

Treasury Management Strategy Statement 2021/22

1. Introduction

- 1.1 Treasury management is the management of the Council's cash flows, borrowing and investments, and the associated risks. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Council's prudent financial management.
- 1.2 Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition* (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year. In addition, the Welsh Government (WG) issued revised Guidance on Local Authority Investments in November 2019 that requires the Council to approve an investment strategy before the start of each financial year. This report fulfils the Council's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the WG Guidance.
- 1.3 In accordance with the WG Guidance, the Council will be asked to approve a revised Treasury Management Strategy Statement should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates, change in the Council's capital programme or in the level of its investment balance, or a material loss in the fair value of a non-financial investment identified as part of the year end accounts preparation and audit process.

2. External Context

2.1 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 December 2020 and Quantitative Easing programme at £895 billion having extended it by £150 billion in the previous month. The Monetary Policy Committee (MPC) voted unanimously for both, but no mention 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 November 2020 registered 0.3% year on year, down from 0.7% in the previous month. Core inflation, which excludes the more volatile components, fell to 1.1% from 1.5%. The most recent labour market data for the three months to October 2020 showed the unemployment rate rose to 4.9% while the employment rate fell to 75.2%. 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 October, the headline 3-month average annual growth rate for wages were 2.7% for total pay and 2.8% for regular pay. In real terms, after adjusting for inflation, total pay growth was up by 1.9% while regular pay was up 2.1%.

GDP growth rebounded by 16.0% in Q3 2020 having fallen by -18.8% in the second quarter, with the annual rate rising to -8.6% from -20.8%. All sectors rose quarter-on-quarter, with dramatic gains in construction (41.2%), followed by services and production (both 14.7%). 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.

2.2 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 uncertainty 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.

2.3 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.

A more detailed economic and interest rate forecast provided by Arlingclose is attached in **Appendix 1**.

- 2.4** For the purpose of setting the budget, it has been assumed that new treasury management investments will be made at an average rate of 0.01% and that the Council will not need any new long-term loans in 2021/22.

3. Local Context

- 3.1** On 31st December 2020, the Council held £112.6m of borrowing and £77.4m of investments. This is set out in further detail at **Appendix 2**. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance sheet summary and forecast

| | 31.3.20 Actual £m | 31.3.21 Forecast £m | 31.3.22 Budget £m | 31.3.23 Budget £m | 31.3.24 Budget £m |
|--------------------------------|----------------------------------|------------------------------------|----------------------------------|----------------------------------|----------------------------------|
| CFR | 176.8 | 174.0 | 176.7 | 180.1 | 178.6 |
| Less: Other debt liabilities * | (2.9) | (2.6) | (2.4) | (1.4) | (5.4) |
| Loans CFR | 173.9 | 171.4 | 174.2 | 178.7 | 173.2 |
| Less: External borrowing ** | (124.9) | (104.2) | (103.0) | (101.7) | (99.5) |
| Internal borrowing | 49.0 | 67.2 | 71.2 | 77.0 | 73.7 |
| Less: Usable reserves | (78.0) | (57.5) | (50.3) | (45.3) | (44.1) |
| Add: Working capital | 0.4 | 0.4 | 0.4 | 0.4 | 0.4 |
| Investments | 28.6 | (10.1) | (21.3) | (32.1) | (30.0) |

*PFI liabilities

**shows only loans to which the Council is committed and excludes optional refinancing

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

- 3.3** Table 1 shows that the Council will need to borrow during the next three years. If this is the case, short term borrowing will be used to reduce the interest rate.

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

4. Liability benchmark

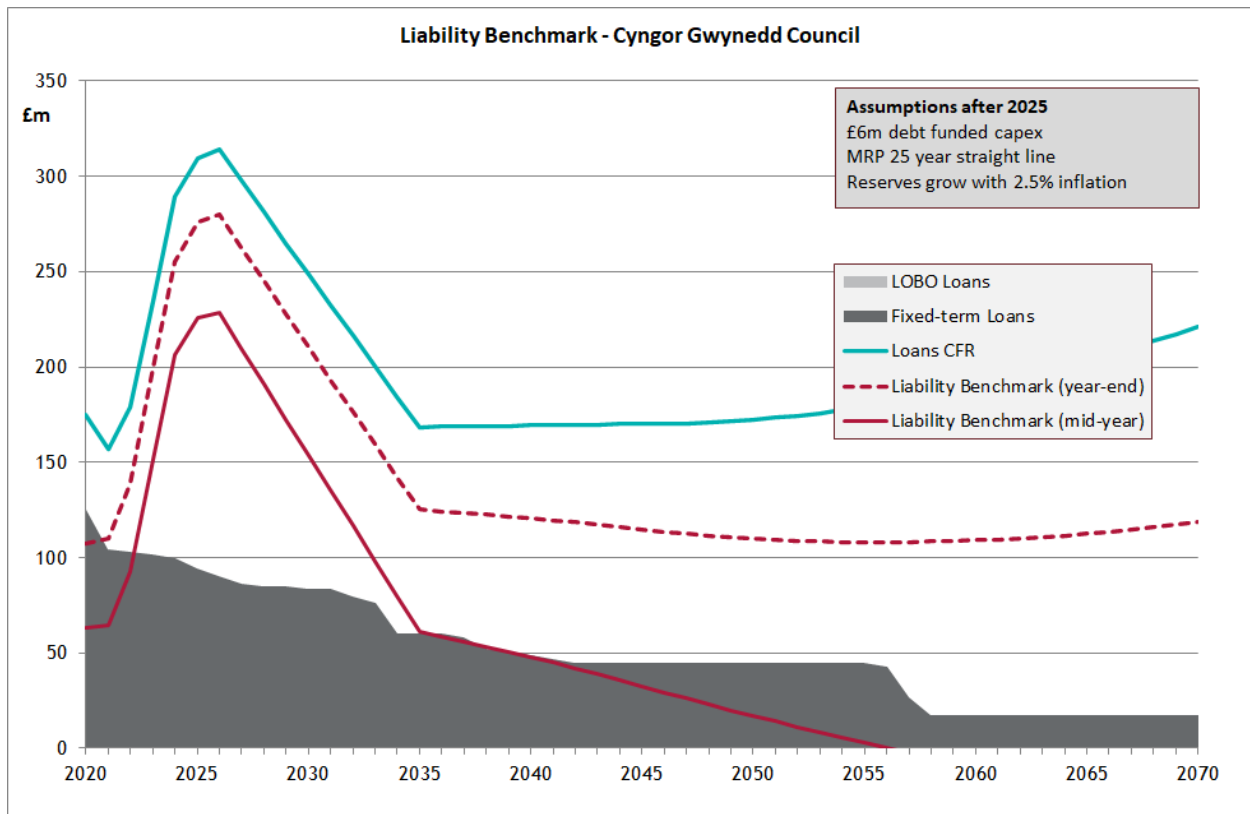
- 4.1 To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as table 1 above, but that cash and investment balances are kept to a minimum level of £10m at each year-end to maintain sufficient liquidity but minimise credit risk.

This year, an additional consideration has been added to the Liability Benchmark as Gwynedd Council is the host authority of the North Wales Economic Ambition Board where a requirement to borrow will arise in future years.

Table 2: Liability Benchmark

| | 31.3.20 Actual £m | 31.3.21 Forecast £m | 31.3.22 Budget £m | 31.3.23 Budget £m | 31.3.24 Budget £m |
|----------------------------|----------------------------------|------------------------------------|----------------------------------|----------------------------------|----------------------------------|
| CFR | 176.8 | 174.0 | 176.7 | 180.1 | 178.6 |
| Less: Usable reserves | (78.0) | (57.5) | (50.3) | (45.3) | (44.1) |
| Plus: Working capital | 0.4 | 0.4 | 0.4 | 0.4 | 0.4 |
| Plus: Minimum investments | 10.0 | 10.0 | 10.0 | 10.0 | 10.0 |
| Plus: NWEAB Borrowing | n/a | 0.0 | 0.0 | 60.5 | 117.2 |
| Liability Benchmark | 109.2 | 126.9 | 136.7 | 205.7 | 262.1 |

- 4.2 Following on from the medium-term forecasts in table 2 above, the long-term liability benchmark assumes capital expenditure funded by borrowing of £6m a year, minimum revenue provision on new capital expenditure based on a 25 year asset life and income, expenditure and reserves all increasing by inflation of 2.5% a year. This is shown in the following chart:



The chart shows that from 2023 that there will be a need to borrow for a period of 15 years. This is to facilitate the North Wales Economic Ambition Board

5. Borrowing Strategy

5.1 The Council currently holds £103.6 million of loans as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 1 shows that the Council does not expect to need to borrow long term in 2020/22 but may need to borrow short term for cash flow reasons. In the future, the Council may also borrow additional sums to pre-fund future years' requirements and to facilitate the North Wales Economic Ambition Board, providing this does not exceed the authorised limit for borrowing.

5.2 Objectives

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

5.3 Strategy

Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal and/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. Arlingclose will assist the Council with this 'cost of carry' and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2021/22 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

The Council has previously raised 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 Council intends to avoid this activity in order to retain its access to PWLB loans.

Alternatively, the Council 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.

In addition, the Council may borrow further short-term loans to cover unplanned cash flow shortages.

5.4 Sources of borrowing

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

- HM Treasury's PWLB Lending facility (formerly the Public Works Loan Board)
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- any other UK public sector body

- UK public and private sector pension funds (except Gwynedd Pension Fund)
- Capital market investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

5.5 Other sources of debt finance

In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- Leasing
- Hire purchase
- Private Finance Initiative
- Sale and leaseback

The Council has previously raised the majority of its long-term borrowing from the PWLB but it continues to investigate other sources of finance, such as local authority loans and bank loans that may be available at more favourable rates.

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 lend 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 full Council.

5.6 Short-term and variable rate loans

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

5.7 Debt rescheduling

The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

6. Treasury Investment Strategy

- 6.1** The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council's investment balance has ranged between £23.2 and £110.4 million, and similar levels are expected to be maintained in the forthcoming year.

This includes the cash balances of Gwynedd Pension Fund which are pooled with the Council's funds for investment purposes. The Pension Fund requests this annually as the returns received are improved and the risks reduced by combining the cash with the Council's funds. The Pensions Committee will approve the relevant elements of this Strategy Statement and request the continuation of the pooling arrangements for 2021/22 at its meeting on 25 March 2021.

Loans to organisation providing local public services and purchases of investment property are not normally considered to be treasury investments, and therefore these are covered separately in **Appendix 3**.

6.2 Objectives

Both the CIPFA Code and the WG Guidance require the Council to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

6.3 Negative interest rates

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.

6.4 Strategy

Given the increasing risk and very low returns from short-term unsecured bank investments, the Council will aim to continue to hold more secure and/or higher yielding asset classes during 2021/22. This is especially the case for the estimated £10m that is available for longer-term investment. The majority of the Council's surplus cash is currently invested in short-term unsecured bank deposits, certificates of deposit and money market funds. This represents a continuation of the strategy adopted in 2015/16.

6.5 Business models

Under the new IFRS 9 standard, the accounting for certain investments depends on the Council's "business model" for managing them. The Council aims to achieve value from its internally managed 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.

6.6 Approved counterparties

The Council may invest its surplus funds with any of the counterparty types in table 3 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 3: Approved investment counterparties and limits

| Sector | Time limit | Counterparty limit | Sector limit |
|---|-------------------|---------------------------|---------------------|
| The UK Government | 50 years | Unlimited | n/a |
| Local authorities & other government entities | 25 years | £10m | Unlimited |
| Secured investments * | 25 years | £10m | Unlimited |
| Banks (unsecured) * | 13 months | £5m | Unlimited |
| Building societies (unsecured) * | 13 months | £5m | £5m |
| Registered providers (unsecured) * | 5 years | £5m | £25m |
| Money market funds * | n/a | £10m | Unlimited |
| Strategic pooled funds | n/a | £10m | £50m |
| Real estate investment trusts | n/a | £10m | £25m |
| Other investments * | 5 years | £5m | £10m |

This table must be read in conjunction with the notes below.

6.7 Credit rating

Investment limits are set by reference to the lowest published long-term credit rating from a selection of external rating agencies. 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.

6.8 Government

Loans to, and bonds and bills issued or guaranteed by, national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Government are deemed to be zero credit risk due to its ability to create additional currency and therefore may be made in unlimited amounts for up to 50 years.

6.9 Secured investments

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.

6.10 Banks and Building Societies (unsecured)

Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

6.11 Registered providers (unsecured)

Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

6.12 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 Council will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

6.13 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.

6.14 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.

6.15 Other investments

This category covers treasury investments not listed above, for example unsecured corporate bonds and company loans. Non-bank companies cannot be bailed-in but can become insolvent placing the Authority's investment at risk.

6.16 Operational bank accounts

The Council may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £900,000 per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.

6.17 Risk assessment and credit ratings

Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. 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.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as “rating watch negative” or “credit watch negative”) 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.

6.18 Other information on the security of investments

The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Council’s treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council’s cash balances, then the surplus will be deposited with the UK Government 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.

6.19 Investment limits

The Council’s revenue reserves available to cover investment losses are forecast to be £43 million on 31st March 2021. In order that no more than 23% 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 £10 million. A group of entities under the same ownership will be treated as a single organisation for limit purposes.

Credit risk exposures arising from non-treasury investments, financial derivatives and balances greater than £500,000 in operational bank accounts count against the relevant investment limits.

Table 4: Additional limits

| | Cash limit |
|---|-------------------|
| Any group of pooled funds under the same management | £25m per manager |
| Negotiable instruments held in a broker's nominee account | £25m per broker |
| Foreign countries | £10m per country |

6.18 Liquidity management

The Council uses prudent cash flow forecasting techniques to determine the maximum period for which funds may prudently be committed. The forecast is compiled on the basis that short-term borrowing is used to cover its financial commitments if required. Limits on long-term investments are set by reference to the Council's medium-term financial plan and cash flow forecast.

The Council will spread its liquid cash over at least four providers (e.g bank accounts and money market funds) to ensure that access to cash is maintained in the event of operational difficulties at any one provider.

7. Treasury Management Indicators

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

7.1 Security

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

| Credit risk indicator | Target |
|--------------------------------|---------------|
| Portfolio average credit score | 6.0 |

7.2 Liquidity

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

| Liquidity risk indicator | Target |
|--------------------------------------|---------------|
| Total cash available within 3 months | £10m |

7.3 Interest rate exposures

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

| Interest rate risk indicator | Limit |
|--|--------------|
| Upper limit on one-year revenue impact of a 1% <u>rise</u> in interest rates | £635,000 |
| Upper limit on one-year revenue impact of a 1% <u>fall</u> in interest rates | £24,000 |

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

7.4 Maturity structure of borrowing

This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing will be:

| Refinancing rate risk indicator | Upper limit | Lower limit |
|--|--------------------|--------------------|
| Under 12 months | 25% | 0% |
| 12 months and within 24 months | 25% | 0% |
| 24 months and within 5 years | 50% | 0% |
| 5 years and within 10 years | 75% | 0% |
| 10 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.

7.5 Principal sums invested for periods longer than a year

The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

| Price risk indicator | 2021/22 | 2022/23 | 2023/24 |
|---|---------|---------|---------|
| Limit on principal invested beyond year end | £20m | £20m | £20m |

8. Related Matters

8.1 The CIPFA Code requires the Council to include the following in its Treasury Management Strategy.

8.2 Financial Derivatives

In the absence of any explicit legal power to do so, the Council will not use standalone financial derivatives (such as swaps, forwards, futures and options). Derivatives embedded into loans and investments, including pooled funds and forward starting transactions, may be used, and the risks that they present will be managed in line with the overall treasury risk management strategy.

8.3 External Funds

Included within the Council balances is the balances for Gwynedd Pension Fund, Gwe, Welsh Church Fund and North Wales Economic Ambition Board. The interest income is allocated to each institution based on daily balances.

8.4 Markets in Financial Instruments Directive

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

9. Welsh Government Guidance

Further matter required by the Welsh Government Guidance are included in **Appendix 3**.

10. Financial Implications

10.1 The budget for investment income in 2021/22 is £0.335 million based on an average investment portfolio of £48 million at an interest rate of 0.01% for deposits and £10 million of pooled funds at a return of 4%. The budget for debt interest paid in 2021/22 is £5.7 million, based on an average debt portfolio of £102.8 million at an average interest rate of 5.51%. If actual levels of investments and borrowing, or actual interest rates, differ from those forecast, performance against budget will be correspondingly different.

11. Other Options Considered

11.1 The WG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Head of Finance, having consulted the Cabinet Member for Finance, 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 Economic & Interest Rate Forecast December 2020

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.

Forecast:

- 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 to the escalation in infection rates and the Brexit transition period ends.

| | Mar-21 | Jun-21 | Sep-21 | Dec-21 | Mar-22 | Jun-22 | Sep-22 | Dec-22 | Mar-23 | Jun-23 | Sep-23 | Dec-23 | Mar-24 |
|--------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Official Bank Rate | | | | | | | | | | | | | |
| Upside risk | 0.00 | 0.00 | 0.15 | 0.15 | 0.15 | 0.15 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 |
| Arlingclose Central Case | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 |
| Downside risk | 0.30 | 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 r. | | | | | | | | | | | | | |
| Upside risk | 0.05 | 0.05 | 0.10 | 0.10 | 0.15 | 0.20 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 |
| Arlingclose Central Case | 0.10 | 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 |
| 1yr 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 |
| Arlingclose 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 |
| 5yr gilt yield | | | | | | | | | | | | | |
| Upside risk | 0.40 | 0.40 | 0.45 | 0.45 | 0.50 | 0.50 | 0.55 | 0.60 | 0.60 | 0.65 | 0.65 | 0.70 | 0.70 |
| Arlingclose Central Case | 0.00 | 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 |
| 10yr gilt yield | | | | | | | | | | | | | |
| Upside risk | 0.30 | 0.35 | 0.40 | 0.45 | 0.50 | 0.50 | 0.55 | 0.60 | 0.60 | 0.65 | 0.65 | 0.70 | 0.70 |
| Arlingclose Central Case | 0.25 | 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 |
| 20yr gilt yield | | | | | | | | | | | | | |
| Upside risk | 0.40 | 0.40 | 0.45 | 0.45 | 0.50 | 0.50 | 0.55 | 0.60 | 0.60 | 0.65 | 0.65 | 0.70 | 0.70 |
| Arlingclose Central Case | 0.70 | 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 |
| 50yr gilt yield | | | | | | | | | | | | | |
| Upside risk | 0.40 | 0.40 | 0.45 | 0.45 | 0.50 | 0.50 | 0.55 | 0.60 | 0.60 | 0.65 | 0.65 | 0.70 | 0.70 |
| Arlingclose Central Case | 0.60 | 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%

Appendix 2- Existing Investment & Debt Portfolio Position

| | 31.12.2020 Actual Portfolio £m | 31.12.2020 Average Rate % |
|--|---|------------------------------------|
| External Borrowing: | | |
| Public Works Loan Board | 87.4 | 5.79 |
| Other loans | 16.2 | 4.22 |
| Local Authority loans | 9.0 | 0.78 |
| Total external borrowing | 112.6 | 5.30 |
| Other long- term liabilities: | | |
| Leases | 1.5 | 0.0 |
| Total other long-term liabilities | 1.5 | 0.0 |
| Total gross external debt | 114.1 | 5.30 |
| Treasury investments: | | |
| Banks and Building societies (unsecured) | 14.9 | 0.21 |
| Government (incl. Local authorities) | 22.0 | 0.06 |
| Money Market Fund | 30.5 | 0.14 |
| Pooled funds | 10.0 | 3.98 |
| Total treasury investments | 77.4 | 0.60 |
| Net debt | 36.7 | |

Appendix 3 – Additional requirements of Welsh Government Investment Guidance

The Welsh Government (WG) published revised Investment Guidance in November 2019 which places additional reporting requirements upon local authorities that are not integral to this Council's treasury management processes. The guidance also covers investments that are not part of treasury management, for example investment property and loans to local organisations.

Contribution: The Council's investments contribute to its service delivery objectives and/or to promote wellbeing as follows:

- treasury management investments support effective treasury management activities,
- loans to local organisations provide financial support to those organisations to enable them to deliver local public services that would otherwise be provided directly by the Council, and
- investment property provides a net financial surplus that is reinvested into local public services.

Climate change: The Council's investment decisions consider long-term climate risks to support a low carbon economy to the extent that if a low carbon investment equivalent is available with the same return, then the low carbon investment would be preferred by the Council.

Specified investments: The WG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement unless the counterparty is a local authority,
- not defined as capital expenditure by legislation, and
- invested with one of:
 - the UK Government,
 - a UK local authority, parish council or community council, or
 - a body or investment scheme of "high credit quality".

The Council defines "high credit quality" organisations and securities as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of A- or higher.

Loans: The WG Guidance defines a loan as a written or oral agreement where the Council temporarily transfers cash to a third party, joint venture, subsidiary or associate who agrees a return according to the terms and conditions of receiving the loan, except where the third party is another local authority.

The Council can demonstrate that its financial exposure to loans to local enterprises, local charities, wholly owned companies and joint ventures is proportionate by setting the limits in table 3a. These ensure that the total exposure is no more than 20% of the Council's usable reserves. The Council's loan book is currently within these self-assessed limits.

Table 3a: Loan limits

| Borrower | Cash limit |
|--|-------------------|
| Local enterprises and local charities | £3m |
| Wholly owned companies and joint ventures | £3m |
| Car and bike loans to employees | £3m |
| Treasury management investments meeting the definition of a loan | Unlimited |

The Council uses an allowed 'expected credit loss' model for loans and receivables as set out in International Financial Reporting Standard 9: Financial Instruments as adopted by proper practices to measure the credit risk of its loan portfolio. Appropriate consideration is given to state aid rules and competition law. The Council has appropriate credit control arrangements to recover overdue repayments in place.

Non-specified investments: Any financial investment not meeting the definition of a specified investment or a loan is classed as non-specified. Given the wide definition of a loan, this category only applies to units in pooled funds and shares in companies. Limits on non-specified investments are shown in table 3b; the Council confirms that its current non-specified investments remain within these limits.

Table 3b: Non-specified investment limits

| | Cash limit |
|--|-------------------|
| Units in pooled funds without credit ratings or rated below A- | £20m |
| Shares in real estate investment trusts | £10m |
| Total non-specified investments | £30m |

Non-financial investments: This category covers non-financial assets held primarily or partially to generate a profit, primarily investment property. Security is determined by comparing each asset's purchase price to its fair value using the model in International Accounting Standard 40: Investment Property as adapted by proper practices. On an assessment as at 31st March 2019, the Council consider that the scale of its non-financial investments as not significant.

Liquidity: For financial investments that are not treasury management investments, or loans, the Council has procedures in place to ensure that the funds are prudently committed for a maximum period of time. Isio mwy fan hyn.

Investment advisers: The Council has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues. The quality of this service is monitored by the Head of Finance and the Investment Manager on a regular basis.

Borrow in advance of need: The Council 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 Council 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 Council's overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit of £200 million. The maximum period between borrowing and expenditure is expected to be two years, although the Council is not required to link particular loans with particular items of expenditure.

Commercial deals: In the event of a commercial deal, the individuals making the deal are aware of the core principles of the prudential framework and of the regulatory regime within which the Council operates.

Capacity, skills and corporate governance: Elected members and officers were invited to a presentation by Arlingclose on 27th January 2021. The information and discussion at the presentation ensures that the members have the appropriate skills and information to enable them to:

- Take informed decisions as to whether to enter into a specific investment.
- To assess individual assessments in the context of the strategic objectives and risk profile of the Council
- Understand how the quantum of these decisions have changed the overall risk exposure of the local authority

Officers also regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA, ACA and other appropriate organisations.