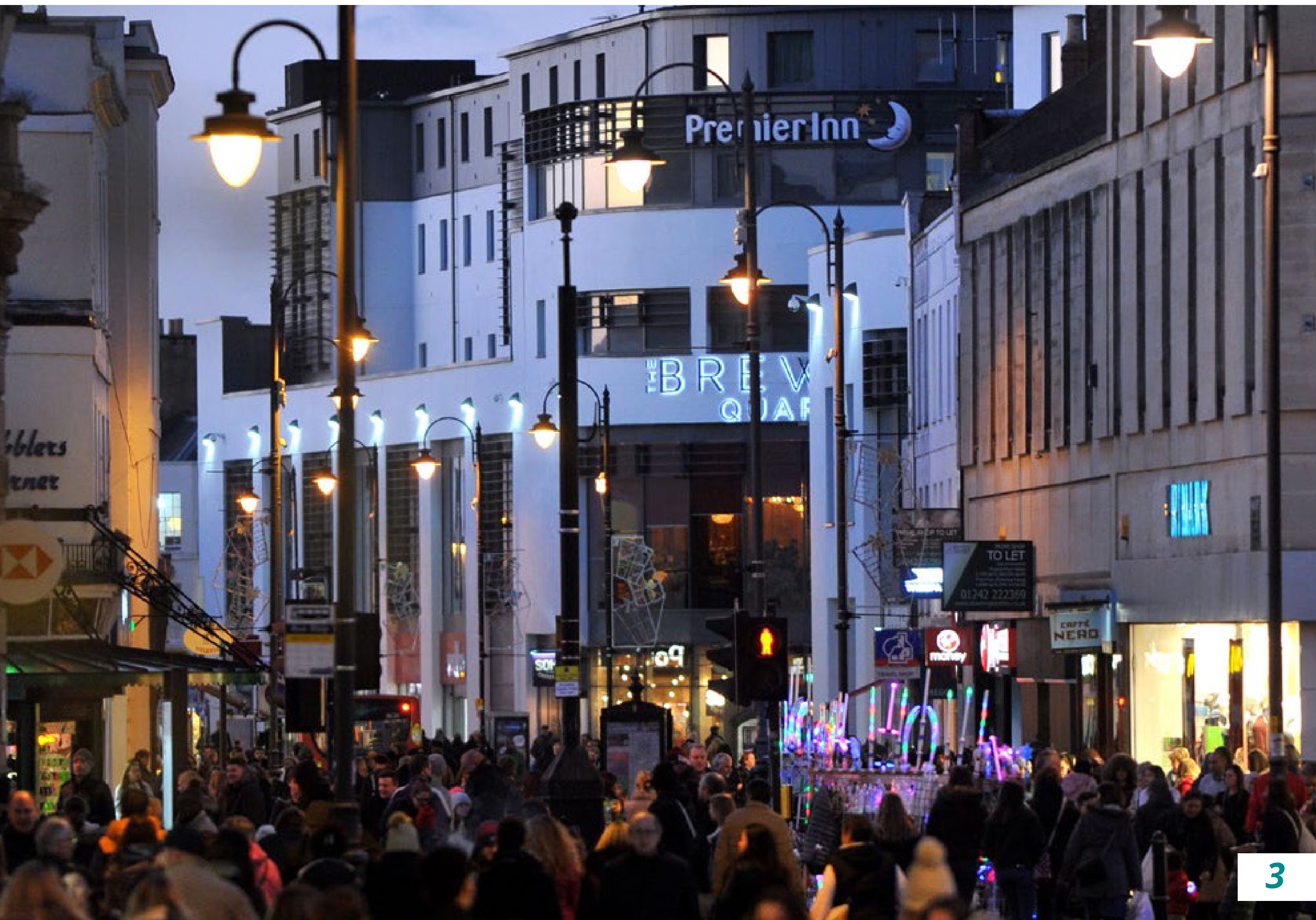
2.1 - Our 2021/22 Treasury Management Strategy has been developed with a focus on working with our partner organisations to lead in future place shaping, investment and regeneration in Cheltenham.

2.2 - The key aims of this document are:

- To outline how we invest our money to ensure we have the financial resources to support the key priorities outlined in the 2019-2023 Corporate Plan and to support the recovery of the town after Covid-19 (see Section 3 and 4, page 4).

- To set out the key principles on which our borrowing and investment decisions are made, including how security and risk have been assessed in the development of our investments (See Section 5, page 8).

- To present the arrangements for managing and monitoring our treasury management decisions, including assessment of outcomes and the continual alignment to our Corporate Plan (See Section 6, page 15).



3. Why we invest our money

3.1 - 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 directly support local public services by lending to other organisations **(service investments)**, and
- to invest in community led and sustainable place shaping, regeneration and economic development of our town **(known as growth investments)**.

Our Investment Strategy outlines the principles and arrangements in place for the second two categories of investment. This strategy focuses on our approach to the first category.

4. How we borrow money

Our Borrowing

4.1 - At 31 March 2021, we are forecast to hold £173.425m of borrowing. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR). The net borrowing can be reduced from this total through the use of reserves and working capital.

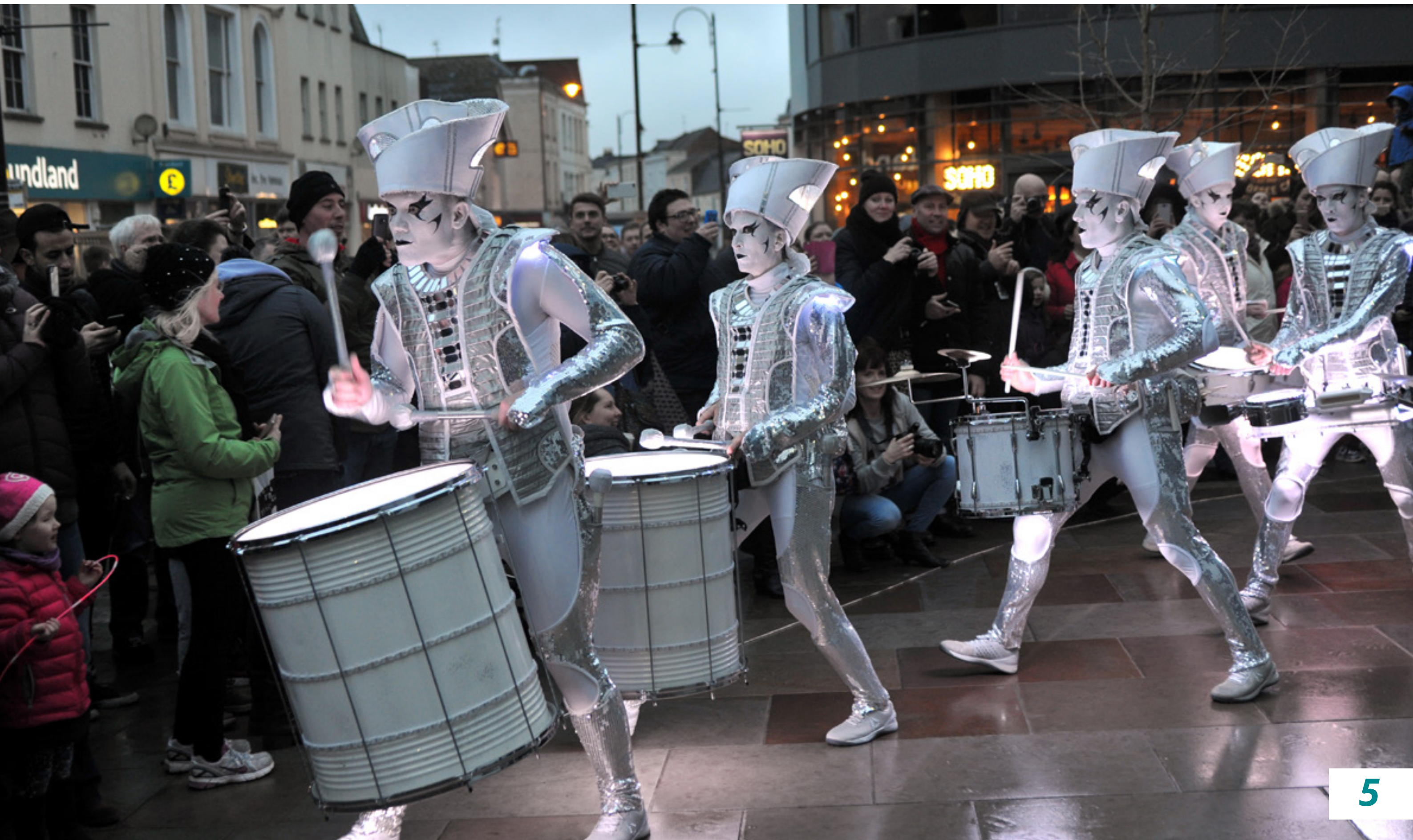
4.2 - CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Authority's external borrowing should be lower than its highest forecast CFR over the following three years.

4.3 - 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 that cash and investment balances are kept to a minimum level of £10m at each year-end to maintain sufficient liquidity but minimise credit risk.

4.4 - The total forecast net borrowing against the CFR and liability benchmark is set out in the table below for the period of the Medium Term Financial Strategy.

	31.3.20 Actual £m	31.3.21 Estimate £m	31.3.22 Forecast £m	31.3.23 Forecast £m	31.3.24 Forecast £m
General Fund CFR	121.344	119.588	117.264	114.871	117822
Housing (HRA) CFR	56.246	59.051	74.547	88.142	107.232
Total CFR	177.59	178.639	191.811	203.013	225.054
Less: External borrowing	(184.951)	(173.425)	(192.031)	(200.605)	-203.402
Less: Usable reserves	(23.529)	(25.134)	(24.634)	(24.134)	(23)
Less: Working capital	(5.692)	(1.5)	(1.5)	(1.5)	(1.5)
Investments/ (New Borrowing)	36.582	21.42	28.268	19.623	2.848
Net Borrowing Requirement	148.369	152.005	163.763	180.982	200.554
Preferred year-end position Investments	10	10	10	10	10
Liability Benchmark (year-end)	158.369	162.005	173.763	190.982	210.55

4.5 - The increase in external borrowing is because of the significant investments planned within the HRA capital programme to deliver on our affordable housing target which will require an increase in borrowing. Further information on our borrowing and the relevant indicators for measuring borrowing are included in the 2021/22 Capital Stategy.



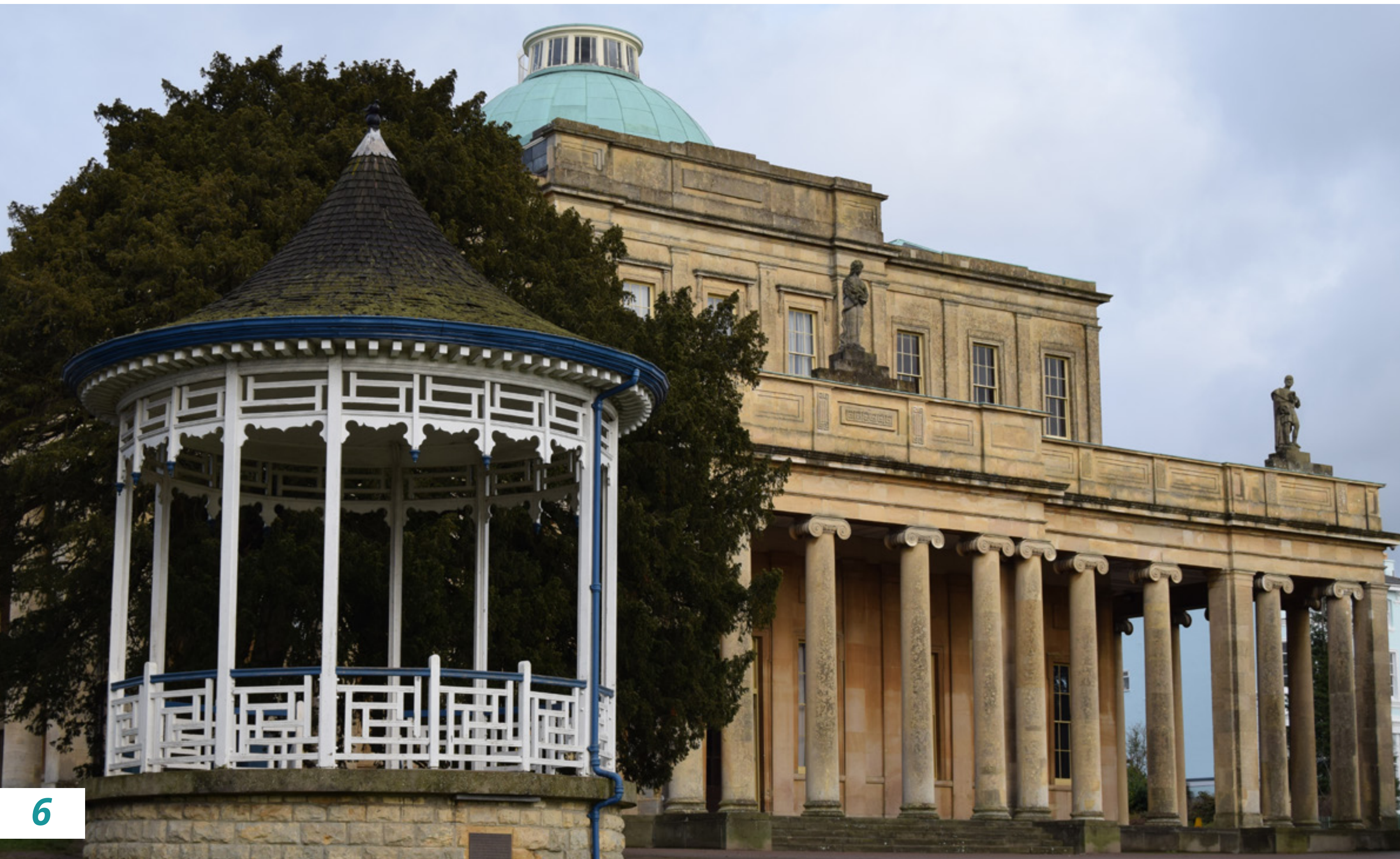
Our Borrowing Strategy

4.6 - The Authority'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 Authority's long-term plans change is a secondary objective.

4.7 - Given the significant cuts to public expenditure and in particular to local government funding, the Authority'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.

4.8 - By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal or 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. Ongoing monitoring may determine whether the Authority 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.

4.9 - Alternatively, the Authority may arrange forward starting loans during 2021/22, 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. The Authority may also borrow short-term loans to cover unplanned cash flow shortages.



Sources of borrowing

The main sources of approved long-term and short-term borrowing for Cheltenham Borough Council are:

HM Treasury's PWLB lending facility (formally the Public Works Loan Board): The Authority has previously raised the majority of its long-term borrowing from the PWLB but will consider long-term loans from other sources including banks, pensions and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Authority intends to avoid this activity in order to retain its access to PWLB loans.

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

LOBOs: The Authority holds £7m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. £2m of these LOBOS have options during 2021/22, and although the Authority understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. Also this loan is due to mature in 2024. The Authority will take the option to repay LOBO loans at no cost if it has the opportunity to do so.

Short-term and variable rate loans: These loans leave the Authority exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators. However the use of short term loans is currently very favourable as borrowing costs are close to zero percent , and Arlingclose predict interest rates to remain at this levels for several years.

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 Authority 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.

5. How we invest money

Our Borrowing

5.1 - The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Authority's investment balance has averaged from as high as £57m and as low as £14m over the last twelve months. On 31 December 2020, we held £20.265m of treasury investments which are outlined in the table below.

	31st December 2020 Actual Portfolio £m	31st December 2020 Average Rate %
Treasury investments:		
Glos Airport-Revolving credit facility	1.050	3.10
Glos Airport – Sub Station loans	0.165	2.00
Cheltenham Borough Homes	1.605	2.40
Money Market Funds/Call Accounts	10.445	0.04
Other pooled funds		
CCLA Property Investment management	3.000	3.91
CCLA Diversified Income	2.000	3.31
Schroders Unit Trusts Ltd	2.000	4.48
Total treasury investments	**20.265**	**1.71%**

5.2 - By the end of the 2020/21 financial year, it is forecast that our investment balance will reduce to £17m split as follows between short and longer term holdings.

	31.3.2020 actual £000	31.3.2021 forecast £000	31.3.2022 budget £000	31.3.2023 budget £000	31.3.2024 budget £000
Near-term investments	11,536	9,000	9,000	9,000	9,000
Longer-term investments	8,000	8,000	8,000	8,000	8,000
TOTAL	19,536	17,000	17,000	17,000	17,000

Table 8: Treasury management investments

Our Treasury Management Investment Strategy

5.3 - The Council's policy on treasury investments, in line with the CIPFA Code, is to prioritise security and liquidity over yield; that is to focus on minimising risk rather than maximising returns. Cash that is likely to be spent in the near term is invested securely, for example with the government, other local authorities or selected high-quality banks, to minimise the risk of loss. Money that will be held for longer terms is invested more widely, including in bonds, shares and property, to balance the risk of loss against the risk of receiving returns below inflation. Both near-term and longer-term investments may be held in pooled funds, where an external fund manager makes decisions on which particular investments to buy and the Council may request its money back at short notice. Where balances are expected to be invested for more than one year, the Authority 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.

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

5.5 - Given the increasing risk and very low returns from short-term unsecured bank investments, we aim if possible to diversify into more secure and/or higher yielding asset classes during 2021/22. The majority of the Authority's surplus cash is invested in bank instant liquidity accounts and money market funds. This diversification will represent a change in strategy over the coming year.

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

5.7 - The Authority may invest its surplus funds with any of the counterparty types in the table below, subject to the cash limits (per counterparty) and the time limits shown.

Credit rating	Banks unsecured	Banks secured	Banks secured	Corporates	Registered Providers
UK Govt	n/a	n/a	n/a	n/a	n/a
AAA	£6m 5 years	£6m 20 years	£6m 20 years	£5m 20 years	£5m 20 years
AA+	£6m 5 years	£6m 10 years	£6m 10 years	£4m 10 years	£5m 10 years
AA	£6m 4 years	£6m 5 years	£6m 5 years	£4m 5 years	£5m 10 years
AA-	£6m 3 years	£6m 4 years	£6m 4 years	£3m 4 years	£5m 10 years
A+	£6m 2 years	£6m 3 years	£6m 3 years	£3m 3 years	£5m 5 years
A	£6m 13 months	£6m 2 years	£6m 2 years	£3m 2 years	£3m 5 years
A-	£6m 6 months	£6 13 months	£6m 13 months	£2m 13 months	£3m 3 years
None	£2m 6 months	£2m 6 months	£2m 6 months	n/a	n/a
MMF Pooled funds	£5m per MMF and Pooled Fund manager				

Table 2: Approved investment counterparties and limits

5.8 - Treasury investments whose lowest published long-term credit rating is no lower than A-. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

Bank & Building Society 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.

Bank & Building Societies secured: Investments secured on the borrower's assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments.

Government: Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. 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

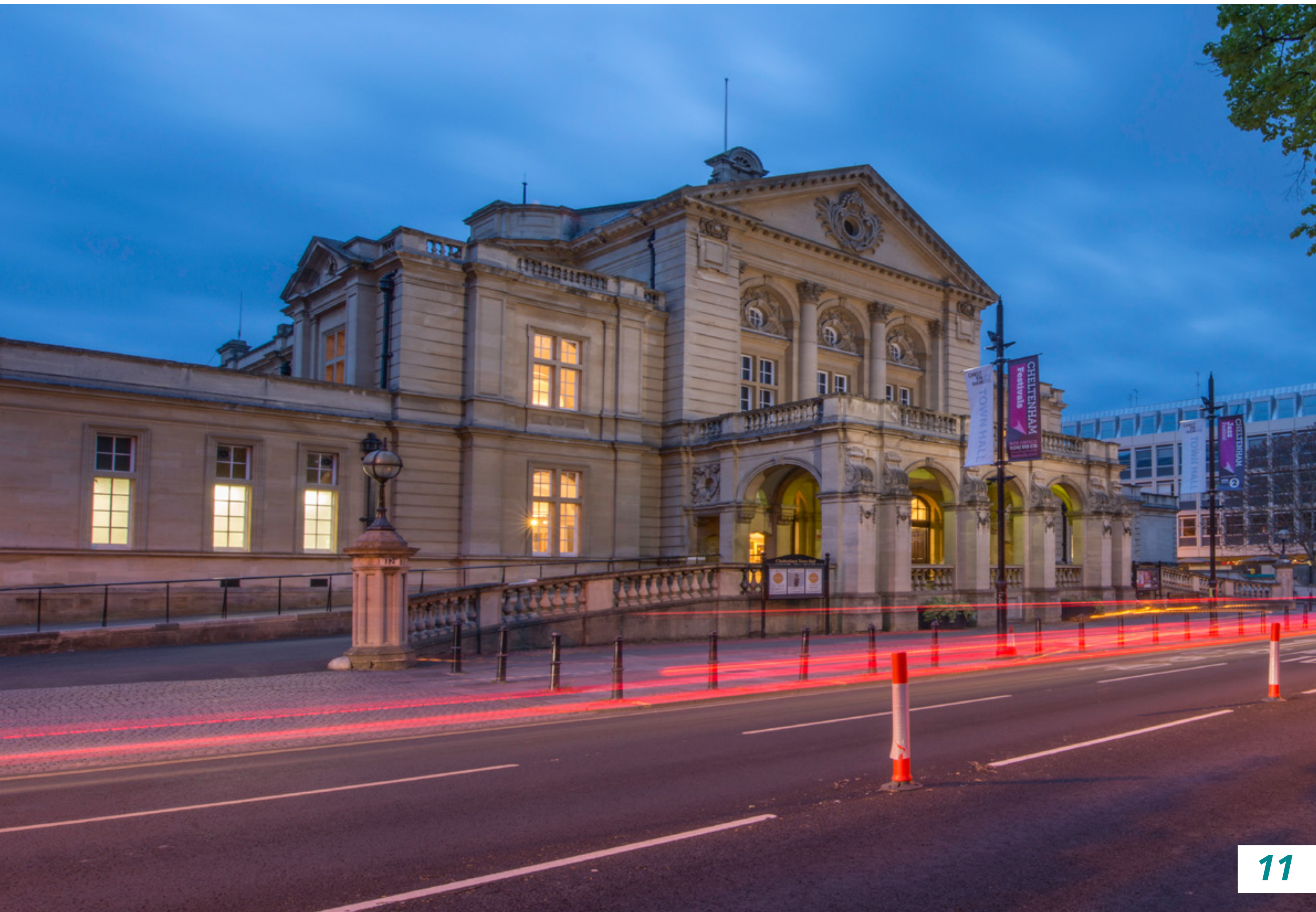
Corporates: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made either following an external credit assessment as part of a diversified pool in order to spread the risk widely.

Registered providers: Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing, formerly known as housing associations. These bodies are tightly regulated by the Regulator of Social Housing (in England) and, as providers of public services; they retain the likelihood of receiving government support if needed.

Money Market funds: Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the Authority will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

Strategic pooled funds: Bond, equity and property funds that offer enhanced returns over the longer term but are more volatile in the short term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.

Real estate investment trusts: Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.



Operational bank accounts

The Council banks with Lloyds (Lloyds Banking Group). On adoption of this Strategy, it will meet the minimum credit criteria of A- (or equivalent) long term. It is the Councils intention that even if the credit rating of Lloyds Bank falls below the minimum criteria A- the bank will continue to be used for short term liquidity requirements (overnight and weekend investments) and business continuity arrangements.

Policy investments - Over the years the Authority has provided cash-flow cover for a number of third-party organisations linked to the Authority. The following limits are set for 2021/22:

- Cheltenham Festivals — £100k up to one year duration
- Gloucestershire Everyman Theatre — £100k up to one year duration
- Gloucestershire Everyman Theatre — £350k Non specified duration
- Ubico Limited — £500k up to one year duration
- Cheltenham BID — £100k up to one year duration
- The Cheltenham Trust — £100k up to one year duration
- Publica Group — £100k up to one year duration
- Cheltenham Borough Homes — £97m Non-specified duration*
- Cheltenham Borough Homes — £10m Equity Non- Specified duration**
- Cheltenham Borough Homes — £500k up to one year
- Gloucestershire Airport Limited — £9m up to one year
- Gloucestershire Airport Limited — £7.250m Non-specified duration
- Folk2Folk (Peer to Peer lending) — £575k Non-specified duration***

*Cheltenham Borough Homes is looking to borrow £90m and a further **£10m Equity Investment from the council to assist in three areas over the coming years to provide substantial new housing in the town by providing Private Rented Sector (PRS) housing, purchasing 106 sites and building new homes. The drawdown of the loans will be over a period of 40 years.

***Folk2Folk is a peer to peer lending platform in which the council can lend to support local, rural and entrepreneurial businesses. The investment limit was £75,000 in 2020/21, which is to be increased in 2021/22. The Chief Finance Officer after consultation with members of the Treasury Management Panel / Cabinet would like to increase this to £575,000 with a capped limit of £100,000 per loan application, up to a maximum of 5 years. Interest rates earned can be between 4.5% and up to 9% per annum.

Renewable Energy investments

Over recent years significant investments from Local Authorities in the Renewable Energy markets has occurred by way of investing in an energy bond. Currently the council has approved the use of Corporate Bonds and has used them on a regular basis but only for a maximum of two years previously. To be able to potentially invest in Green Renewable energy recommendation was made following consultation with members of the Treasury Management Panel on the 5th June 2017 and approved by Council on 24 July 2017 that up to £2m in relation to Green Investment bonds can be invested up to five years.

Monitoring our Treasury Management Investments

5.9 - Credit ratings are obtained and monitored by the Authority's treasury advisers, who will notify changes in ratings as they occur. The credit rating agencies in current use are listed in the Treasury Management Practices document. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

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

5.10 - 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.

5.11 - The Authority 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 and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

5.12 - 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 Authority 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 Authority's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

5.13 - In order to monitor this, we have set cash limits on the credit quality of the investments.

	Cash limit
Total long-term investments	£15m
Total investments without credit ratings or rated below A- (except UK Government and local authorities)	£10m
Total investments (except pooled funds) with institutions domiciled in foreign countries rated below AA+	£10m

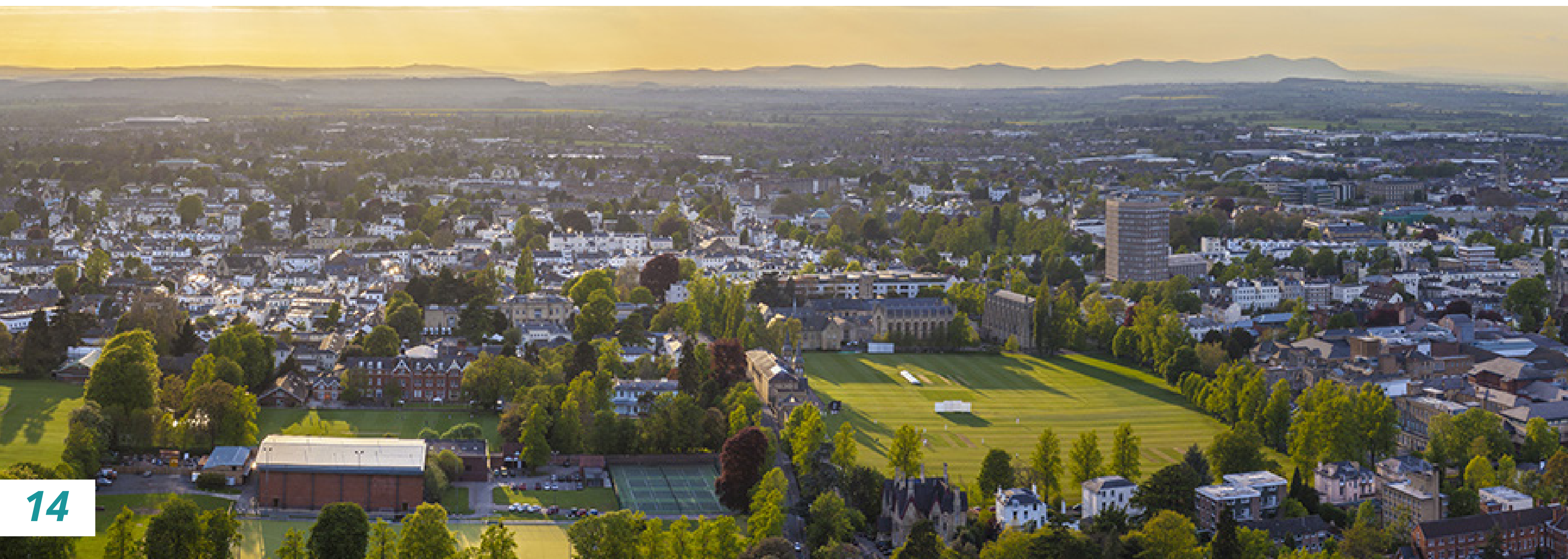
Investment Limits

5.14 - The Authority's revenue reserves available to cover investment losses are forecast to be £25 million on 31st March 2021. In order that no more than 25% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £6 million. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

	Cash limit
Any single organisation, except the UK Central Government	£6m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£6m per group
Any group of pooled funds under the same management	£5m per manager
Foreign countries	£4m per country
Registered providers	£5m in total
Unsecured investments with building societies	£5m in total
Loans to unrated corporates – Renewable Energy	£4m in total-£2m max in each
Money Market Funds	£15m in total

Table 4: Investment limits

5.15 - The Authority uses purpose-built 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 Authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Authority's medium term financial plan and cash flow forecast.



6. Treasury Management Indicators

6.1 - The Authority measures and manages its exposures to treasury management risks using the following indicators.

6.2 - **Security:** The Authority 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.

	Target
Portfolio average credit rating	A

6.3 - **Interest rate exposures:** This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed will be:

	2021/22	2022/23	2023/24
Upper limit on fixed interest rate exposure	100%	100%	100%
Upper limit on variable interest rate exposure	75%	75%	75%

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

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

	Upper	Lower
Under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and within 20 years	100%	0%
20 years and within 30 years	100%	0%
30 years and within 40 years	100%	0%
40 years and above	100%	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.

6.5 - **Principal sums invested for periods longer than 364 days:** The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

	2021/22	2022/23	2023/24
Limit on principal invested beyond year end	£12m	£12m	£12m

7. Other items

There are a number of additional items that the Authority is obliged by CIPFA or MHCLG to include in its Treasury Management Strategy.

7.1 - Policy on the use of financial derivatives

Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

The Authority will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Authority is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

7.2 - Policy on apportioning interest to the HRA

On 1st April 2012, the Authority notionally split each of its existing long-term loans into General Fund and HRA pools. In the 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 each year and interest transferred between the General Fund and HRA at the Authority's average interest rate on investments, adjusted for credit risk.

7.3 - Markets in Financial Instruments Directive

The Authority 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 Authority's treasury management activities, the Chief Financial Officer believes this to be the most appropriate status.

7.4 - Investment training

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

Officers regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA.

7.5 - Investment advisers

The Authority appointed Arlingclose Limited as treasury management advisers for three years plus the option for a further two years after a joint tender with Gloucestershire County Council, South Gloucestershire Council and the Forest of Dean District Council back in December 2017. The option was taken up for a further two years. The Authority receives specific advice on investment, debt and capital finance issues.

7.6 - Investment of money borrowed in advance of need

The Authority may, from time to time, borrow in advance of need, where this is expected to provide the best long-term value for money. Since amounts borrowed will be invested until spent, the Authority is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Authority's overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit of £317m. The maximum period between borrowing and expenditure is expected to be two years, although the Authority is not required to link particular loans with particular items of expenditure.

7.7 - Financial Implications

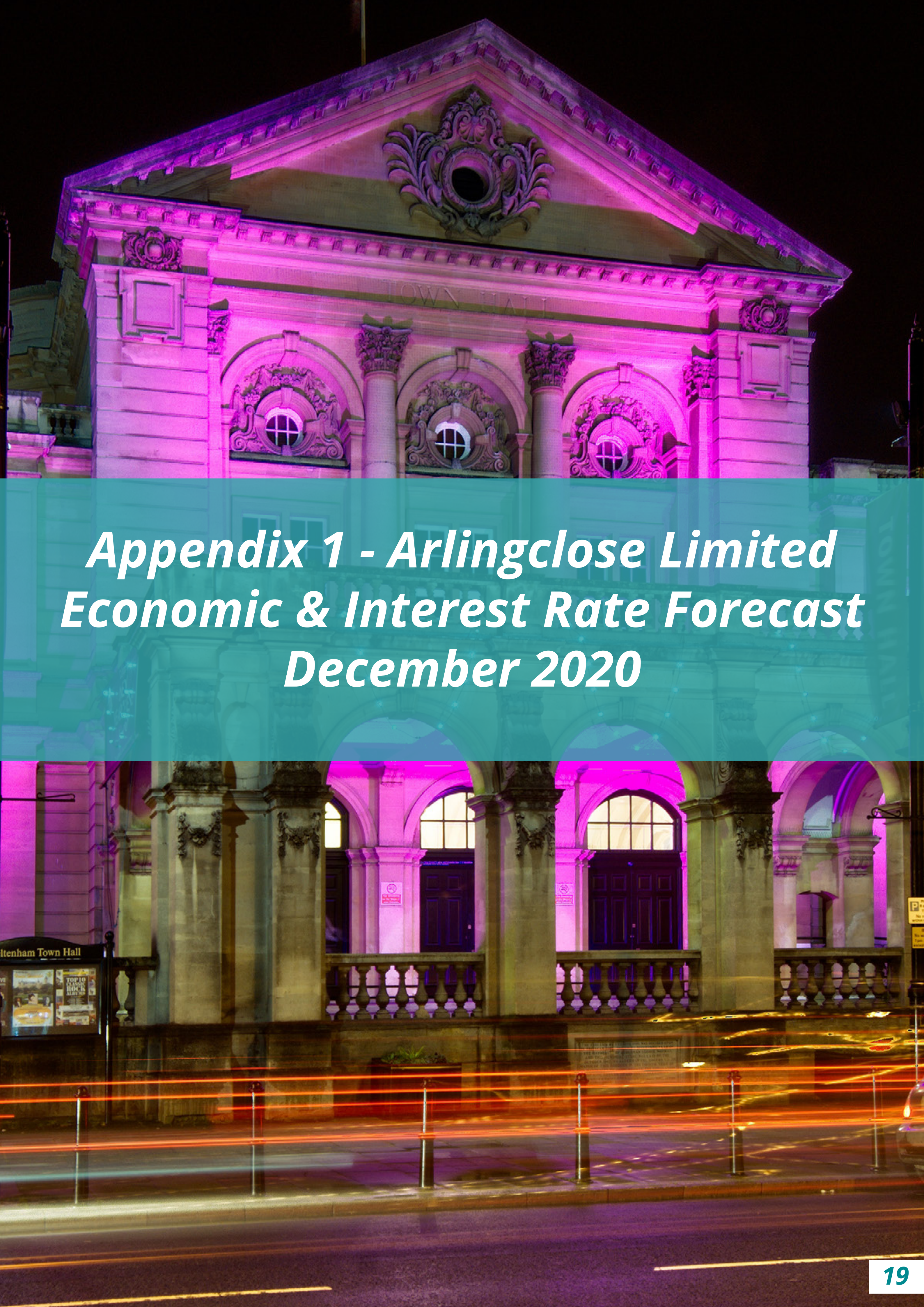
The budget for investment income in 2021/22 is £327k, based on an average investment portfolio of £19 million at an interest rate of 1.55%. For the purpose of setting the budget, it has been assumed that new treasury investments will be made at an average rate of 0.01 to 0.20%, and that new long-term loans will be borrowed at an average rate of 1.50% to 2%.

On top of this interest received on third parties loans amounts to £266k.The budget for debt interest to be paid in 2021/22 is forecast to be £3.826 million, based on an average debt portfolio of £173m at an average interest rate of 2.21%.The HRA will reimburse the General Fund £1.784m for its share of the debt it holds as at 1 April 2021. If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different.

7.8 - Alternative options

The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Financial Officer, having consulted the Cabinet Member for Finance and Assets, 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
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



Appendix 1 - Arlingclose Limited Economic & Interest Rate Forecast December 2020

Appendix 1 – Arlingclose Limited Economic & Interest Rate Forecast December 2020

Economic Background

The impact on the UK from coronavirus, lockdown measures, the rollout of vaccines, as well as the new trading arrangements with the European Union (EU), will remain major influences on the Authority's treasury management strategy for 2021/22.

The Bank of England (BoE) maintained Bank Rate at 0.10% in February 2021 and Quantitative Easing programme at £895 billion having extended it by £150 billion in November 2020. The Monetary Policy Committee (MPC) voted unanimously for both, but also an annoucement was made of the potential future use of negative interest rates. In the November Monetary Policy Report (MPR) forecasts, the Bank expects the UK economy to shrink -2% in Q4 2020 before growing by 7.25% in 2021, lower than the previous forecast of 9%. The BoE also forecasts the economy will now take until Q1 2022 to reach its pre-pandemic level rather than the end of 2021 as previously forecast. By the time of the December MPC announcement, a COVID-19 vaccine was approved for use, which the Bank noted would reduce some of the downside risks to the economic outlook outlined in the November MPR.

UK Consumer Price Inflation (CPI) for January 2021 registered 0.7% year on year, up from 0.6% in the previous month. Core inflation, which excludes the more volatile components, remained at 1.4%. The most recent labour market data for the three months to December 2020 showed the unemployment rate rose to 5.1% while the employment rate fell to 75%. Both measures are expected to deteriorate further due to the ongoing impact of coronavirus on the jobs market, particularly when the various government job retention schemes start to be unwound in 2021, with the BoE forecasting unemployment will peak at 7.75% in Q2 2021. In December, the headline 3-month average annual growth rate for wages were 4.7% for total pay and 4.1% for regular pay. In real terms, after adjusting for inflation, total pay growth was up by 3.8% while regular pay was up 3.3%.

GDP growth rebounded by 1% in Q4 2020 having rose to 12.2% in the previous quarter, with the annual rate rising to -8.6% from -20.8%. All sectors rose quarter-on-quarter, with dramatic gains in construction (4.6%), followed by services (0.6%) and production (1.8%). Monthly GDP estimates have shown the economic recovery slowing and remains well below its pre-pandemic peak. Looking ahead, the BoE's November MPR forecasts economic growth will rise in 2021 with GDP reaching 11% in Q4 2021, 3.1% in Q4 2022 and 1.6% in Q4 2023.

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

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

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

Credit outlook

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

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

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

Interest rate forecast

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

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

The assumptions used by our specialist treasury management advisors informing our forecasts are outlined below.

Underlying assumptions:

- The medium-term global economic outlook has improved with the distribution of vaccines, but the recent upsurge in coronavirus cases has worsened economic prospects over the short term.

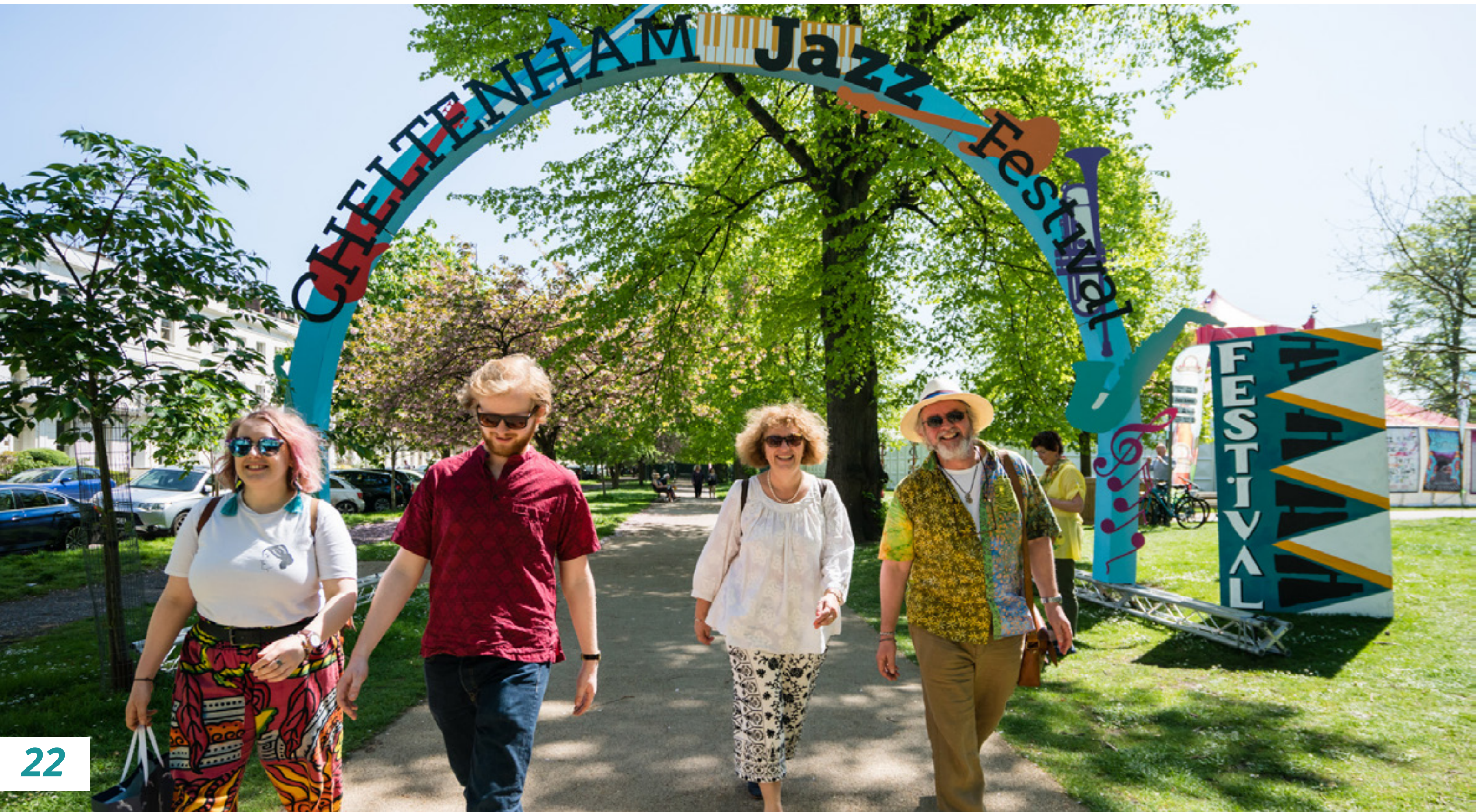
- Restrictive measures and further lockdowns are likely to continue in the UK and Europe until the majority of the population is vaccinated by the second half of 2021. The recovery period will be strong thereafter, but potentially longer than previously envisaged.

- Signs of a slowing UK economic recovery were already evident in UK monthly GDP and PMI data, even before the second lockdown and Tier 4 restrictions. Employment is falling despite an extension to support packages.

- The need to support economic recoveries and use up spare capacity will result in central banks maintaining low interest rates for the medium term.

- Brexit will weigh on UK activity. The combined effect of Brexit and the after-effects of the pandemic will dampen 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.

- Longer-term yields will also remain depressed, anchored by low central bank policy rates, expectations for potentially even lower rates and insipid longer-term inflation expectations. There is a chance yields may follow a slightly different path in the medium term, depending on investor perceptions of growth and inflation, or the deployment of vaccines.



Specific inputs:

- Arlingclose expects Bank Rate to remain at the current 0.10% level.
- Our central case for Bank Rate is no change, but further cuts to zero, or perhaps even into negative territory, cannot be completely ruled out, especially with likely emergency action in response to a no-deal Brexit.
- Gilt yields will remain low in the medium term. Shorter term gilt yields are currently negative and will remain around zero or below until either the Bank expressly rules out negative Bank Rate or growth/inflation prospects improve.
- Downside risks remain, and indeed appear heightened, in the near term, as the government reacts

	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
Artington 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	0.30	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
3-month money market rate													
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
Artington Central Case	0.10	0.10	0.15	0.15	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
Downside risk	0.30	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
1 year money market rate													
Upside risk	0.05	0.05	0.10	0.10	0.15	0.20	0.40	0.40	0.40	0.40	0.40	0.40	0.40
Artington Central Case	0.15	0.15	0.25	0.25	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Downside risk	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15
5 year 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
Artington Central Case	0.00	0.00	0.05	0.10	0.15	0.20	0.20	0.20	0.25	0.25	0.25	0.25	0.25
Downside risk	0.40	0.45	0.50	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60
10 year 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
Artington Central Case	0.25	0.30	0.35	0.35	0.40	0.40	0.45	0.45	0.50	0.55	0.55	0.55	0.60
Downside risk	0.50	0.50	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55
20 year 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
Artington Central Case	0.70	0.70	0.75	0.75	0.75	0.80	0.80	0.85	0.85	0.85	0.85	0.90	0.90
Downside risk	0.30	0.30	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40
50 year 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
Artington Central Case	0.60	0.60	0.65	0.65	0.65	0.70	0.70	0.75	0.75	0.75	0.75	0.80	0.80
Downside risk	0.30	0.30	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40

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

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