



**Treasury Management Strategy  
2020/21 – 2023/24**

# Treasury Management Strategy 2020/21 - 2023/24

## **1 Strategy Details**

- 1.1 Treasury risk management at the Authority 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 Authority to approve a Treasury Management Strategy before the start of each financial year. This strategy fulfils the Authority's legal obligation under the *Local Government Act 2003* to have regard to the CIPFA Code.
- 1.2 The strategy outlines the Authority's Treasury Management Strategy for the years 2020/21 to 2023/24 for consideration and approval by Council.
- 1.3 Investments held for service purposes or for commercial profit are considered in a different strategy, the Corporate Investment Strategy.
- 1.4 A further strategy, the Capital Strategy, sets out the Authority's Capital Expenditure programme and Minimum Revenue Provision policy (MRP).

### **Introduction**

- 1.5 Treasury management is the management of the Authority's cash flows, borrowing and investments, and the associated risks. The Authority 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 Authority's prudent financial management.

### **External Context**

- 1.6 **Economic background:** The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Authority's treasury management strategy for 2020/21. The General Election has removed some uncertainty within the market, however following the expected Withdrawal Bill, uncertainties around the future trading relationship with the EU remain.
- 1.7 Gross Domestic Product growth rose by 0.4% in the third quarter of 2019 from -0.2% in the previous three months with the annual rate falling further below its trend rate to 1.1% from 1.2%. Services, construction and production added positively to growth, by 0.5%, 1.2% and 0.1% respectively, while agriculture recorded a fall of 0.1%. Looking ahead, the Bank of England's Monetary Policy Report (formerly the Quarterly

Inflation Report) forecasts economic growth to pick up during 2020 as Brexit-related uncertainties dissipate and provide a boost to business investment helping GDP reach 1.6% in Q4 2020, 1.8% in Q4 2021 and 2.1% in Q4 2022.

- 1.8 The headline rate of UK Consumer Price Inflation remained the same in November 2019 at 1.5% year-on-year, the same as October 2019, however continuing to fall from highs of 2.1% in July and April 2019 as accommodation services and transport continued to contribute to a level of inflation below the Bank of England target of 2%. Labour market data continues to be positive. The International Labour Office unemployment rate continues to hold at historic lows at 3.8%, its lowest level since 1975. The 3-month average annual growth rate for pay excluding bonuses rose to 3.5% in November 2019 providing some evidence that a shortage of labour is supporting wages. However, adjusting for inflation this means real wages were only up by 0.9% in October 2019 and only likely to have a moderate impact on household spending.
- 1.9 Domestic inflationary pressures have abated, as domestic gas and electricity price freezes have taken effect until 2020. The price of oil has fallen through the year, despite a rise in prices in December 2019. The limited inflationary pressure from real wages will likely keep inflation below the Bank of England target of 2%. The Bank of England maintained Bank Rate to 0.75% in November following a 7-2 vote by the MPC. Despite keeping rates on hold, MPC members did confirm that if Brexit uncertainty drags on or global growth fails to recover, they are prepared to cut interest rates as required. Moreover, the downward revisions to some of the growth projections in the Monetary Policy Report suggest the Committee may now be less convinced of the need to increase rates even if there is a Brexit deal.
- 1.10 The US economy has continued to perform relatively well compared to other developed nations; however, the Federal Reserve has started to unwind its monetary tightening through 2019. The Federal Reserve has cut rates three times to 1.5% - 1.75%, to stimulate growth as GDP growth has started to fall (to 2.1%). The fallout from the US-China trade war continues, which risks contributing to a slowdown in global economic activity in 2019. Recent suggestions have been an initial compromise and potential unwinding of tariffs; however, this can change quickly. Slow growth in Europe, combined with changes in leadership at the European Central Bank and International Monetary Fund has led to a change of stance in 2019. Quantitative easing has continued and been extended.
- 1.11 **Credit outlook:** The recent Bank of England stress tests assessed all seven UK banking groups. The tests scenarios include deep simultaneous recessions in the UK and global economies that are more severe overall than the global financial crisis, combined with large falls in asset prices and a separate stress of misconduct costs. All seven banks passed the test on both a CET1 ratio and a leverage ratio basis. Major banks have steadily increased their capital for many years now.

- 1.12 However, there are a number of shortcomings in the Bank's approach; timeliness as the results are over 11 months old when they are published, being based on end-2018 balance sheets; ringfencing, as the tests ignore the restrictions on transferring capital between ringfenced "retail" banks and non-ringfenced "investment" banks within the larger groups and; coverage – the tests should be expanded to cover a wider range of UK banks and building societies.
- 1.13 The Bank of England will seek to address some of these issues in 2020, when Virgin Money/Clydesdale will be added to the testing group and separate tests will be included of ringfenced banks.
- 1.14 Challenger banks hit the news headlines in 2019 with Metro Bank and TSB Bank both suffering adverse publicity and falling customer numbers. Looking forward, the potential for a "no-deal" Brexit and/or a global recession remain the major risks facing banks and building societies in 2020/21 and a cautious approach to bank deposits remains advisable.
- 1.15 **Interest rate forecast:** The Authority's treasury management adviser Arlingclose is forecasting that Bank Rate will remain at 0.75% until the end of 2022. The risks to this forecast are deemed to be significantly weighted to the downside, particularly given the need for greater clarity on Brexit and the continuing global economic slowdown. The Bank of England, having previously indicated interest rates may need to rise if a Brexit agreement was reached, stated in its November Monetary Policy Report and its Bank Rate decision (7-2 vote to hold rates) that the MPC now believe this is less likely even in the event of a deal.
- 1.16 Gilt yields have risen but remain at low levels and only some very modest upward movement from current levels are expected based on Arlingclose's interest rate projections. The central case is for 10-year and 20-year gilt yields to rise to around 1.00% and 1.40% respectively over the time horizon, with broadly balanced risks to both the upside and downside. However, short-term volatility arising from both economic and political events over the period is a near certainty.
- 1.17 A more detailed economic and interest rate forecast provided by Arlingclose is attached at **Appendix A**.
- 1.18 For the purpose of setting the budget, it has been assumed that new treasury management investments will be made at an average rate of 0.75%.

### **Local Context**

- 1.19 On 31<sup>st</sup> December 2019, the Authority held £99.1m of borrowing and £40.7m of treasury investments. This is set out in further detail at **Appendix B**. Forecast changes in these sums are shown in the balance sheet analysis in **table 1** below.

**Table 1:** Balance sheet summary and forecast

	<b>31.3.19 Actual £m</b>	<b>31.3.20 Estimate £m</b>	<b>31.3.21 Forecast £m</b>	<b>31.3.22 Forecast £m</b>	<b>31.3.23 Forecast £m</b>	<b>31.3.24 Forecast £m</b>
General Fund CFR	9.3	8.7	7.9	7.2	6.8	6.3
HRA CFR	106.5	108.7	108.7	108.7	108.7	108.7
<b>Total CFR</b>	<b>115.8</b>	<b>117.4</b>	<b>116.6</b>	<b>115.9</b>	<b>115.5</b>	<b>115.0</b>
Less: External borrowing **	(102.1)	(99.1)	(97.1)	(93.4)	(89.4)	(86.0)
<b>Internal borrowing</b>	<b>13.7</b>	<b>18.3</b>	<b>19.5</b>	<b>22.5</b>	<b>26.1</b>	<b>29.0</b>
Less: Usable reserves	(42.5)	(42.5)	(42.5)	(42.5)	(42.5)	(42.5)
Less: Working capital (balance)	(7.2)	(7.2)	(7.2)	(7.2)	(7.2)	(7.2)
<b>Treasury Investments</b>	<b>36.0</b>	<b>31.4</b>	<b>30.2</b>	<b>27.2</b>	<b>23.6</b>	<b>20.7</b>

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

1.20 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 Authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

1.21 The Authority has a decreasing CFR due to the decision to use £3.937m of funding from the Transformation Reserve to finance the capital programme rather than use borrowing for the period 20/21 to 22/23 to make savings through reduced debt charges.

1.22 **Liability benchmark:** To compare the Authority'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.

**Table 2: Liability benchmark**

	<b>31.3.19 Actual £m</b>	<b>31.3.20 Estimate £m</b>	<b>31.3.21 Forecast £m</b>	<b>31.3.22 Forecast £m</b>	<b>31.3.23 Forecast £m</b>	<b>31.3.24 Forecast £m</b>
<b>CFR</b>	<b>115.8</b>	<b>117.4</b>	<b>116.6</b>	<b>115.9</b>	<b>115.5</b>	<b>115.0</b>
Less: Usable reserves	(42.5)	(42.5)	(42.5)	(42.5)	(42.5)	(42.5)
Less: Working capital	(7.2)	(7.2)	(7.2)	(7.2)	(7.2)	(7.2)
Plus: Minimum investments	10	10	10	10	10	10
<b>Liability Benchmark</b>	<b>76.1</b>	<b>77.7</b>	<b>76.9</b>	<b>76.2</b>	<b>75.8</b>	<b>75.3</b>

### **Borrowing Strategy**

1.23 The Authority currently holds £99.1m of loans, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 1 shows that the Authority does not anticipate borrowing during the period 2020/21 to 2023/24. .

1.24 **Objectives:** The Authority's chief 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 Authority's long-term plans change is a secondary objective.

1.25 **Strategy:** Given the significant cuts to public expenditure and in particular to local government funding, the Authority'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.

1.26 By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal 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 Authority with this 'cost of carry' and breakeven analysis. Its output may determine whether the Authority borrows additional sums at long-term fixed rates in 2020/21 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

1.27 Alternatively, the Authority may arrange forward starting loans during 2020/21, 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.

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

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

- Public Works Loan Board (PWLB) and any successor body
- 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 Derbyshire County Council Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

1.30 **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

1.31 The Authority has previously raised all 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.

1.32 **Municipal Bonds Agency:** UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be 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 Council.

1.33 **LOBOs:** The Authority doesn't hold or intend to hold any LOBO (Lender's Option Borrower's Option) loans.

1.34 **Short-term and variable rate loans:** These loans leave the Authority 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.

1.35 **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. The Authority 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.

### **Treasury Management Investment Strategy**

1.36 The Authority holds an average of £39m invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Authority's investment balance has ranged between £31m and £43m, and similar levels are expected to be maintained in the forthcoming year.

1.37 **Objectives:** The CIPFA Code requires the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority'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.

1.38 Where balances are expected to be invested for more than one year, the Authority 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.

1.39 **Negative interest rates:** If the UK enters into a recession in 2020/21, there is a small chance that the Bank of England could 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. This situation already exists in many other European countries. 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.

1.40 **Strategy:** Given the increasing risk and very low returns from short-term unsecured bank investments, the Authority aims to diversify into more secure and higher yielding asset classes during 2020/21. This is especially the case for the estimated £10m that is available for longer-term investment. The majority of the Authority's surplus cash is currently invested in short-term unsecured bank deposits, short term fixed deposits with local authorities and money market funds. This diversification will represent a substantial change in strategy over the coming year

1.41 **Business models:** Under the new IFRS 9 standard, the accounting for certain investments depends on the Authority's "business model" for managing them. The Authority 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.



1.42 **Approved counterparties:** The Authority 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

Credit rating	Banks unsecured	Banks secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£5m 5 years	£5m 20 years	£5m 50 years	£5m 20 years	£5m 20 years
AA+	£5m 5 years	£5m 10 years	£5m 25 years	£5m 10 years	£5m 10 years
AA	£5m 4 years	£5m 5 years	£5m 15 years	£5m 5 years	£5m 10 years
AA-	£5m 3 years	£5m 4 years	£5m 10 years	£5m 4 years	£5m 10 years
A+	£2.5m 2 years	£5m 3 years	£5m 5 years	£2.5m 3 years	£5m 5 years
A	£2.5m 13 months	£5m 2 years	£5m 5 years	£2.5m 2 years	£5m 5 years
A-	£2.5m 6 months	£5m 13 months	£5m 5 years	£2.5m 13 months	£5m 5 years
None	n/a	n/a	£5m 25 years	n/a	£5m 5 years
<b>Pooled funds and real estate investment trusts</b>	£5m per fund				

1.43 **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.

1.44 **Banks 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.

1.45 **Banks secured:** Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event

of insolvency, and means that they 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 to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

- 1.46 **Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities, Parish Councils 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 Central Government may be made in unlimited amounts for up to 50 years.
- 1.47 **Corporates:** Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made either following an external credit assessment or as part of a diversified pool in order to spread the risk widely.
- 1.48 **Registered providers:** 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 tightly regulated by the Regulator of Social Housing. As providers of public services, they retain the likelihood of receiving government support if needed.
- 1.49 **Pooled funds:** Shares or units in diversified investment vehicles consisting of any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.
- 1.50 Bond, equity and property funds 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.
- 1.51 **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. Investments

in REIT shares cannot be withdrawn but can be sold on the stock market to another investor.

- 1.52 **Operational bank accounts:** The Authority 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 £5m 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 Authority maintaining operational continuity.
- 1.53 **Risk assessment and credit ratings:** Credit ratings are obtained and monitored by the Authority's treasury advisers, who will notify changes in ratings as they occur. 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.
- 1.54 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.
- 1.55 **Other information on the security of investments:** The Authority 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 Authority'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.
- 1.56 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Authority 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 Authority'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 a reduction in the level of investment income earned, but will protect the principal sum invested.

1.57 **Investment limits:** In order to minimise investments that 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 £5m. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

**Table 4: Investment limits**

	<b>Cash limit</b>
Any single organisation, except the UK Central Government	£5m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£5m per group
Any group of pooled funds under the same management	£10m per manager
Foreign countries	£10m per country
Registered providers and registered social landlords	£10m in total
Unsecured investments with building societies	£5m per society
Loans to unrated corporates	£5m in total
Money market funds	£30m in total
Real estate investment trusts	£5m in total
Lloyds Bank (as providers of operational banking services)	£5m overnight

1.58 **Liquidity management:** The Authority uses its own cash flow forecasting techniques to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Authority's medium-term financial plan and cash flow forecast.

### **Treasury Management Indicators**

1.59 The Authority measures and manages its exposures to treasury management risks using the following indicators:

1.60 **Interest rate exposures:** This indicator is set to control the Authority'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 each year
Upper limit on one-year revenue impact of a 1% <u>rise</u> in interest rates	£79,905
Upper limit on one-year revenue impact of a 1% <u>fall</u> in interest rates	(£79,905)

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

1.62 **Maturity structure of borrowing:** This indicator is set to control the Authority's exposure to refinancing risk. This indicator used to be for fixed rate borrowing only but now includes all borrowing. The upper and lower limits on the maturity structure of borrowing will be:

Refinancing rate risk indicator	Upper limit	Lower limit
Under 12 months	20%	0%
12 months and within 24 months	40%	0%
24 months and within 5 years	60%	0%
5 years and within 10 years	80%	0%
10 years and above	100%	0%

1.63 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.

1.64 **Principal sums invested for periods longer than a year:** The purpose of this indicator is to control the Authority'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	2020/21	2021/22	2022/23	2023/24
Limit on principal invested beyond year end	£5m	£4m	£3m	£2m

### **Related Matters**

1.65 The CIPFA Code requires the Authority to include the following in its treasury management strategy.

- 1.66 **Financial Derivatives:** Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the *Localism Act 2011* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).
- 1.67 The Authority will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Authority is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.
- 1.68 Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit. In line with the CIPFA code, the Authority will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.
- 1.69 **Housing Revenue Account:** The Authority completed the HRA self-financing settlement in March 2012 which resulted in an increase in housing debt of £94.386m. Interest payable and other costs/income arising from current and new long-term loans (e.g. Premiums and discounts on early redemption) will be charged / credited to the respective revenue account based on the average CFR and consolidated interest rate calculated at the 31 March.
- 1.70 **Markets in Financial Instruments Directive:** The Authority 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 Authority's treasury management activities, the Chief Financial Officer believes this to be the most appropriate status.