READING BOROUGH COUNCIL

REPORT BY DIRECTOR OF FINANCE

TO:	**POLICY COMMITTEE**		
DATE:	**14 FEBRUARY 2022**		
TITLE:	**TREASURY MANAGEMENT STRATEGY STATEMENT (2022/23); MINIMUM REVENUE PROVISION POLICY (2022/23); ANNUAL INVESTMENT STRATEGY (2022/23)**		
LEAD COUNCILLOR:	**COUNCILLOR BROCK**	**PORTFOLIO:**	**COUNCIL WIDE**
SERVICE:	**FINANCE**	**WARDS:**	**BOROUGHWIDE**
LEAD OFFICER:	**STUART DONNELLY**	**TEL:**	**01189 373468**
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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 2022/23 under which the Council's Treasury Team will manage day to day activity. The TMSS reflects the Council's Draft Capital Programme 2022/23 – 2024/25.

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 This report has been prepared with reference to the following documents:

- 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)

2. RECOMMENDED ACTION

That Policy Committee endorse and recommend that Full Council approve:

2.1. The Treasury Management Strategy Statement for 2022/23 as set out in Appendix A;

2.2. The Treasury Management Policy for 2022/23 as set out in Appendix A;

2.3. The Minimum Revenue Provision (MRP) Policy for 2022/23 as set out in Appendix A;

2.4. The Annual Investment Strategy for 2022/23 as set out in Appendix A; and

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

APPENDICES:

Appendix A - Treasury Management Strategy Statement 2022/23 (including the Borrowing & Investment Strategy, Treasury Management Indicators and Prudential Indicators); Treasury Management Policy (2022/23); Minimum Revenue Provision Policy (2022/23); Annual Investment Strategy (2022/23).

3. ECONOMIC BACKGROUND

3.1 In December 2021, the Bank of England increased bank rate from 0.10% to 0.25% as recovery progresses from the Covid recession of 2020. The Council's Treasury Management advisors, Link Group, Treasury Solutions are forecasting that bank rate will increase to 0.50% in June 2022 and then to 0.75% in March 2023.

3.2 With inflation expected to peak at around 6% in April 2022, the Bank of England Monetary Policy Committee (MPC) may want to be seen to be active in taking action to counter inflation on 5th May 2022, the release date for its Quarterly Monetary Policy Report. The December 2021 MPC meeting was more concerned with combating inflation over the medium term than supporting economic growth in the short term. Bank Rate increases beyond May are difficult to forecast as inflation is likely to drop sharply in the second half of 2022.

3.3 Covid remains a major potential downside threat in all three years as there is a high likelihood that further mutations of the virus will develop.

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 2021, the Council had £393.171m 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 2021/22 to 31st December 2021.

4.5 Market projections, per Table 11 in Appendix A, indicate that long-term borrowing costs will increase gradually, but remain relatively low for some time (at least until March 2025) compared to historic averages. Consequently, the Council intends to use lower cost temporary borrowing in the coming year where required. 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 2022/23-2024/25 totals £311.756m (£171.498m General Fund and £140.258m 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 £160.750m per Table 2 of Appendix A (£85.729m General Fund and £75.021m HRA). The cost of borrowing together with any associated revenue savings is included within the Council's Medium-Term Financial Strategy 2022/23 – 2024/25.

4.8 All schemes included in the approved capital programme, including those planned to start in 2022/23 shall remain subject to:

(i) spending approval in detail by the responsible Committee or Policy Committee or Council, as appropriate, for all schemes

(ii) the Director of Finance confirming the availability of funds, including that sufficient revenue budget is available to meet the ongoing capital financing costs of schemes. This is especially important given the budget gap in future years and the need to ensure affordability.

4.9 After reducing the borrowing requirement by a total Minimum Revenue Provision charge of £33.163m across the period, the Council has a projected increase in its CFR of £127.587m, as set out in Table 3 of Appendix A.

4.10 The Director of Finance 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

4.11 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.

4.12 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 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, that the costs of borrowing can be met and that the Council can ensure the security of such funds.

4.13 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 £156.750m at the end of December 2021 (per Table 6 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 2.88% and the average weighted rate of return 1.28%.

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 Department for Levelling Up, Housing and Communities (DLUHC) 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 European Union (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 has been formally adopted into UK legislation

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 responded by improving 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. MINIMUM REVENUE PROVISION (MRP) CONSULTATION

8.1 The Department for Levelling Up, Housing and Communities launched a consultation on 30th November 2021 until 8th February 2022, seeking views on proposed change to regulations to better enforce the duty of local authorities to make prudent Minimum Revenue Provision each year.

8.2 One of these proposals would, if implemented, require Council's to provide MRP on any capital loans given to third parties and wholly owned companies. The Council's current MRP policy would therefore need to be reviewed and additional budgetary provision made within the Council's revenue budget in order to comply with this change should it materialise.

8.3 The proposal is that the changes will first come into force for the financial year beginning 1st April 2023 therefore there will be no impact on 2022/23; it is not the government's intention that these changes are applied retrospectively. Based on the level of existing loans, the estimated additional MRP that the Council would need to provide in 2023/24 should the regulations change per the MRP consultation, would be approximately £1.3m. However, this would be mitigated downwards in future years when the capital loan repayments are received, and treated as capital receipts, and applied to fund the capital programme.

9. RISK CONTROLS

Investment Risk

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

9.2 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

9.3 The main risks when deciding to borrow is around the timing of the decision and ensuring affordability. 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.

9.4 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.

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

10. CONTRIBUTION TO STRATEGIC AIMS

10.1 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 three inter-connected themes which contribute to delivering this vision. The themes are:

- Healthy environment;
- Thriving communities;
- Inclusive economy.

10.2 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.

11. ENVIRONMENTAL AND CLIMATE IMPLICATIONS

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

11.2 As set out in the Council's Annual Investment Strategy (Appendix A paragraph 6.17), the Council will not knowingly invest directly in businesses whose activities and practices pose a risk of serious harm to individuals or groups, or whose activities are inconsistent with the Council's Corporate Plan and values. This would include institutions with material links to environmentally harmful activities (e.g. pollution, destruction of habitat, fossil fuels).

12. COMMUNITY ENGAGEMENT AND INFORMATION

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

13. EQUALITY IMPACT ASSESSMENT

13.1 None arising directly from this report.

14. LEGAL IMPLICATIONS

14.1 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.

15. FINANCIAL IMPLICATIONS

15.1 Financial implications are contained in the body of this report.

16. BACKGROUND INFORMATION

16.1 None.