READING BOROUGH COUNCIL

REPORT BY EXECUTIVE DIRECTOR OF RESOURCES

TO:	**COUNCIL**		
DATE:	**23rd FEBRUARY 2021**		
TITLE:	**TREASURY MANAGEMENT STRATEGY STATEMENT (2021/22); MINIMUM REVENUE PROVISION POLICY (2021/22); ANNUAL INVESTMENT STRATEGY (2021/22)**		
LEAD COUNCILLOR:	**COUNCILLOR EMBERSON**	**PORTFOLIO:**	**COUNCIL WIDE**
SERVICE:	**FINANCIAL SERVICES**	**WARDS:**	**BOROUGHWIDE**
LEAD OFFICER:	**PETER ROBINSON**	**TEL:**	
JOB TITLE:	**ASSISTANT DIRECTOR OF FINANCE**	**E-MAIL:**	Peter.robinson@reading.gov.uk

1. PURPOSE OF REPORT AND EXECUTIVE SUMMARY

1.1 In accordance with the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 and the CIPFA Prudential and Treasury Management Code (2017), the Council is required to approve a Treasury Management Strategy before the start of each financial year. This report fulfils that obligation.

1.2 The Council's Treasury Management Strategy Statement (TMSS), attached at Appendix A, sets out the parameters for the Council's planned treasury activity during 2021/22 under which the Council's Treasury Team will manage day to day activity. The TMSS reflects the Council's Draft Capital Programme 2021/22 – 2023/24.

1.3 The successful identification, monitoring and control of financial risk are central to the Strategy.

1.4 The CIPFA 2017 Prudential and Treasury Management Code also requires the Council to prepare a Capital Strategy report which sets out the Council's capital requirements arising from policy objectives, as well as the associated governance procedures and risk appetite.

1.5 The Capital Strategy is reported separately from the Treasury Management Strategy Statement and includes non-treasury investments.

1.6 In light of the current levels of uncertainty in the economy and the reform of PWLB lending terms, the Council's Policy Committee approved the removal of all commercial property investment from its Capital Programme at its meeting on 14th December 2020.

1.7 It is proposed in the Annual Investment Strategy attached at Appendix 1 that the Council's cash investment limit for Non-Specified Investments which include pooled property funds is increased from £20m to £30m to provide the Council with additional investment flexibility given the significant uncertainty within the market.

2. RECOMMENDED ACTION

That Full Council approve:

2.1. The Treasury Management Strategy Statement for 2021/22 as set out in Appendix A;

2.2. The Treasury Management Policy for 2021/22 as set out in Appendix A;

2.3. The Minimum Revenue Provision (MRP) Policy for 2021/22 as set out in Appendix A;

2.4. The Annual Investment Strategy for 2021/22 as set out in Appendix A, noting the revised total limit for Non-Specified Investments; and

2.5. The Prudential and Treasury Management indicators as set out in Appendix A.

APPENDICES:

Appendix A - Treasury Management Strategy Statement 2021/22 (including the Borrowing & Investment Strategy, Treasury Management Indicators and Prudential Indicators); Treasury Management Policy (2021/22); Minimum Revenue Provision Policy (2021/22); Annual Investment Strategy (2021/22).

3. ECONOMIC BACKGROUND

3.1 The Bank of England's Monetary Policy Committee (MPC) kept Bank Rate unchanged at 0.10% on 16th December 2020 and warned that Covid-19 restrictions were likely to hit economic activity in early 2021. The MPC also voted unanimously to keep the Bank's programme of bond buying, known as Quantitative Easing, unchanged at £895bn.

3.2 The MPC's long-term outlook for the UK had improved slightly since its last meeting in November 2020, thanks to the positive news around Covid-19 vaccine rollout. However, it should be noted that the MPC meeting took place prior to Central Government announcements of tighter and wider tier and Christmas restrictions on 17th December 2020 and the subsequent national lockdown announced on the 4th January 2021.

3.3 The Bank of England's forward guidance in its policy statement in August 2020 was that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% (inflation) target sustainably". Which in effect means that even if inflation rises to 2% in over time, the MPC are unlikely to raise Bank Rate - until they can clearly see that level of inflation is going to be persistently above target. The Bank Rate forecast currently shows no increase through to March 2024, but it will depend on the speed of economic recovery and the current debt to Gross Domestic Product (GDP) ratio falling significantly. Inflation is expected to briefly peak at around 2% towards the end of 2021 but is unlikely to pose a threat requiring increases in Bank Rate during this period as there is expected to be spare capacity in the economy for a considerable time.

3.4 Public borrowing is now forecast by the Office for Budget Responsibility (the OBR) to reach £394bn in the current financial year, the highest ever peace time deficit and equivalent to 19% of GDP. Ordinarily, such an increase in gilt issuance would lead to a rise in gilt yields, and hence PWLB rates. However, the Quantitative Easing (QE) has depressed yields to historically low levels, (consistent with QE measures in the US, the EU and Japan). This means that new UK debt issued across the yield curve, is locking in those low levels. In addition, the UK has one of the longest average maturities for its entire debt portfolio of any country in the world. This means that the total interest bill paid by the Government is manageable despite the huge increase in the total amount of debt.

4. BORROWING

4.1 Under the Prudential Code, the Council can borrow to fund capital expenditure if such borrowings are sustainable, affordable and prudent.

4.2 The underlying need to borrow (the net borrowing requirement) for capital purposes is measured by the Capital Financing Requirement (CFR). Usable reserves and working capital are the underlying resources available for investment.

4.3 Historically the Council has borrowed to pay for new assets including schools, roads and community facilities etc. The value of the Council's assets is circa £1.1bn. As at 31st December 2020, the Council had £407m of loans outstanding in respect of these assets for both the General Fund and the Housing Revenue Account (HRA).

4.4 The Council has not taken out any borrowing (short or long-term) in 2020/21 to 31 December 2020.

4.5 Market projections, per Table 12 in Appendix A, indicate that long-term borrowing costs will increase gradually, but remain relatively low for some time (at least until March 2024) compared to historic averages. Consequently, the Council intends to use lower cost temporary borrowing in the coming year. This strategy will be kept under review with the Council's Treasury Management advisors. Longer term borrowing will not be taken out until necessary, thereby avoiding the "cost of carry" (the difference between the cost of borrowing and return on investing the funds until such time as the capital expenditure is incurred).

4.6 The Capital Programme 2021/22-2023/24 totals £300.825m (£200.023m General Fund and £100.802m HRA) as set out in Table 1 of Appendix A. The Programme aims to improve the infrastructure, asset base and effectiveness of service provision for the residents of Reading.

4.7 After accounting for specific grants, s106 contributions and capital receipts, the total borrowing requirement is £156.543m per Table 2 of Appendix A (£98.331m General Fund and £58.212m HRA). The cost of borrowing together with any associated revenue savings is included within the Council's Medium-Term Financial Strategy 2021/22 – 2023/24.

4.8 After reducing the borrowing requirement by a total Minimum Revenue Provision charge of £28.123m across the period, the Council has a projected increase in its CFR of £128.420m, as set out in Table 4 of Appendix A.

4.9 The Executive Director of Resources has delegated responsibility for borrowing and works closely with the Council's treasury management team and advisors, Link Group, on borrowing decisions taking into account several factors including:

- The cost of borrowing short or long-term
- Anticipated changes in the cost of borrowing
- The level of cash balances held under investment
- The return on invested balances

4.10 The Council's long-term borrowing (loans over 12 months in length) is from two sources: The Public Works Loans Board (PWLB) and private banks for debt relating to Lender Option Borrower Option loans (LOBO loans currently stand at £25m). For short term borrowing the Council will continue to use other sources of finance, e.g. loans from other local authorities that it can borrow from at lower rates of interest than PWLB.

4.11 The framework for taking borrowing decisions in the coming year is set out in the Council's TMSS, attached at Appendix A. The Council may increase its longer term PWLB borrowing to cover new capital project expenditure in advance of need to minimise the risk of interest rate fluctuations. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

4.12 The Council's self-imposed limits on sustainable, affordable and prudent borrowing and investment, the Prudential and Treasury Management Indicators that need to be approved by Council are set out in Appendix A.

5. INVESTMENTS

5.1 The Council's investments for Treasury Management purposes seek to manage in year fluctuations in cash-flow. Treasury investments can be called on at short-notice and in the main are held in Money Market Funds. These are low-risk investments and give higher rates of interest compared to leaving balances in the Council's bank account. Other investments include the CCLA property fund and loans to the Council's wholly owned companies.

5.2 The level of investments fluctuates throughout the year dependent on cash balances. The balance of investments was £95.596m at the end of December 2020 (per Table 7 in Appendix A), which is higher than usual due to the volume of Covid related grants received from Central Government in advance of need. The average interest was 3.24% and the average weighted rate of return of 1.35%.

5.3 The Council can legally invest in the following funds and instruments:

- Fixed Term Deposits (Government, public sector bodies, Banks and Building Societies)
- Callable deposits (Banks and Building Societies)
- Money Market Funds
- Certificates of Deposit (tradable term deposits)
- Governments Gilts and Treasury Bills
- Corporate Bonds
- Derivatives (where used for risk management)

5.4 The Ministry for Housing Communities & Local Government (MHCLG) published updated guidance on investments in February 2018. The previous edition covered treasury investments only, but the latest edition focuses on non-treasury investments. These are commercial investments such as the purchase of investment properties, investments in subsidiaries or investments for service objectives including regeneration.

5.5 The revised PWLB borrowing terms announced in November 2020, prevent Local Authorities from borrowing from the PWLB for any purpose should their ongoing Capital Programme contain commercial schemes that are primarily investments to generate a financial yield. Consequently, Policy Committee approved the removal of the Capital budget for the Purchase of Commercial Property from its Capital Programme at its meeting in December 2020.

6. MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE (MiFID) II

6.1 MiFID II is the EU directive regulating the provision of financial services within the European Economic Area and became effective on 3 January 2018. The objective of MFIS II is to provide greater safeguards for non-professional clients who invest or trade in financial instruments. Although the UK has now left the EU, the MiFID II Directive continues to apply until at least 31st March 2022.

6.2 Local authorities are classified as retail clients by default, unless they exercise the option to 'opt-up' to 'elective professional client status' subject to meeting certain qualitative and quantitative tests.

6.3 The Council successfully opted up to professional client status which means it can maintain its ability to maximise interest on its balances and not have to limit its current range of investments. This status has to be agreed individually with each financial institution, broker and adviser and certain conditions have to be met relating to the quantity of transactions carried out and the experience and knowledge of those carrying out those transactions.

6.4 Under the legislation, professional status requires the Council to assume more direct responsibility for its investment decisions. Effectively this is incorporated into the due diligence the Council already undertakes before making any investment.

7. APPROVED INVESTMENTS AND COUNTERPARTIES

7.1 The counterparty criteria are kept under regular review and are detailed in annexe A of the appendix to this report. The criteria set out the value and duration limits which are applied in the day to day investment of the Council's cash balances.

7.2 The value and duration limits as well as the minimum credit ratings required of individual institutions seek to minimise the Council's exposure to counterparty risk, i.e. limit any potential loss due to the failure of any single institution or group.

7.3 The credit ratings agencies' criteria are relative measures of financial strength, any changes are notified to the Council's Treasury Team on the same day by our treasury advisor, Link Group. Over recent years the agencies have downgraded many financial institutions by removing the implied sovereign support. However, financial institutions have improved their capital ratios to meet new regulatory standards to enable them to withstand market shocks like that experienced during the financial crisis in 2008. This requirement for increased resilience is designed to give higher assurance that institutions will be going concerns in the medium to long term.

7.4 In addition, central banks such as the Bank of England and European Central Bank provide financial support to financial institutions through Term Funding Schemes (TFS) that ensures they have access to enough liquidity at low rates. The TFS was launched in 2016 and provides funding to banks and building societies at rates close to Base Rate.

8. RISK CONTROLS

Investment Risk

8.1 The main risk of investing is that the borrower or counterparty defaults on the loan and cannot repay it.

8.2 The main controls on investment risk are the application of counterparty criteria which limit the amount and duration of investments with both individual and groups of related counterparties. The criteria are generally based on rating agency evaluations as detailed in Appendix A.

Borrowing Risk

8.3 The main risk when deciding to borrow is around the timing of the decision. There is a risk that interest rates will increase before any planned borrowing is taken. The Council receives regular interest rate forecasts which are used to inform decisions on the timing of external borrowing.

8.4 The latest guidance requires the use of other information as well as rating agency evaluations. When ratings change, the Treasury Team are notified on the same day by our treasury advisors. There are regular internal and external meetings the Treasury Team attend to keep abreast of latest topics. The monthly updates from Link Group include other market sources of information, such as the prices of financial instruments and shares. In addition, professional publications and sector specific reports are reviewed by the Team to ensure that any decision to borrow is based a broad array of available information.

8.5 The Treasury Management Policies deal with risk controls, decision making and reporting processes, along with high level administration of the Treasury Management activities.

9. CONTRIBUTION TO STRATEGIC AIMS

9.1 The Council's vision is to ensure that Reading realises its potential – and to ensure that everyone who lives and works in Reading can share the benefits of its success. The Council has six priorities which contribute to delivering this vision. The priorities are:

- Securing the economic success of Reading;
- Improving access to decent housing to meet local needs;
- Protecting and enhancing the lives of vulnerable adults and children;
- Keeping Reading's environment clean, green and safe;
- Promoting health, education, culture and wellbeing; and
- Ensuring the Council is fit for the future.

9.2 Delivery of the Council's revenue and capital budgets is essential to ensuring the Council meets its strategic aims and remains financially sustainable going forward. The treasury management functions are crucial in ensuring that the Council has access to funds when required and in investing surplus funds in secure investments.

10. ENVIRONMENTAL AND CLIMATE IMPLICATIONS

10.1 There are no environmental implications arising directly from this report.

11. COMMUNITY ENGAGEMENT AND INFORMATION

11.1 Budget-related communications and consultations will continue to be a priority over the next three years as we work to identify savings.

12. FINANCIAL IMPLICATIONS

12.1 Financial implications are contained in the body of this report

13. LEGAL IMPLICATIONS

13.1 This report assists the Council in fulfilling its statutory obligation to set out its Treasury Strategy for borrowing and to prepare an Annual Investment Strategy for the coming year setting out the Council's policies for managing its borrowing and investments and giving priority to the security and liquidity of those investments.

14. BACKGROUND INFORMATION

- CIPFA Code of Practice for Treasury Management in the Public Services 2017
- CIPFA The Prudential Code 2017
- MHCLG Statutory Guidance on Local Government Investments (February 2018)
- CIPFA Bulletin Treasury and Capital Management Update (October 2018)