worcestershire
countycouncil

# Appendix 5

**Extract from Worcestershire County Council Treasury Management Strategy 2021/22**

## Background

In accordance with the County Council's Treasury Management Practices (TMPs) and The Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management in the Public Services: Code of Practice the Council is required to approve the Treasury Management Strategy and Annual Investment Strategy for 2021/22. The Treasury Management Strategy is reflected in the Personal Assurance Statement given by the Chief Financial Officer concerning the 2021/22 budget calculations.

Treasury management is undertaken by a small team of professionally qualified staff within financial services.

In addition, the County Council employs Treasury Management advisors, Link Asset Services (formally Capita Asset Services), who provide information and advice on interest rate movements which is used to inform borrowing and investment decisions. The advisors have been engaged on a fixed term basis after a tendering procedure completed in August 2016.

Relevant information is also obtained from other financial commentators, the press and seminars arranged by other organisations, for example CIPFA and the Local Government Association.

Information received from these different sources is compared in order to ensure all views are considered and there are no significant differences or omissions from information given by the County Council's advisors.

All Treasury Management employees take part in the County Council's Staff Review and Development scheme, where specific individual development needs are highlighted training in Treasury Management activities and networking opportunities provided by both professional and commercial organisations are taken up where appropriate.

During 2020/21 the County Council has invested its surplus cash with selected Banks, AAA-rated Money market and cash-plus funds, the UK Debt Management Office and with other local authorities.

## Economic Commentary

The COVID-19 outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its subsequent meetings to 16th December, although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected in the near-term as economic recovery is expected to be only gradual and, therefore, prolonged.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably even, but dependent on how quickly the economy can reopen over the coming months.

- The balance of risks to increases in Bank Rate and shorter term PWLB rates are broadly similarly to the downside.

One risk that is both an upside and downside risk, is that all central banks are now working in very different economic conditions than before the 2008 financial crash as there has been a major increase in consumer and other debt due to the exceptionally low levels of borrowing rates that have prevailed since 2008. This means that the neutral rate of interest in an economy, (i.e. the rate that is neither expansionary nor deflationary), is difficult to determine definitively in this new environment, although central banks have made statements that they expect it to be much lower than before 2008. Central banks could therefore either over or under do increases in central interest rates. Another complication is a post-COVID inflation spike, which could effectively end the post-2008 era of ultra-low interest rates, but this is not certain.

The Council has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Link provided the following forecasts on 11th of August 2020. However, following the conclusion of the review of PWLB margins over gilt yields on 25th November 2020, all forecasts below have been reduced by 1%. These are forecasts for certainty rates, gilt yields plus 80bps:

| Link Group Interest Rate View 9.11.20 | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| These Link forecasts have been amended for the reduction in PWLB margins by 1.0% from 26.11.20 | | | | | | | | | | | | | |
| | 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 |
| BANK RATE | 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 |
| 3 month ave earnings | 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 |
| 6 month ave earnings | 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 |
| 12 month ave earnings | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 |
| 5 yr PWLB | 0.80 | 0.80 | 0.80 | 0.80 | 0.90 | 0.90 | 0.90 | 0.90 | 0.90 | 1.00 | 1.00 | 1.00 | 1.00 |
| 10 yr PWLB | 1.10 | 1.10 | 1.10 | 1.10 | 1.20 | 1.20 | 1.20 | 1.20 | 1.20 | 1.30 | 1.30 | 1.30 | 1.30 |
| 25 yr PWLB | 1.50 | 1.60 | 1.60 | 1.60 | 1.60 | 1.70 | 1.70 | 1.70 | 1.70 | 1.80 | 1.80 | 1.80 | 1.80 |
| 50 yr PWLB | 1.30 | 1.40 | 1.40 | 1.40 | 1.40 | 1.50 | 1.50 | 1.50 | 1.50 | 1.60 | 1.60 | 1.60 | 1.60 |

**Treasury Management Strategy**

The Prudential Code for Capital Finance requires the Council to set several Prudential Indicators. The Treasury Management Strategy has been developed in accordance with these indicators.

**Borrowing Strategy**

There was much speculation during the second half of 2019 that bond markets were in a bubble which was driving bond prices up and yields down to historically very low levels. The context for that was a heightened expectation that the US could have been heading for a recession in 2020. In addition, there were growing expectations of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China, together with inflation generally at low levels in most countries and expected to remain subdued. Combined, these conditions were conducive to very low bond yields. While inflation targeting by the major central banks has been successful over the last thirty years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers. This means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. The consequence of this has been the gradual lowering of the overall level of interest rates and bond yields in financial markets over the last 30 years. Over the year prior to the coronavirus crisis, this has seen many bonds yield up to 10 years turn negative in the Eurozone. In addition, there has, at times, been an inversion of bond yields in the US whereby 10-year yields have fallen below shorter-term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities.

Gilt yields had therefore already been on a generally falling trend up until the coronavirus crisis hit western economies during March 2020. After gilt yields spiked up during the financial crisis in March, we have seen these yields fall sharply to unprecedented lows as investors panicked during March in selling shares in anticipation of impending recessions in western economies, and moved cash into safe haven assets i.e. government bonds. However, major western central banks took rapid action to deal with excessive stress in financial markets during March, and started massive quantitative easing purchases of government bonds: this also acted to put downward pressure on government bond yields at a time when there has been a huge and quick expansion of government expenditure financed by issuing government bonds. Such unprecedented levels of issuance in “normal” times would have caused bond yields to rise sharply. Gilt yields and PWLB rates have been at remarkably low rates so far during 2020/21.

As the interest forecast table for PWLB certainty rates above shows, there is expected to be little upward movement in PWLB rates over the next two years as it will take economies, including the UK, a prolonged period to recover all the momentum they have lost in the sharp recession caused during the coronavirus shut down period. From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment, (as shown on 9th November when the first results of a successful COVID-19 vaccine trial were announced). Such volatility could occur at any time during the forecast period.

The County Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with external debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This will continue, given the current low to non-existent returns on cash.

As HM Treasury has, de-facto removed the 100-bps uplift from PWLB rates, this is now a viable source for long-term funding again. Other borrowing sources are not ruled-out, when assessing these, the following will be considered:

- Borrowing from other local authorities -an active and easily accessible market with terms of up to 5 years available
- Plain vanilla, fixed rate borrowing from other financial institutions, for fixed terms of up to 30 years, requiring some credit assessment by the lender and longer lead-times than PWLB.
- Forward rate agreements with lenders for fixed rate loans above, to secure funding for drawdown at a future date, for a certain rate.

The strategy will be to borrow to replenish a proportion of the reserves and cash balances used to support capital expenditure since October 2008. This will mitigate any interest rate risk in that borrowing and will be taken before borrowing rates increase significantly. The timing of the borrowing will depend on cashflow requirements and forecast future developments and on interest rate movements and the forecast for those future movements. A mixture of shorter and longer-term loans will be taken to fit with the County Council's debt maturity profile.

Interest rates will be monitored but as forecasts stand it is likely that borrowing could be undertaken late in 2020/21 and mid-year 2021/22.

The gross capital borrowing requirement for 2021/22 is estimated to be £71.3 million. After the use of the minimum revenue provision to repay debt of £13.5 million, the net capital borrowing requirement is estimated to be £57.8 million.

The management of the County Council’s debt will be exercised in the most efficient manner considering maturing debt. The opportunity may be taken to reschedule any outstanding debt if rates become favourable to delivering savings in the revenue budget. The cost of external interest of maintaining the council debt is estimated to be £14.7 million in 2021/22.

**Annual Investments Strategy**

The County Council's Investment Strategy has been drawn up having regard to both the Communities and Local Government's Guidance on Local Authorities Investments and the CIPFA Treasury Management in Public Services Code of Practice and CIPFA Cross-Sectoral Guidance Notes. This strategy will be revised and presented to Council if changes occur outside those envisaged within this strategy.

The policy objective for the County Council is the prudent investment of its cash balances. The investment priorities are firstly the security of capital (protecting sums from capital loss) and secondly the liquidity of investments (ensuring cash is available when required). Only when these two priorities are met will the third, of achieving the optimum return on investments, be taken into account.

The County Council will not borrow money purely to invest. The County Council will only borrow up to 2 years in advance of cash being required to fund its capital expenditure and the amount borrowed will not exceed the annual borrowing requirement.

The investments, which the County Council can use for the prudent management of cash balances are categorised as ‘Specified Investments’ and ‘Non-Specified Investments’.

A Specified Investment offers high security and high liquidity, must be in sterling and have a maturity date of less than a year. Any Specified Investment must be with the United Kingdom Government, a local authority in England or Wales or a similar body in Scotland or Northern Ireland, a parish or community council, a AAA-rated Money Market Fund, a bank which is part-owned by the UK Government, or with a body of high credit quality. The County Council defines a body of high credit quality as counterparties who satisfy the criteria as described below:

- For overnight investments, or money placed in instant access accounts, the council defines a body of high credit quality as firstly having the below Short-Term ratings:

| **Agency:** | **Short-Term rating:** |
|---|---|
| Fitch | F1 |
| Moodys | P-1 |
| Standard and Poors | A-1 |

- For **unsecured** term deposits between 2 and 364 days, the council will firstly define a body of high credit quality as having the below Long-term ratings:

| **Agency:** | **Long-Term rating:** |
|---|---|
| Fitch | A+ |
| Moodys | A1 |
| Standard and Poors | A+ |

- The County Council will undertake continued due diligence and will not automatically lend to Counterparties that merely satisfy the above criteria. As additional consideration, the County Council will assess for each:

    - Input from Treasury Advisors
    - Other market data from a reputable source
    - Press coverage
    - Market presence by the Counterparty
    - Availability of suitable products from the Counterparty
    - Ease of execution with the Counterparty
    - Level of Customer service from the Counterparty

- The above list is not exhaustive, the County Council may at any time exclude a Counterparty should it perceive any reasonable doubt concerning its Creditworthiness; the 2011 Code and subsequent revisions advise that subjective criteria may be used, in line with the Council's risk appetite.

- For **secured** term deposits, the council defines high credit quality as an **instrument** that has the above ratings with every agency that rates it.

- Enhanced Money Market funds or Cash Plus funds, which carry a AAA-rating from at least one rating agency.

Non-Specified Investments have a range of vehicles not covered by the definition of Specified Investments, which are set out in the Treasury Management Practices (TMPs) and generally carry more risk.

The only types of non-specified investments the County Council will enter into or hold during the coming financial year are as below:

- A routine term deposit with a counterparty as described above for Specified Investments, for a period of more than 1 year. This type of investment will be considered when rates are favourable and cash balances allow. The Council's prudential indicators allow no more than £10 million to be invested in this category.

- Investments in Pooled Property Funds, these will be considered as having a 5 to 10-year term.

The credit ratings of Fitch, Moodys and Standard and Poors are monitored at least weekly, ratings-watches and downgrades are acted upon immediately. Any other information that is deemed relevant to the creditworthiness of any Counterparty will be acted upon, in line with the 2009 code revision.

The County Council may hold cash within its current account overnight as a transactional control to mitigate the risk of going overdrawn and incurring penalty and interest charges. The County Council may also leave funds in this account when it is impractical and/or not economically feasible to invest elsewhere. These balances are considered as cash or cash equivalents and not investments. This also applies to the Fire Authority current account.

The County Council will aim to have not less than 50% of its investments returnable within 28 days with at least 20% within 7 days.