ARGYLL AND BUTE COUNCIL	POLICY AND RESOURCES COMMITTEE
FINANCIAL SERVICES	16 FEBRUARY 2023

TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY

1. EXECUTIVE SUMMARY

1.1 The Council has adopted the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management in Local Authorities. A requirement of the Code is for an annual Treasury Management Strategy Statement and Investment Strategy to be approved by Council for the forthcoming financial year. This report seeks Member's approval of the proposed Treasury Management Strategy Statement and Annual Investment Strategy. The report also sets out the policy for the repayment of loans fund advances for 2023-24.

1.2

1.7 The review considered new loans fund advances and historic loans fund advances to assess whether the repayment methodology was still the most prudent option. In doing so a revised policy on loans fund advance repayment profiling was introduced as follows:

For all new loans fund advances the policy for repayment is:

- Asset life method – loans fund advances will be repaid with reference to the life of an asset using a 5.1% annuity rate;
- Funding / Income profile method – loans fund advances will be repaid by reference to an associated income stream using a 5.1% annuity rate. This would be utilised where the asset will generate income which can be used to repay the debt or as a result of spend to save schemes where again the savings can be used to repay the loans fund advances.

1.8 During 2022-23 a decision was taken to repay three of our loans early to take advantage of a discount which was on offer. This has provided the Council with a one-off gain of £5.397m which will be transferred to the General Fund and can assist with budget pressures.

1.9 Section 3 of the document outlines the current actual external debt against the capital financing requirement highlighting any over or under borrowing. There is information on the interest rates projections and the borrowing strategy.

1.10 Section 4 of the document outlines the annual investment strategy. The Council's investment priorities will be security first, liquidity second and then return. It explains the creditworthiness policy and the use of Link Treasury Services in this respect as well as the Country and Sector limits.

1.11 There are a number of appendices in Section 5. Some of this information has been provided by the Council's external treasury management advisors.

2. RECOMMENDATIONS

2.1 It is recommended that Policy and Resources Committee refer to Council to:

a) Approve the proposed Treasury Management Strategy Statement and Annual Investment Strategy and the indicators contained within. Note that the figures within the Strategy will be updated to reflect the budget decisions agreed at Council.

b) Approve the continued use of the asset life method for the repayment of loan fund advances using a 5.1% annuity interest rate, with the exception of spend to save schemes where the funding/income profile method could be used.

c) Approve the proposed asset repayment periods as detailed within section 2.7 of the Treasury Management Strategy Statement.

d) Approve the ability to continue to use countries with a sovereign rating of AA- and above, as recommended by the Council's external treasury management advisors.

3. IMPLICATIONS

3.1 Policy – Sets the policy for borrowing and investment decisions.

3.2 Financial – An effective Treasury Management Strategy forms a significant part of the Council's financial arrangements and its financial well-being.

3.3 Legal - None.

3.4 HR - None.

3.5 Fairer Scotland Duty – None.

3.5.1 Equalities – None.

3.5.2 Socio-Economic Duty – None.

3.5.3 Islands Duty – None.

3.6 Climate Change – None.

3.7 Risk - This report does not require any specific risk issues to be addressed, however members will be aware that the management of risk is an integral part of the Council's treasury management activities.

3.8 Customer Service - None.

Kirsty Flanagan
Executive Director/Section 95 Officer
9 February 2023

Policy Lead for Finance and Commercial Services: Councillor Gary Mulvaney

APPENDICES
Appendix 1 – Treasury Management Strategy Statement and Annual Investment Strategy 2023-24

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and Annual Investment Strategy 2023-2024

1 INDEX

1 INTRODUCTION (Key Considerations)

2021 revised CIPFA Treasury Management Code and Prudential Code – changes which will impact

1.1 Background

The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the 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

initially before considering investment return.

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

The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

CIPFA defines treasury management as:

"The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

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

1.2 Treasury Management reporting

The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

An **Annual Treasury Management Strategy Statement** (this report)

1.4 Training

The CIPFA Code requires the responsible officer to ensure that Members with responsibility for treasury management receive adequate training in treasury management. This especially applies to Members responsibl

2 CAPITAL PRUDENTIAL AND TREASURY

2.5 Limits to Borrowing Activity

The operational boundary: This is the limit beyond which external debt is not normally expected to

forward projections for borrowing, are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

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Within the prudential indicsps the3e a3e a number of key indicsps to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2022/23 and the following two financial years. This allows some flexibility for limited early borrowing for future years

Our central forecast reflects a view that the Monetary Policy Committee (MPC) will be keen to demonstrate its anti-inflation credentials by delivering a succession of rate increases. This has happened throughout 2022,
probably mean Bank Rate does not now need to increase to further than 4.5%.

Further down the road, we anticipate the Bank of England will be keen to loosen monetary policy when the worst of the inflationary pressures have lessened but that timing will be one of fine judgment: cut too soon, and inflationary pressures may well build up further; cut too late and any downturn or recession may be prolonged.

The CPI measure of inflation will peak at close to 11% in Q4 2022. Despite the cost-of-living squeeze that is still taking shape, the Bank will want to see evidence that wages are not spiralling upwards in what is evidently a very tight labour market. Wage increases, excluding bonuses, are currently running at 5.7%.

Regarding the plan to sell £10bn of gilts back into the market each quarter (Quantitative Tightening), this has started but will focus on the short to medium end of the curve for the present. This approach will prevent any further disruption to the longer end of the curve following on from the short-lived effects of the Truss/Kwarteng unfunded dash for growth policy.

In the upcoming months, our forecasts will be guided not only by economic data releases and clarifications from the MPC over its monetary policies and the Government over its fiscal policies, but the on-going conflict between Russia and Ukraine. (More recently, the heightened tensions between China/Taiwan/US also have the potential to have a wider and negative economic impact.)

On the positive side, consumers are still estimated to be sitting on over £160bn of excess savings left over from the pandemic so that will cushion some of the impact of the above challenges. However, most of those are held by more affluent people whereas lower income families already spend nearly all their income on essentials such as food, energy and rent/mortgage payments.

Link Treasury Services have also provided commentary in relation to interest rates and this is included within Appendix 3.

3.3 Investment and borrowing rates

Yield curve movements have become less volatile under the Sunak/Hunt government. PWLB 5 to 50 years Certainty Rates are, generally, in the range of 3.75% to 4.5

While this authority will not be able to avoid borrowing to finance new capital expenditure, to replace maturing debt and the rundown of reserves, there will be a *cost of carry*, (the difference between higher borrowing costs and lower investment returns), to any new borrowing that causes a temporary increase in cash balances.

3.7 New financial institutions as a source of borrowing and / or types of borrowing

Currently the PWLB Certainty Rate is set at gilts + 80 basis points for both HRA and non-HRA borrowing. However, consideration may still need to be given to sourcing funding from the following sources for the following reasons:

Local authorities (primarily shorter dated maturities out to 3 years or so still cheaper than the Certainty Rate).

Financial institutions (primarily insurance companies and pension funds but also some banks,

certainty over the next few years).

Our advisors will keep us informed as to the relative merits of each of these alternative funding sources.

3.8 Approved Sources of Long and Short term Borrowing

A list of approved sources of long and short term borrowing is shown below:

On Balance Sheet	Fixed	Variable
PWLB		
Municipal bond agency		
Local authorities		
Banks		
Pension funds		
Insurance companies		
UK Infrastructure Bank		
Market (long-term)		
Market (temporary)		
Market (LOBOs)		
Stock issues		

4 ANNUAL INVESTMENT STRATEGY

4.1 Investment policy

the requirements of the Local Government Investments (Scotland) Regulations 2010, (and accompanying Finance Circular 5/2010), and the CIPFA Treasury Management in Public Services Code of Practice and Cr and CIPFA Treasury Management Guidance Notes 2021.

The above regulations and guidance place a high priority on the management of risk. **The Council's investment priorities will be security first, liquidity second and then return.** This authority has adopted a

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Investment returns expectations

The current forecast shown in Appendix 3, includes a forecast for Bank Rate to reach 4.5% in Q2 2023.

The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows.:

Average earnings in each year	
2022/23 (remainder)	3.95%
2023/24	4.40%
2024/25	3.30%
2025/26	

are increasing the Council will look to move to fixed rate borrowing and if interest rates are likely to fall then the level of variable rate borrowing will be increased to minimise future interest payments.

Appendix 2 – Detailed Current Portfolio Position

		Actual	Actual	Current	Current
		31.3.22	**31.3.22**	**31.12.22**	**31.12.22**
Treasury investments		**£000**	**%**	**£000**	**%**
Banks	Clydesdale Bank	5,117	5%	6,921	7%
	Bank of Scotland	0	0%	0	0%
	Goldman Sachs	10,000	9%	0	0%
	Qatar National Bank	5,000	5%	0	0%
	Commonwealth Bank of Australia	0	0%	0	0%
	Santander	5,000	5%	0	0%
	ANZ Banking Group/London	0	0%	10,000	10%
	Close Brothers	15,000	14%	2,500	2%
	First Abu Dhabi Bank	10,000	9%	15,000	15%
	AL Rayan Bank	10,000	9%	5,000	5%
	Toronto Dominion Bank	5,000	5%	5,000	5%
	National Bank of Kuwait	5,000	5%	7,500	7%
		70,117	63%	51,921	50%
Local Authorities	London Borough of Croydon	7,500	7%	5,000	5%
	Rotherhan Metropolitan Borough Council	7,500	7%	0	0%
	Thurrock Borough Council	0	0%	10,000	10%
	Cheshire West & Chester Council	2,500	2%	2,500	2%
	Cambridgeshire County Council	0	0%	5,000	5%
	Spelthorn Borough Council	0	0%	5,000	5%
	Slough Borough Council	0	0%	10,000	10%

		Actual 31.3.22	Actual 31.3.22	Current 31.12.22	Current 31.12.22
Treasury external borrowing					
Local Authorities		0	0%	0	0%
PWLB		118,145	66%	84,273	58%
LOBOs	Commerzbank Finance & Covered Bonds S.A.	13,000	7%	13,000	9%
	FMS Wertmanagement	5,255	3%	5,255	4%
	Bayerische Landesbank	21,000	12%	21,000	15%
		39,255	22%	39,255	27%
Market	Barclays (formerly LOBO)	10,000	6%	10,000	7%
		10,000	6%	10,000	7%
Special					

Appendix 3 – Interest Rate Forecasts 2023 - 2025 and Commentary Provided by Link Treasury Services (08.12.22)

Appendix 4 – Economic Background Provided by Link Treasury Services (at 08.12.22)

Against a backdrop of stubborn inflationary pressures, the easing of Covid restrictions in most developed economies, the Russian invasion of Ukraine, and a range of different UK Government policies, it is no surprise that UK interest rates have been volatile right across the curve, from Bank Rate through to 50-year gilt yields, for all of 2022.

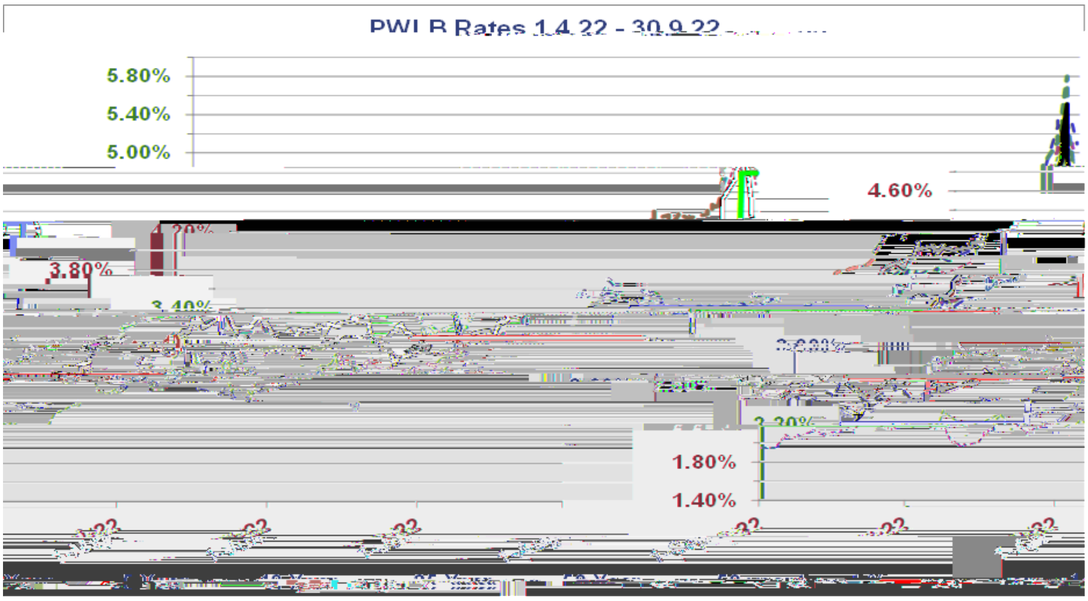
placed optimism around inflation has been the root cause of the rout in the bond markets with, for example, UK, EZ and US 10

Globally, though, all the major economies are expected to struggle in the near term. The fall below 50 in the composite Purchasing Manager Indices for the UK, US, EZ and China all point to at least one if not more quarters of GDP contraction. In November, the MPC projected eight quarters of negative growth for the UK lasting throughout 2023 and 2024, but with Bank Rate set to peak at lower levels than previously priced in by the markets and the fiscal tightening deferred to some extent, it is not clear that things will be as bad as first anticipated by the Bank.

The £ has strengthened of late, recovering from am0 g08q0.0000088.s8 low of $1.035, onhe Mony tter

runof late, 2023 is likely to see a housing cor8q0.tionof some magnitude as fixed-rate mortgages have moved above 5% and affordability has been squeezed despite proposed Stamp Duty cuts remaining in place.

In the table below, the rise in gilt yields, and therein PWLB rates, through the first half of 2022/23 is clear to see.



However, the peak in rates on 28th September as illustrated in the table covering April to September 2022 below, has been followed by the whole curve shifting ever lower. PWLB rates at the front end of the curve are generally over 1% lower now whilst the 50 years is over 1.75% lower.

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Date	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

After a shaky start to the year, the S&P 500 and FTSE 100 have climbed in 8q0.ent weeks, albeit the former is still 17% down and the FTSE 2% up. The German DAX is 9% down for the year.

CENTRAL BANK CONCERNS NOVEMBER 2022

Appendix 5 - Treasury Management Practice (TMP1) Permitted Investments

This Council approves the following forms of investment instrument for use as permitted investments as set out in table 1.

Treasury risks

All the investment instruments in table 1 are subject to the following risks: -

> **Credit and counter-party risk:** this is the risk of failure by a counterparty (bank or building society) to meet its contractual obligations to the organisation particularly as a
>
> evenue) resources. There are no counterparties where this risk is zero although AAA rated organisations have the highest, relative, level of creditworthiness.
>
> **Liquidity risk:** this is the risk that cash will not be available when needed. Whilst it could

Controls on treasury risks

Credit and counter-party risk: this authority has set minimum credit criteria to determine which counterparties and countries are of sufficiently high creditworthiness to be considered for investment purposes. See paragraphs 4.2 and 4.3.

Liquidity risk: this authority has a cash flow forecasting model to enable it to determine how long investments can be made for and how much can be invested.

Market risk: this authority purchases , as they offer a higher rate of return than depositing in the DMADF. They are usually held until maturity but in exceptional circumstances, they can be quickly sold at the current market value, (which may vary from the purchase cost), if the need arises for extra cash at short notice. Their value does not usually vary much during their short life.

Interest rate risk: this authority manages this risk by having a view of the future course of interest rates and then formulating a treasury management strategy accordingly which aims to maximise investment earnings consistent with control of risk or alternatively, seeks to minimise expenditure on interest costs on borrowing. See paragraph 4.4.

Legal and regulatory risk: this authority will not undertake any form of investing until it has ensured that it has all necessary powers and complied with all regulations.

Unlimited investments

Regulation 24 states that an investment can be shown in table 1
maximum amount or percentage of the total portfolio that can be put into that type of investment. However, it also requires that an explanation must be given for using that category.

The authority has given the following types of investment an unlimited category: -

Debt Management Agency

Objectives of each type of investment instrument

DEPOSITS WITH COUNTERPARTIES CURRENTLY IN RECEIPT OF GOVERNMENT SUPPORT / OWNERSHIP

These banks offer another dimension of creditworthiness in terms of Government backing through either partial or full direct ownership. The view of this authority is that such backing makes these banks attractive institutions with whom to place deposits, and that will remain our view if the UK sovereign rating were to be downgraded in the coming year.

Term deposits with high credit worthiness banks which are fully or semi [illegible]. As for term deposits in the previous section, but Government full, (or substantial partial), ownership, implies that the Government stands behind this bank and will be deeply committed to providing whatever support that may be required to ensure the continuity of that bank. This authority considers that this indicates a low and acceptable level of residual risk.

Fixed term deposits with variable rate and variable maturities (structured deposits). This line encompasses ALL types of structured deposits. There has been considerable change in the types of structured deposits brought to the market over the last few years, some of which are already no longer available. In view of the fluidity of this area, this is a generic title for all structured deposits so as to provide councils with greater flexibility to adopt new instruments as and when they are brought to the market. However, this does mean that members ought to be informed as to what instruments are presently covered under this generic title so that they are aware of the current situation, and that they are informed and approve of intended changes in an appropriate manner.

COLLECTIVE INVESTMENT SCHEMES STRUCTURED AS OPEN ENDED INVESTMENT COMPANIES (OEICS)

Government liquidity funds. These are the same as money market funds (see below) but only invest in government debt issuance with highly rated governments. Due risk exposure to banks, MMFs offer an effective way of minimising risk exposure while still delivering superior rates of return available through the DMADF.

Ultra short dated bond funds. Ultra short dated bond funds. These funds are similar to MMFs and can carry a AAA bond fund rating. Due to the longer dated nature of the assets they invest in the funds use a VNAV pricing method meaning the price will move up and down inline with market movements. They aim to achieve a higher yield and to do this either take longer term credit risk by using floating rate notes or by investing in longer durations, which means their assets are more volatile. Typically, these funds can have weighted heir primary objective is to firstly generate a competitive total return, whilst preserving capital. They therefore carry a higher level of risk than MMFs and correspondingly have the potential to earn higher returns than MMFs.

Gilt funds. These are funds which invest only in U.K. Government gilts. They offer a lower rate of return than bond funds but are highly rated both as a fund and through investing only in highly rated government securities. They offer a higher rate of return than investing in the DMADF but they do have an exposure to movements in market prices of assets held.

Bond funds. These can invest in both government and corporate bonds. This therefore entails a higher level of risk exposure than gilt funds and the aim is to achieve a higher rate of return than normally available from gilt funds by trading in

1.5 Securities issued by corporate organisations

	* Minimum Credit Criteria	Liquidity risk	Market risk	Max % of total investments	Max. maturity period
Certificates of deposit issued by banks and building societies	Green	Sale T+0	yes	50	2 Years
Commercial paper other	Green	Sale T+0	yes	20	2 Years
Floating rate notes	Green	Sale T+0	yes	20	2 Years
Corporate Bonds other	Green	Sale T+3	yes	20	2 Years

Accounting treatment of investments. The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

1.6 Other

	* Minimum Credit Criteria / fund rating	Liquidity risk	Market risk	Max % of total investments	Max. maturity period
Property funds	--	T+4	yes	100	5 Years

Type of Investment	Treasury Risks

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits	Common Good Limits
on period & credit rating)	broken with the agreement of the counterparty, and penalties may apply.			
g. Government Gilts and Treasury Bills **(Very low risk)**	These are marketable securities issued by the UK Government and as such counterparty and liquidity risk is very low, although there is potential risk to value arising from an adverse movement in interest rates (no loss if these are held to maturity.	Little counterparty mitigating controls are required, as this is a UK Government investment. The potential for capital loss will be reduced by limiting the maximum monetary and time exposures.	£10m maximum 1 year.	100% maximum 1 year.
h. Certificates of deposits with financial institutions **(Low risk)**	These are short dated marketable securities issued by financial institutions and as such counterparty risk is low, but will exhibit higher risks than categories (a), (b) and (c) above. There is risk to value of capital loss arising from selling ahead of maturity if combined with an adverse movement in interest rates (no loss if these are held to maturity). Liquidity risk will normally be low.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.	£10m per counterparty maximum 1 year.	20% maximum 1 year.
i. Structured deposit facilities with banks and building societies (escalating rates, de-escalating rates etc.) **(Low to medium risk**	These tend to be medium to low risk investments, but will exhibit higher risks than categories (a), (b) and (c) above. Whilst there is no risk to value with these types of investments, liquidity is very low and investments can only be broken with the agreement	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Day to day investment dealing with this criteria	As shown in the counterparty section criteria above.	As shown in the counterparty section criteria above.

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits	Common Good Limits
depending on period & credit rating)	of the counterparty (penalties may apply).	will be further strengthened by the use of additional market intelligence.		
j. Corporate bonds **(Medium to high risk depending on period & credit rating)**	These are marketable securities issued by financial and corporate institutions. Counterparty risk will vary and there is risk to value of capital loss arising from selling ahead of maturity if combined with an adverse movement in interest rates. Liquidity risk will be low.			

Appendix 9 – Treasury Management Scheme of Delegation

The Council

Overall responsibility for Treasury Management Strategy.

Adoption of Treasury Policy Statements.

Receive an Annual Report and other reports on the Treasury Management Operation and on the exercise of delegated treasury management powers.

The Policy and Resources Committee

Responsibility for the overall investment of money under the control of the Council.

Keeping under review the level of borrowing.

Approval of Annual Strategy Statement.

Receiving and reviewing reports on treasury management policies, practices and activities.

Approval of Treasury Policy Statements.

Implementation and monitoring of Treasury Management Policies and Practices.

The Audit and Scrutiny Committee

Review the overall internal and management control framework related to the treasury function.

Review internal and external audit reports related to treasury management.

Review provision in the internal and external audit plans to ensure there is adequate audit coverage of treasury management.

Monitor progress with implementing recommendations in internal and external audit reports.

Reviewing the treasury management policy and procedures and making recommendations to the responsible body.

Appendix 11 – Policy on environmental, social and governance (E.S.G.)

This Council is supportive of the Principles for Responsible Investment (www.unpri.org) and will seek to bring ESG (environmental, social and governance) factors into the decision-making process for investments. Within this, the Council is also appreciative of the Statement on ESG in Credit Risk and Ratings which commits signatories to incorporating ESG into credit ratings and analysis in a systemic and transparent way. The Council uses ratings

counterparties. Each of these rating agencies is a signatory to the ESG in credit risk and ratings statement, which is as follows:

> *"We, the undersigned, recognise that environmental, social and governance (ESG) factors can affect borrowers' cash flows and the likelihood that they will default on their debt obligations. ESG factors are therefore important elements in assessing the creditworthiness of borrowers. For corporates, concerns such as stranded assets linked to climate change, labour relations challenges or lack of transparency around accounting practices can cause unexpected losses, expenditure, inefficiencies, litigation, regulatory pressure and reputational impacts.*
>
> *At a sovereign level, risks related to, inter alia, natural resource management, public health standards and corruption can all affect tax revenues, trade balance and foreign investment. The same is true for local governments and special purpose vehicles issuing project bonds. Such events can result in bond price volatility and increase the risk of defaults.*
>
> *In order to more fully address major market and idiosyncratic risk in debt capital markets, underwriters, credit rating agencies and investors should consider the potential financial materiality of ESG factors in a strategic and systematic way. Transparency on which ESG factors are considered, how these are integrated, and the extent to which they are deemed material in credit assessments will enable better alignment of key stakeholders.*
>
> *In doing this the stakeholders should recognise that credit ratings reflect exclusively an assessment of an issuer's creditworthiness. Credit rating agencies must be allowed to maintain full independence in determining which criteria may be material to their ratings. While issuer ESG analysis may be considered an important part of a credit rating, the two assessments should not be confused or seen as interchangeable.*
>
> *With this in mind, we share a common vision* ***to enhance syst project bonds*** [illegible]