

**AUDIT, GOVERNANCE &
STANDARDS COMMITTEE**

18th January 2021

**Treasury Management, Investment and Capital Strategies
2021/22**

Final Decision-Maker	Council
Lead Head of Service	Ellie Dunnet – Head of Finance
Lead Officer and Report Author	John Owen – Finance Manager
Classification	Public
Wards affected	All

Executive Summary

This report sets out the draft Treasury Management Strategy, Investment Strategy and Capital Strategy for 2021/22 for consideration by the Audit, Governance & Standards Committee and recommendation to Council for adoption. The strategies are attached as Appendices A-C to this report.

Purpose of Report

This report requires discussion from the Committee.

This report makes the following recommendations to this Committee:

1. That the Treasury Management Strategy for 2021/22 attached as Appendix A to this report is agreed and recommended to Council for adoption, along with increased counterparty limits, subject to any amendments arising from consideration of the Capital Programme by Policy and Resources Committee at its meeting on 20th January 2021.
2. That the Investment Strategy for 2021/22 attached as Appendix B to this report is agreed and recommended to Council for adoption.
3. That the Capital Strategy for 2021/22 attached as Appendix C to this report is agreed and recommended to Council for adoption.

Timetable

Meeting	Date
Audit, Governance & Standards Committee	18 th January 2021
Policy & Resources Committee	20 th January 2021
Council	24 th February 2021

Treasury Management, Investment and Capital Strategies 2021/22

1. CROSS-CUTTING ISSUES AND IMPLICATIONS

Issue	Implications	Sign-off
Impact on Corporate Priorities	The Treasury Management function ensures the safeguarding of Council finances and the liquidity of funds when liabilities become due to support the Strategic Plan objectives.	Head of Finance
Cross Cutting Objectives	The report recommendations support the achievements of the cross cutting objectives embedded within the Strategic Plan.	Head of Finance
Risk Management	Covered in Section 5 of this report.	Head of Finance
Financial	This report relates to the financial activities of the Council in respect of Treasury Management and specific financial implications are therefore detailed within the body of the report.	Section 151 Officer & Finance Team
Staffing	None.	Head of Finance
Legal	The legal implications are detailed within the body of the report which is compliant with statutory and legal regulations such as the CIPFA Code of Practice on Treasury Management in Local Authorities.	Principal Solicitor (Corporate Governance), MKLS
Privacy and Data Protection	None.	Policy and Information Team
Equalities	The recommendations do not propose a change in service delivery therefore will not	Equalities and

	require an Equalities Impact Assessment (EIA).	Corporate Policy Officer
Public Health	The recommendations will not negatively impact on population health or that of individuals.	Public Health Officer
Crime and Disorder	None.	Head of Finance
Procurement	None.	Head of Finance

2. INTRODUCTION AND BACKGROUND

- 2.1 The Council is required to operate a balanced budget, which broadly means that cash raised during the year must meet cash expenditure. The Treasury Management Strategy assists the Council in achieving this objective while maintaining value for money.
- 2.2 The first function of the Council's Treasury Management operation is to ensure that this 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.
- 2.3 The second function of the Treasury Management operation is the funding of the Council's capital plans. The capital plans provide a guide to the borrowing need of the Council, so this means longer term cash flow planning to ensure that the Council can meet its capital spending obligations. The management of longer-term cash may involve arranging long or short-term loans or using longer term cash flow surpluses. On occasion, any debt previously drawn may be restructured to meet Council risk or cost objectives.
- 2.4 The council has adopted the Treasury Management in Public Services: Code of Practice 2011 Edition ('the Code') issued by the Chartered Institute of Public Finance and Accountancy (CIPFA).
- 2.5 CIPFA defines Treasury Management as:
- "The management of the local authority's 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."*
- 2.6 The current 2020/21 Treasury Management Strategy (TMS) was reviewed by this Committee and agreed by Council in February 2020. The current Strategy is primarily to:

- Utilise cash balances rather than loan debt to finance the capital programme in the short term, due to low investment returns and high counterparty risk in the current economic climate; and
- Further diversify its portfolio, as far as is operationally feasible, ensuring that a combination of secured and unsecured investments is considered. Greater use of local authority investments will be used where the borrowers offer a high level of security.

2.7 A mid-year monitoring report was considered by this Committee at its November 2020 meeting. Essentially the Council is taking a similar stance with its Strategy for 2021/22, however as cash balances will be fully utilised by the end of 2020/21, the Council will be looking to its borrowing options, which will include long term as well as short term. This will spread the risk of refinancing and to lock the Council into a low long-term rate especially when rates are so low.

2.8 The Treasury Management Strategy for 2021/22 is set out at **Appendix A** to this report. It is consistent with the requirements of the CIPFA and MHCLG and has been developed in line with currently approved spending and financing proposals.

2.9 CIPFA revised the 2011 edition of the Code in 2017, which ensures that local authorities also take into account the risks involved with non-treasury investments. CIPFA have therefore recommended that authorities develop an Investment Strategy – **Appendix B** and a Capital Strategy – **Appendix C** which set out the Council’s risk appetite and specific policies and arrangements for non-treasury investments.

2.10 The three strategy documents are linked and support the overall Medium Term Financial Strategy (MTFS), alluding to the risk appetites around capital investment priorities and funding decisions including borrowing. Below is an illustration of how these documents are linked:

Table A.



2.11 Current Treasury Management investments as at 31st December 2020 total £24.19m. A list of these can be found within **Appendix D**.

2.12 The Council has short term borrowings of £9m with other local authorities to fund its capital programme, which is likely to increase in 2021/22. A list of

these can also be found within **Appendix D**. Although the Council had cash in hand as at 31 December, most of this relates to grants to business and individuals in relation to COVID-19 and cash which has to be paid in respect of the business rates pool and precepts.

- 2.13 The existing Treasury Management Strategy provided approval for a range of sources of borrowing, including the Public Works Loan Board. As PWLB rates have dropped 100bps for non-commercial activities, this may well be a good source of funding for the Council, however other options will be explored, like Municipal Bonds Agency and corporate markets, to see what the best fit is for the Council.
- 2.14 The Policy & Resources Committee will consider a capital programme for the period 2021/22 to 2025/26 at its meeting on 20th January 2021. The attached Strategy includes assumptions about the Capital Programme and it is not anticipated that the Capital Programme as finally agreed will differ significantly from these.
- 2.15 The following table shows the expected borrowing required to fund the draft capital programme. Internal borrowing will be fully utilised within 2020/21 programme, with the only internal sources of funding being New Homes Bonus and small capital receipts.

	2021/22 £m	2022/23 £m	2023/24 £m
Capital Programme	57.000	30.404	17.746
External Funding Streams	(6.524)	(0.850)	(0.850)
Internal Funding Including Revenue Funding & MRP	(5.012)	(2.410)	(2.241)
Expected Borrowing	45.464	27.144	14.655

2.16 **Revenue Funding**

The strategy proposes the application of £3.8m New Homes Bonus and £0.139m Lower Tier Services Grant to fund the capital programme. This is supplemented by other revenue funding of £1.02m.

Initial considerations on the medium term financial strategy for 2021-22 onwards had allowed for New Homes Bonus to be used to support the revenue budget, given the significance of the expected budget gap for the next financial year.

This strategy reflected previous forecasts of a significant reduction in reserves arising from financial impacts of the pandemic during 2020/21, and sought to mitigate further reductions in the general fund balance through use of New Homes Bonus to support the revenue budget. More recent forecasts indicate that it will be possible to largely offset the financial impacts of Covid-19 during the current financial year through additional government funding.

It is therefore proposed that next year's allocation of New Homes Bonus and the Lower Tier Services Grant be used to fund the capital programme in order to minimise borrowing and the revenue costs associated with this. This follows the approach which the Council has taken to applying this resource in previous years.

This is subject to the requirement to cover any shortfall in next year's revenue budget from other revenue resources including New Homes Bonus.

2.17 Increased Counterparty Limits

It is being proposed that the current counterparty limits are increased from the previous year to be effective immediately. Current limits have served their purpose in ensuring the levels of funding lent to each counterparty is not excessive and reduces the exposure to loss if an institution were to fall into financial difficulty. However, due to tightening of financial regulations for financial institutions, they are now better placed to withstand losses.

It has been highlighted in 2020/21 that, with the increased funding local authorities have received from Central Government in respect of COVID-19, placement of short term funding within these limits has been an issue. This is due to the delay between receiving funding and making payments to eligible bodies. In the meantime, funds have to be securely held until the time they are due for payment. Increasing the limits on money market funds and highly rated banks which are used for instant access/short term notice would help alleviate this issue without the risk of placing funds with a lower rated counterparty or sovereignty. The following changes are proposed:

	Colour (and long term rating where applicable)	Previous Limit	Amended Limit
Banks *	yellow	£5m	£8m
Banks	purple	£5m	£7m
Banks	orange	£3m	£5m
Banks – part nationalised	blue	£3m	£5m
Banks	red	£3m	£5m
Banks	green	£1m	£3m
	Fund rating**	Money Limit	Transaction limit
Money Market Funds CNAV	AAA	£8m	£10m
Money Market Funds LVNAV	AAA	£8m	£10m
Money Market Funds VNAV	AAA	£8m	£10m

Investment Strategy

- 2.18 The Investment Strategy focuses on service investments (supporting local services by lending or buying shares) and non-treasury investments.
- 2.19 The Council has made third party loans to Kent Savers for £25,000 in 2017/18 which is repayable in 2022/23 at an interest rate of 1% and a loan to Cobtree Manor Estates Trust has been agreed in 2019/20 for £323,000 repayment over 5 years at an annual interest rate of 3%. A loan to Maidstone Property Holdings Limited may also be offered in the near future in relation to refurbishment of rental properties for which the interest rate applicable would be at commercial rates. There is a provision for this service loans of £1 million.
- 2.20 The Council does not currently have any investments in property that are considered to be purely commercial in nature. Acquisitions are limited to properties situated within the borough, with the intention of supporting the local community, housing and regeneration objectives rather than for the exclusive purpose of generating profits. All property investments are therefore classified as general fund capital projects.

Capital Strategy

- 2.21 The capital strategy gives a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability.
- 2.22 The strategy forms part of the Council's integrated revenue, capital and balance sheet planning and requires annual approval by full Council. It sets out the long term context in which capital expenditure and investment decisions are made, and considers risk, reward and impact on the achievement of the Council's priority outcomes identified within the strategic plan.
- 2.23 The strategy for 2021/22 is an update with the latest capital proposal plans for the Council subject to review.

3. AVAILABLE OPTIONS

- 3.1 **Option 1:** The Committee could decide not to recommend the strategies to Council. The Council must adopt strategies for 2021/22 and should the Committee decide not to recommend it would need to recommend an alternative to Council. The strategies are in line with the necessary codes and practice guides and take a low risk approach favouring liquidity and security over return. As such the approach set out within the strategy is considered suitable for this Council.
- 3.2 **Option 2:** Subject to any legal obligations placed upon the Council, the Committee could amend the strategies prior to recommendation to Council.

The Committee would need to provide Council with detailed reasons for the amendments and the risks and benefits that the proposed amendments provide in order for the Council to make a fully informed decision on the recommendation.

- 3.3 **Option 3:** The Committee could agree the attached strategies and recommend them to Council. The attached strategies have been produced in line with current guidance from CIPFA and the Ministry of Housing for Communities and Local Government (MHCLG). They have also been developed in line with advice and guidance from the Council's Treasury Management Advisors.
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4. PREFERRED OPTION AND REASONS FOR RECOMMENDATIONS

- 4.1 The recommended option is Option 3, to recommend to Council the Treasury Management Strategy, Investment Strategy and the Capital Strategy for 2021/22.
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5. RISK

- 5.1 Detailed risk management policies are included within the Treasury Management Practices and have been included in both investment strategies and capital strategies to which the Council adheres . A brief description of these risks along with the Council's actions to mitigate these risks are as follows:

Liquidity Risk - Liquidity risk is the risk that cash will not be available when it is required. The Council has sufficient standby facilities to ensure that there is always sufficient liquidity to deal with unexpected occurrences. The Council also has the option of short-term borrowing.

Interest Rate Risk - Interest rate risk is the risk that unexpected changes in interest rates expose the Council to greater costs or a shortfall in income than have been budgeted for. This risk is mitigated by borrowing and lending on a fixed rate basis. The Council will also seek to minimise this risk by seeking expert advice on forecasts of interest rates from treasury management consultants and agreeing with them its strategy for the coming year for the investment and debt portfolios. It will also determine appropriate limits and trigger points which are set out in the annual Treasury Management Strategy.

Exchange Rate Risk - Exchange rate risk is the risk that unexpected changes in exchange rates expose the Council to greater costs or a shortfall in income than have been budgeted for. The Council has a minimal exposure to exchange rate risk as it has no powers to enter into loans or investments in foreign currency for treasury management purposes.

Inflation Risk - Inflation risk is the risk that unexpected changes in inflation expose the Council to greater costs or a shortfall in income than

have been budgeted for. Inflation both current and projected will form part of the debt and investment decision-making criteria both within the strategy and operational considerations.

Credit and Counterparty Risk - Credit and counter-party risk is the risk of failure by a third party to meet its contractual obligations under an investment, loan or other commitment, especially one due to deterioration in its creditworthiness, which causes the Council an unexpected burden on its capital or revenue resources. Treasury management staff will add or delete counterparties to/from the approved counterparty list in line with the policy on criteria for selection of counterparties. Due to volatility of the financial market, Treasury Management staff will use information from various sources, e.g. brokers, Treasury Management Consultants and other local Authority experience to determine the credit worthiness of an institution and to decide if funds are at risk and agree best course of action with Director of Finance & Business Improvement.

Refinancing Risk - Refinancing risk is the risk that when loans or other forms of capital financing mature, that they cannot be refinanced where necessary on terms that reflect the assumptions made in formulating revenue and capital budgets. The Council currently borrows to fund a portion of its capital programme and will continue to do so in the coming years. In considering the affordability of its capital plans, the Council will consider all the resources currently available/estimated for the future together with the totality of its capital plans, revenue income and revenue expenditure forecasts for the forthcoming year and the two following years and the impact these will have on council tax. It will also take into account affordability in the longer term beyond this three year period.

Legal and Regulatory Risk - Legal and regulatory risk is the risk that either the Council, or a third party which it is dealing with in its treasury management activities, acts outside of its legal powers or regulatory requirements and as a result the Council incurs loss. The treasury management activities of the Council shall comply fully with legal statute, guidance, Codes of Practice and the regulations of the Council. The Authority will provide written evidence of its powers and authorities to any counterparty that requests us to do so. Counterparties will also provide their details to the Authority as a matter of course.

Fraud, Error and Corruption Risk - Fraud, error and corruption risk is the risk that the Council may fail to employ adequate systems, procedures and other arrangements which identify and prevent losses through such occurrences. The Council will seek to ensure an adequate division of responsibilities and maintenance at all times of an adequate level of internal checks which minimises such risks along with maintaining records of all treasury management transactions so that there is a full audit trail and evidence of the appropriate checks being carried out. Delegated members of staff have the responsibility for the treasury management function for the Council and the Director of Finance & Business Improvement authorises who these are. The Council also has a Fidelity Guarantee insurance policy with Zurich Insurance which covers against loss of cash through fraud or dishonesty of employees.

Risk Appetite – The Council takes a slightly higher risk with its non-treasury investments compared to its treasury management investments due to the fact that treasury investments are mainly maintaining funds in high security instruments for when they are required and non-treasury decisions are for service delivery where there is a different risk profile.

6. CONSULTATION RESULTS AND PREVIOUS COMMITTEE FEEDBACK

6.1 None.

7. NEXT STEPS: COMMUNICATION AND IMPLEMENTATION OF THE DECISION

7.1 This report will be considered by Council at its meeting on 24th February 2021.

8. REPORT APPENDICES

8.1 The following documents are to be published with this report and form part of the report:

- Appendix A: Treasury Management Strategy
 - Appendix B: Investment Strategy
 - Appendix C: Capital Strategy
 - Appendix D: Investment and Borrowing Position as at 31st December 2020.
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9. BACKGROUND PAPERS

9.1 None.