

## TREASURY MANAGEMENT REPORT

- 1.1 The Local Government Act 2003 requires the Council to “have regard to” the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council’s capital investment plans are affordable, prudent and sustainable.
- 1.2 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 counterparties or instruments commensurate with the Council’s low risk appetite, providing adequate liquidity initially before considering investment return.
- 1.3 The second main function of the treasury management service is the funding of the Council’s capital plans. 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.
- 1.4 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.
- 1.5 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.”*

### Capital Strategy

The CIPFA revised 2017 Prudential and Treasury Management Codes requires all local authorities to prepare a capital strategy report, which will provide the following:

- a high-level long term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial sustainability

The Council published its Capital Strategy in 2019. It has been reviewed by officers and will be updated for 2023/24 to be reviewed by Governance and Audit Committee before being published. If any non-treasury investment sustains a loss during the final accounts and audit process, the strategy and revenue implications will be reported through the same procedure as the capital strategy.

### Treasury Management reporting

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

**a. Prudential and treasury indicators and treasury strategy (this report) -**

The first, and most important report is forward looking and covers:

- the capital plans, (including prudential indicators);
- a minimum revenue provision (MRP) policy, (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy, (how the investments and borrowings are to be organised), including treasury indicators; and
- an investment strategy, (the parameters on how investments are to be managed).

**b. A mid-year treasury management report –** This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision.

**c. An annual treasury report –** This is a backward looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

1.6 The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Governance and Audit Committee.

1.7 There are no substantial changes to the Treasury Strategy to be adopted in 2023/24. CIPFA's proposed changes to the Prudential Code have sparked a great deal of debate in the local government sector, with the Local Government Association requesting that their introduction be held back, pending further clarifications being formally issued. As a consequence, the proposed changes, particularly those potentially impacting on existing commercial property holdings, are not yet cast in the Code as it currently stands. The Council is, however, complying with proposed new requirement to split the Capital Financing Requirement into assets held for service purposes and others held for investment purposes, which is purely presentational and adds transparency.

1.8 The Treasury Management Strategy for 2023/24 covers two main areas:

**Capital issues**

- the capital expenditure plans and the associated prudential indicators;
- the minimum revenue provision (MRP) policy.

**Treasury management issues**

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and

- the policy on use of external service providers.

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, MHCLG MRP Guidance, the CIPFA Treasury Management Code and MHCLG Investment Guidance.

## **The Capital Prudential Indicators 2023/24 – 2025/26**

The Local Government Act 2003 requires the Council to adopt the CIPFA Prudential Code and produce prudential indicators. Each indicator either summarises the expected capital activity or introduces limits upon that activity and reflects the outcome of the Council's underlying capital appraisal systems. Within this overall prudential framework there is an impact on the Council's treasury management activity – as it will directly impact on borrowing or investment activity and as such the Treasury Management Strategy for 2023/24 to 2025/26 complements these indicators.

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

### **The Capital Expenditure Plans**

The Council's capital expenditure plans are summarised below, and this forms the first of the prudential indicators. A certain level of capital expenditure is grant supported by the Government; any decisions by the Council to spend above this level will be considered unsupported capital expenditure. This capital expenditure needs to have regard to:

- Service objectives (e.g. strategic planning);
- Stewardship of assets (e.g. asset management planning);
- Value for money (e.g. option appraisal);
- Prudence and sustainability (e.g. implications for external borrowing and whole life costing);
- Affordability (e.g. implications for the council tax);
- Practicality (e.g. the achievability of the forward plan).

The revenue consequences of capital expenditure, particularly the unsupported capital expenditure, will need to be paid for from the Council's own resources. This capital expenditure can be paid for immediately (by applying capital resources such as capital receipts, capital grants, or revenue resources), but if these resources are insufficient any residual capital expenditure will add to the Council's borrowing need.

The key risks to the plans are that the level of Government support has been estimated and is therefore maybe subject to change. Similarly some estimates for other sources of funding, such as capital receipts, may also be subject to change over this timescale. For instance anticipated asset sales may be postponed due to external factors such as the impact of the wider economy.

The Council is asked to approve the summary capital expenditure projections below.

<b>Capital Expenditure</b>	<b>2023/24 Estimate £000</b>	<b>2024/25 Estimate £000</b>	<b>2025/26 Estimate £000</b>
Capital Expenditure	12,293	6,286	5,547
Commercial Activities	0	0	0
<b>Financed by:</b>			
Capital receipts	2,250	2,000	2,000
Capital grants & Contributions	5,866	3,270	3,270
<b>Net financing need</b>	<b>4,177</b>	<b>1,016</b>	<b>277</b>

### **The Council's Borrowing Need (the Capital Financing Requirement)**

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. The capital expenditure above which has not immediately been paid for will increase the CFR. Due to the nature of some of the capital expenditure identified above (ie grant), an element will be immediately impaired or will not qualify as capital expenditure for CFR purposes. As such the net financing figure above may differ from that used in the CFR calculation. The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the indebtedness in line with each assets life, and so charges the economic consumption of capital assets as they are used.

The Council is required to pay off an element of the accumulated General Fund capital spend each year through a revenue charge (the Minimum Revenue Provision - MRP), although it is also allowed to undertake additional voluntary payments (VRP). No additional voluntary payments are planned.

The Council is asked to approve the CFR projections below:

	<b>2022/23</b>	<b>2023/24</b>	<b>2024/25</b>	<b>2025/26</b>
	<b>Estimate</b>	<b>Estimate</b>	<b>Estimate</b>	<b>Estimate</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
<b>Capital Financing Requirement</b>				
CFR – services	137,009	145,233	146,700	143,632
CFR - Commercial activities/ non-financial investments	84,591	84,055	83,507	83,331
<b>Total CFR</b>	<b>221,600</b>	<b>229,288</b>	<b>230,207</b>	<b>226,964</b>
<b>Movement in CFR</b>	<b>7,875</b>	<b>7,688</b>	<b>919</b>	<b>-3,243</b>
<b>Movement in CFR represented by</b>				
Net financing need for the year (above)	5,484	4,741	-2,201	-6,387
Less MRP/VRP and other financing movements	2,391	2,947	3,120	3,143
<b>Movement in CFR</b>	<b>7,875</b>	<b>7,688</b>	<b>919</b>	<b>-3,243</b>

The net financing need for the year includes expenditure related to budgets approved in prior years in addition to the new capital expenditure approved in 2023/24.

CLG Regulations have been issued which require full Council to approve an MRP Statement in advance of each year. The Council is recommended to approve the MRP Statement attached in Annex E(ii)

### **Minimum Revenue Provision (MRP) Policy Statement**

The concept of the Minimum Revenue Provision (MRP) was introduced when the Local Government Capital Finance System was changed on 1 April 1990. This required local authorities to assess their outstanding debt and to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (MRP)

Department for Local Government & Communities (DCLG) issued regulations in 2008 which require a local authority to calculate for the current financial year an amount of MRP which it considers “prudent”. The broad aim of a prudent provision is to ensure that debt is repaid over a period that is reasonably commensurate with that over which the capital expenditure provides benefits or in the case of borrowing supported by government, reasonably commensurate with the period implicit in the determination of the grant. The Council can choose to charge more than the minimum.

Further statutory guidance on MRP was issued by Government on 2 February 2018, which largely becomes effective from 1 April 2019. The exception related to the section allowing local authorities to change their approach to calculating MRP at any time, which took effect immediately. A key part of the updated guidance clarified that the duty to make MRP extends to investment properties where their acquisition has been partially or fully funded by an increase in borrowing or credit arrangements.

In order to minimise the impact on the revenue budget whilst ensuring that prudent provision is made for repayment of borrowing, the Council moved from the equal instalments method to the annuity method in calculating the annual charge over the estimated life of the asset from 1st April 2017. A variety of options are provided to councils under the regulations and guidance, so long as there is a prudent provision. Having sought advice from Counsel on permissible approaches following the revised guidance, the Executive Director:Resources recommends that Council approves the following MRP Statement.

- For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:

**Based on CFR** – MRP will be based on the CFR. This option provides for an approximate 4% reduction in the borrowing need (CFR) each year.

- From 1 April 2008 for all unsupported borrowing (including PFI and finance leases but excluding CPIS expenditure) the MRP policy will be:

**Asset life method** - MRP will be based on the annuity basis, in accordance with the regulations. Repayments included in annual PFI or finance leases are applied as MRP.

- For assets purchased under the Commercial Property Investment Strategy (CPIS) the MRP policy will be:

**Partial deferral method** – MRP will be charged at 10% of the property value over a 15 year period to reflect a realistic level of value risk, on the basis that the properties will typically be held for a period of no greater than around 10 to 20 years.

- For all other capital expenditure funded from borrowing where there is an intention to repay the borrowing from future related receipts (including loans to companies wholly or partly owned by the Council) and there is a strong likelihood that this will happen, the MRP policy will be:

**Deferral method** - MRP will be deferred and the liability repaid through future capital receipts from disposing of the asset or loan repayments from third parties

There will be a presumption that capital receipts will be allocated to the appropriate assets in relation to the constraints of the medium term financial strategy.

The actual charge made in the year will be based on applying the above policy to the previous year's actual capital expenditure and funding decisions. Therefore the 2023/24 charge will be based on 2022/23 capital out-turn.

### **MRP Overpayments**

A change introduced by the revised MHCLG MRP Guidance was the allowance that any charges made over the statutory minimum revenue provision (MRP), voluntary revenue provision or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year. Up until the 31 March 2023 the total VRP overpayments are expected to be £2.081m.

## TREASURY MANAGEMENT STRATEGY STATEMENT

The Treasury Management service is an important part of the overall financial management of the Council's affairs. The prudential indicators in Annex E(i) consider the affordability and impact of capital expenditure decisions, and set out the Council's overall capital framework. The Treasury Management service considers the effective funding of these decisions. Together they form part of the process which ensures the Council meets its balanced budget requirement under the Local Government Finance Act 1992.

The Council's treasury activities are strictly regulated by statutory requirements and a professional code of practice - 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). This Council has adopted the revised Code.

As a result of adopting the Code the Council also adopted a Treasury Policy Statement. This adoption is the requirement of one of the prudential indicators.

The Code of Practice requires an annual strategy to be reported to Council outlining the expected treasury activity for the forthcoming 3 years. A key requirement of this report is to explain both the risks, and the management of the risks, associated with the treasury service. A further treasury report is produced after the year-end to report on actual activity for the year, and a new requirement of the revision of the Code of Practice is that there is a mid-year monitoring report.

This strategy covers:

- The Council's debt and investment projections;
- The Council's estimates and limits on future debt levels;
- The expected movement in interest rates;
- The Council's borrowing and investment strategies;
- Treasury performance indicators;
- Specific limits on treasury activities;

### **Debt and Investment Projections 2023/24 – 2025/26**

The borrowing requirement comprises the expected movement in the CFR and any maturing debt which will need to be re-financed.

	<b>2023/24 Estimated</b>	<b>2024/25 Estimated</b>	<b>2025/26 Estimated</b>
<b>External Debt</b>			
Debt at 31 March	£80m	£85m	£90m
<b>Investments</b>			
Investments at 31 March	£15m	£10m	£10m

### Current Portfolio

The overall treasury management portfolio as at 31 March 2022 and for the position as at 31<sup>st</sup> October 2022 are shown below for both borrowing and investments

	Actual	Actual	Current	Current
	31/03/22	31/03/22	31/10/22	31/10/22
<b>Treasury Investments</b>	£000	%	£000	%
Money Market Funds	43,488	100	27,591	100
<b>External Borrowing</b>	£000	%	£000	%
Local Authorities	0	0	0	0
PWLB	80,000	100	80,000	100
<b>Net Treasury Borrowing</b>	36,512		52,409	

### Limits to Borrowing Activity

Within the prudential indicators there are a number of key indicators to ensure the Council operates its activities within well defined limits. For the first of these the Council needs to ensure that its total borrowing net of any investments, 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 2023/24 and the following two financial years. This allows some flexibility for limited early borrowing for future years but ensures that borrowing is not undertaken for revenue purposes.

The Executive Director:Resources reports that the Council has complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

### The Authorised Limit for External Debt

A further key prudential indicator represents a control on the overall level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although no control has yet been exercised.

The Council is asked to approve the following Authorised Limit:

Authorised limit	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Borrowing	£230m	£235m	£240m
Other long term liabilities	£20m	£20m	£20m
Total	£240m	£255m	£260m

### Operational Boundary for External Debt

The Authority is also recommended to approve the Operational Boundary for external debt for the same period. The proposed Operational Boundary is based on the same

estimates as the Authorised Limit but reflects directly the estimate of the most likely but not worst case scenario, without the additional headroom included within the Authorised Limit to allow for unusual cash movements.

Operational Boundary	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Borrowing	£235m	£240m	£245m
Other long term liabilities	£20m	£20m	£20m
Total	£255m	£260m	£265m

### Borrowing in advance of need.

The Executive Director:Resources may do this under delegated power where, for instance, a sharp rise in interest rates is expected, and so borrowing early at fixed interest rates will be economically beneficial or meet budgetary constraints. Whilst the Executive Director:Resources will adopt a cautious approach to any such borrowing, where there is a clear business case for doing so borrowing may be undertaken to fund the approved capital programme or to fund future debt maturities. Risks associated with any advance borrowing activity will be subject to appraisal in advance and subsequent reporting through the mid-year or annual reporting mechanism.

### Expected Movement in Interest Rates

The Council's treasury advisor, Link Asset Services has provided the following forecast:

Link Group Interest Rate View 27.09.22												
	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25
<b>BANK RATE</b>	4.00	5.00	5.00	5.00	4.50	4.00	3.75	3.25	3.00	2.75	2.75	2.50
3 month ave earnings	4.50	5.00	5.00	5.00	4.50	4.00	3.80	3.30	3.00	2.80	2.80	2.50
6 month ave earnings	4.70	5.20	5.10	5.00	4.60	4.10	3.90	3.40	3.10	3.00	2.90	2.60
12 month ave earnings	5.30	5.30	5.20	5.00	4.70	4.20	4.00	3.50	3.20	3.10	3.00	2.70
5 yr PWLB	5.00	4.90	4.70	4.50	4.20	3.90	3.70	3.50	3.40	3.30	3.20	3.20
10 yr PWLB	4.90	4.70	4.60	4.30	4.10	3.80	3.60	3.50	3.40	3.30	3.20	3.20
25 yr PWLB	5.10	4.90	4.80	4.50	4.30	4.10	3.90	3.70	3.60	3.60	3.50	3.40
50 yr PWLB	4.80	4.60	4.50	4.20	4.00	3.80	3.60	3.40	3.30	3.30	3.20	3.10

Whilst the Council is in no longer debt-free the level of internal resources has enabled the Council to avoid any new external borrowing since 2018. However, given the economic conditions over the last 5 years returns on surplus cash have been historically low leading into 2022/23. This prolonged period of low global interest rates changed markedly from April 2022 onwards, with central banks around the world increasing rates. This has led to the highest UK Base Rate for over 13 years, with the Bank Rate now sitting at 3% and expected to move higher over the coming months.

The coronavirus outbreak wrought huge economic damage to the UK and to economies around the world with the Bank of England (BoE) taking emergency action in March 2020 to cut the Bank Rate to 0.10%. There were however increasing grounds for viewing the nascent economic recovery as running out of steam during 2022 with the potential for stagflation creating a dilemma for the Monetary Policy Committee (MPC) as to whether to focus on combating inflation or supporting economic growth through keeping interest rates low.

A number of events came to dominate both global and domestic economies over the last 12 months. Supply chain difficulties continued to force prices higher, and with an exceptionally tight labour market, inflation continued to rise in 2022. These problems were overshadowed by the war in Ukraine which has had a tumultuous impact on energy prices around the world. The Consumer Prices Index (CPI), the government preferred indicator of inflation, rose to over 10% - a 40 year high – forcing the BoE to begin a series of Bank Rate increases.

In August 2022 the MPC increased Bank Rate to 1.75%, with a further rise in September to 2.25%. As a result of political events in Westminster, a new government was formed and brought forward a step change in government policy aimed at delivering faster growth in the UK economy by cutting taxes in addition to supporting the intense energy pressures faced by the public. Unfortunately, the UK Treasury did not follow normal practices and the Fiscal Event was published without an analysis by the Office for Budget Review (OBR) and the economic markets took fright at the amount of unfunded tax cuts and future borrowing requirements. The market turmoil that followed led to a spike in market borrowing rates and a substantial fall in the pound. This led to the formation on a new Government and almost all the measures reversed in the proceeding weeks.

As such, whilst domestic factors have largely been unravelled, the UK still faces historically high inflation, a substantial risk of recession and the potential for further economic shocks from global insecurity, a resurgence of COVID limiting impacts on growth and general financial-market risk. This led the MPC to raise interest rates to 3% in November 2022.

In terms of current market views, pricing for December's meeting remains at 3.5% with markets continuing to expect the BoE to hike rates to 4.0% by February 2023 and to finish the year close to 4.75%. Increases in the base rate of this magnitude will clearly benefit the Council if it can continue to rely on internal resources to fund its Capital Programme and offers the potential for higher investment returns.

#### **Investment and borrowing rates**

- **Investment returns** are expected to continue to improve in 2023/24. However, while markets are pricing in a series of further Bank Rate hikes, actual economic circumstances may see the MPC fall short of these elevated expectations, but will need to balance the risk of continued higher inflation or a prolonged recession.
- **Borrowing interest rates** fell to historically very low rates as a result of the COVID crisis and the quantitative easing operations of the Bank of England however the economic conditions highlighted above reflect a different path in borrowing rates is now in place. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years and indeed the gap between investment rates and borrowing rates support this policy to be continued.

#### **Borrowing Strategy 2023/24**

The 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 loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.

Against this background and the risks within the economic forecast, caution will be adopted with the 2023/24 treasury operations. The Executive Director:Resources will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- if it was felt that there was a significant risk of a sharp FALL in long and short term rates (e.g. due to a marked increase of risks around relapse into recession as a result of COVID or other economic risks), then any long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.
- if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from an increase in world economic activity or a further spikes in inflation risks, then the portfolio position will be re-appraised.

The current and short-term economic conditions place considerable challenges on the Council's treasury activities. With considerable cash-balances the Council is clearly benefitting from the steep increase in investment rates, however this is matched by steadily rising borrowing rates which the Council may need to face in the near term. The cost of carry (the difference between borrowing and investment rates) is currently prohibitive at present and as such a policy of using internal resources whilst available is deemed to be the most appropriate. Any decisions will be reported to the Executive at the next available opportunity.

The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. 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.

### **Debt rescheduling**

In this period of uncertainty and historically wild swings in gilt prices over such a short period of time, there may be potential opportunities to generate savings by switching from long-term debt to short-term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

All rescheduling will be reported to the Executive, at the earliest meeting following its action.

## Investment Strategy 2023/24 – 2025/26

### Investment Policy

The Ministry of Housing, Communities and Local Government (MHCLG) and CIPFA have extended the meaning of ‘investments’ to include both financial and non-financial investments. This report deals solely with financial investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy.

The Council’s investment policy has regard to the following: -

- MHCLG’s Guidance on Local Government Investments (“the Guidance”)
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 (“the Code”)
- CIPFA Treasury Management Guidance Notes 2018

The Council’s investment priorities will be security first, portfolio liquidity second and then yield, (return).

The above guidance from the MHCLG and CIPFA place a high priority on the management of risk. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -

1. Minimum acceptable **credit criteria** are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.
2. Other information: ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as “credit default swaps” and overlay that information on top of the credit ratings.
3. Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.
4. This authority has defined the list of types of investment instruments that the treasury management team are authorised to use. There are two lists in appendix under the categories of ‘specified’ and ‘non-specified’ investments.
  - **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year.
  - **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.
5. Lending and transaction limits, (amounts and maturity), for each counterparty will be set through applying the matrix table shown under the Council’s creditworthiness policy

6. This authority has engaged external consultants, (see paragraph 1.5), to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.
7. All investments will be denominated in sterling.

### **Creditworthiness policy**

This Council applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following maturities .

Dark pink	5 years for Enhanced money market funds (EMMFs) with a credit score of 1.25
Light pink	5 years for Enhanced money market funds (EMMFs) with a credit score of 1.5
Blue	1 year (only applies to nationalised or semi nationalised UK Banks)
Orange	1 year
Red	6 months
Green	100 days
No colour	not to be used

## Annex A(iv)

Y	Pi1	Pi2	P	B	O	R	G	N/C
1	1.25	1.5	2	3	4	5	6	7
Up to 5yrs	Up to 5yrs	Up to 5yrs	Up to 2yrs	Up to 1yr	Up to 1yr	Up to 6mths	Up to 100days	No Colour

	Colour (and long term rating where applicable)	Money and/or % Limit	Time Limit
Banks	orange	£7m	1 yr
Banks – part nationalised	blue	£7m	1 yr
Banks	red	£7m	6 months
Banks	green	£7m	100 days
Banks	No colour	£0m	0 days
Debt Management Account Deposit Facility	AAA	£10m	6 months
Local authorities	n/a	£7m	1 yr
Money Market Funds (CNAV, LVNAV & VNAV)	AAA	£10m	liquid
Enhanced money market funds with a credit score of 1.25	Dark pink / AAA	£10m	liquid
Enhanced money market funds with a credit score of 1.5	Light pink / AAA	£10m	liquid

The creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue influence to just one agency's ratings.

Typically the minimum credit ratings criteria the Council use will be a short term rating (Fitch or equivalents) of short term rating F1, long term rating A-, viability rating of A-, and a support rating of 1. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

All credit ratings will be monitored in real time. The Council is alerted to changes to ratings of all three agencies through its use of our creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information, information on government support for banks and the credit ratings of that supporting government

In the normal course of the council's cash flow operations it is expected that both Specified and Non-specified investments will be utilised for the control of liquidity as both categories allow for short term investments.

The use of longer term instruments (greater than one year from inception to repayment) will fall in the Non-specified investment category. These instruments will only be used where the Council's liquidity requirements are safeguarded however the current investment limits for 2023/24 restrain all investments to less than 1 year. Any amendment to this strategy will require the credit-criteria to be amended to include a long-term rating. This will be addressed through the formal approval by Council of a revised Treasury Management Strategy and Annual Investment Strategy.

### **Country and Sector Considerations**

Due care will be taken to consider the country, group and sector exposure of the Council's investments. The current investment strategy limits all investments to UK Banks, Building Societies and Local Authorities, in addition to Sterling denominated AAA Money Market Funds.

### **Economic Investment Considerations**

Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates. The criteria for choosing counterparties set out above provides a sound approach to investment in "normal" market circumstances. Whilst Members are asked to approve this base criteria above, under the exceptional current market conditions the Executive Director:Resources may temporarily restrict further investment activity to those counterparties considered of higher credit quality than the minimum criteria set out for approval. These restrictions will remain in place until the banking system returns to "normal" conditions. Similarly the time periods for investments will be restricted.

Examples of these restrictions would be the greater use of the Debt Management Deposit Account Facility (a Government body which accepts local authority deposits), Money Market Funds, and strongly rated institutions. The credit criteria have been amended to reflect these facilities.

### **Sensitivity to Interest Rate Movements**

Future Council accounts will be required to disclose the impact of risks on the Council's treasury management activity. Whilst most of the risks facing the treasury management service are addressed elsewhere in this report (credit risk, liquidity risk, market risk, maturity profile risk), the impact of interest rate risk is discussed but not quantified. The table below highlights the estimated impact of a 1% change in interest rates to the estimated treasury management costs for next year per £m. However as all borrowing is fixed any increase in rates will only impact on new borrowing.

	<b>2023/24 Estimated + 1% per £m</b>	<b>2023/24 Estimated - 1% per £m</b>
<b>Revenue Budgets</b>	<b>£'000</b>	<b>£'000</b>
Borrowing costs	100	100

### Treasury Management Limits on Activity

There are four further treasury activity limits, which were previously prudential indicators. The purpose of these are to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. However if these are set to be too restrictive they will impair the opportunities to reduce costs/improve performance. The indicators are:

Upper limits on variable interest rate exposure – This identifies a maximum limit for variable interest rates based upon the debt position net of investments

Upper limits on fixed interest rate exposure – Similar to the previous indicator this covers a maximum limit on fixed interest rates.

Maturity structures of borrowing – These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

Total principal funds invested for greater than 364 days – These limits are set with regard to the Council's liquidity requirements and are based on the availability of funds after each year-end.

The Council is asked to approve the limits:

	2023/24	2024/25	2025/26
<b>Interest rate Exposures</b>			
	<b>Upper</b>	<b>Upper</b>	<b>Upper</b>
<b>Limits on fixed interest rates based on net debt</b>	£255m	£260m	£265m
<b>Limits on variable interest rates based on net debt</b>	£255m	£260m	£265m
<b>Maturity Structure of fixed interest rate borrowing 2017/18</b>			
		<b>Lower</b>	<b>Upper</b>
Under 12 months		0%	100%
12 months to 2 years		0%	100%
2 years to 5 years		0%	100%
5 years to 10 years		0%	100%
10 years and above		0%	100%
<b>Maximum principal sums invested &gt; 364 days</b>			
Principal sums invested > 364 days	£m 0	£m 0	£m 0

### Performance Indicators

The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking. For 2023/24 the relevant benchmark will relate only to investments and will be the Sterling Overnight Index Average (SONIA) The results of these indicators will be reported in the Treasury Annual Report.

### Treasury Management Advisers

The Council uses Link Asset Services as its treasury management consultants. The Council recognises that responsibility for treasury management decision remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subject to regular review.

**Member and Officer Training**

The increased Member consideration of treasury management matters and the need to ensure officers dealing with treasury management are trained and kept up to date requires a suitable training process for Members and officers. Following the nomination of the Governance and Audit Committee to examine and assess the effectiveness of the Treasury Management Strategy and Policies, initial training was provided and additional training has been undertaken as necessary. Officer training is carried out in accordance with best practice and outlined in TMP 10 Training and Qualifications to ensure that all staff involved in the Treasury Management function are fully equipped to undertake the duties and responsibilities allocated to them

**SPECIFIED INVESTMENTS**

*All investments listed below must be sterling-denominated.*

Investment	Share/ Loan Capital?	Repayable/ Redeemable within 12 months?	Security / Minimum Credit Rating **	Circumstance of use	Maximum period
<b>Debt Management Agency Deposit Facility*</b> (DMADF) * this facility is at present available for investments up to 6 months	No	Yes	Govt-backed	In-house	364 Days
<b>Term deposits</b> with the UK government or with Local Authority (including Parish Councils) in England, Wales, Scotland or Northern Ireland with maturities up to 364 Days	No	Yes	High security although LAs not credit rated.	In-house and by external fund managers subject to the guidelines and parameters agreed with them	364 Days
<b>Term deposits</b> with credit-rated deposit takers (banks and building societies), including callable deposits, with maturities up to 364 Days	No	Yes	<i>As per list of approved Counterparties</i>	In-house and by external fund managers subject to the guidelines and parameters agreed with them	364 Days
<b>Certificates of Deposit</b> issued by credit-rated deposit takers (banks and building societies) : up to 364 Days.  <i>Custodial arrangement required prior to purchase</i>	No	Yes	<i>As per list of approved Counterparties</i>	To be used by external fund managers only subject to the guidelines and parameters agreed with them	364 Days
<b>Gilts</b> : up to 364 Days	No	Yes	Govt-backed	To be used by external fund managers only subject to the guidelines and parameters agreed with them	364 Days

Investment	Share/ Loan Capital?	Repayable/ Redeemable within 12 months?	Security / Minimum Credit Rating **	Circumstance of use	Maximum period
<b>Money Market Funds</b> CNAV, LVNAV, and VNAV <i>These funds do not have any maturity date</i>	No	Yes	<i>AAA Rating by Fitch, Moodys or S&amp;P</i>	In-house and by external fund managers subject to the guidelines and parameters agreed with them	The period of investment may not be determined at the outset but would be subject to cash flow and liquidity requirements
<b>Forward deals</b> with credit rated banks and building societies < 1 year (i.e. negotiated deal period plus period of deposit)	No	Yes	<i>As per list of approved Counterparties</i>	In-house and by external fund managers subject to the guidelines and parameters agreed with them. Tracking of all forward deals to be undertaken and recorded.	1 year in aggregate
<b>Commercial paper</b> <i>[short-term obligations (generally with a maximum life of 9 months) which are issued by banks, corporations and other issuers]</i>  <i>Custodial arrangement required prior to purchase</i>	No	Yes	<i>As per list of approved Counterparties</i>	To be used by external fund managers only subject to the guidelines and parameters agreed with them	9 months
<b>Treasury bills</b> <i>[Government debt security with a maturity less than one year and issued through a competitive bidding process at a discount to par value] Custodial arrangement required prior to purchase</i>	No	Yes	Govt-backed	To be used by external fund managers only subject to the guidelines and parameters agreed with them	1 year

## NON-SPECIFIED INVESTMENTS

***All investments listed below must be sterling-denominated.***

<b><u>Investment</u></b>	<b><u>(A) Why use it?</u> <u>(B) Associated risks?</u></b>	<b><u>Share/ Loan Capital?</u></b>	<b><u>Repayable/ Redeemable within 12 months?</u></b>	<b><u>Security / Minimum credit rating **</u></b>	<b><u>Circumstance of use</u></b>	<b><u>Maximum maturity of investment</u></b>
Deposits with Authority's Banker where credit rating has dropped below minimum criteria	Where the Council's bank no longer meets the high credit rating criteria set out in the Investment Strategy the Council has little alternative but to continue using them, and in some instances it may be necessary to place deposits with them, these deposits should be of a very short duration thus limiting the Council to daylight exposure only (i.e. flow of funds in and out during the day, or overnight exposure).	No	Yes	n/a	In-House	<i>364 Days</i>
<b>Term deposits</b> with credit rated deposit takers (banks and building societies) with maturities greater than 1 year	(A) (i) Certainty of rate of return over period invested. (ii) No movement in capital value of deposit despite changes in interest rate environment. (B) (i) Illiquid : as a general rule, cannot be traded or repaid prior to maturity. (ii) Return will be lower if interest rates rise after making the investment. (iii) Credit risk : potential for greater deterioration in credit quality over longer period	No	No	<i>As per list of approved Counterparties</i>	In-house and by external fund managers subject to the guidelines and parameters agreed with them	<i>5 Years</i>
<b>Certificates of Deposit</b> with credit rated deposit takers (banks and building societies) with maturities greater than 1 year <i>Custodial arrangement required prior to purchase</i>	(A) (i) Although in theory tradable, are relatively illiquid. (B) (i) 'Market or interest rate risk' : Yield subject to movement during life of CD which could negatively impact on price of the CD.	No	Yes	<i>As per list of approved Counterparties</i>	To be used by external fund managers only subject to the guidelines and parameters agreed with them	<i>5 years</i>

<u>Investment</u>	<u>(A) Why use it?</u> <u>(B) Associated risks?</u>	<u>Share/ Loan Capital?</u>	<u>Repayable/ Redeemable within 12 months?</u>	<u>Security / Minimum Credit Rating?</u>	<u>Circumstance of use</u>	<u>Maximum maturity of investment</u>
<b>Callable deposits</b> with credit rated deposit takers (banks and building societies) with maturities greater than 1 year	(A) (i) Enhanced income ~ Potentially higher return than using a term deposit with similar maturity.  (B) (i) Illiquid – only borrower has the right to pay back deposit; the lender does not have a similar call. (ii) period over which investment will actually be held is not known at the outset. (iii) Interest rate risk : borrower will not pay back deposit if interest rates rise after deposit is made.	No	No	<i>As per list of approved Counterparties</i>	In-house and by external fund managers subject to the guidelines and parameters agreed with them	<i>5 years</i>
<b>UK government gilts</b> with maturities in excess of 1 year  <i>Custodial arrangement required prior to purchase</i>	(A) (i) Excellent credit quality. (ii) Very Liquid. (iii) If held to maturity, known yield (rate of return) per annum ~ aids forward planning. (iv) If traded, potential for capital gain through appreciation in value (i.e. sold before maturity) (v) No currency risk  (B) (i) 'Market or interest rate risk' : Yield subject to movement during life of sovereign bond which could negatively impact on price of the bond i.e. potential for capital loss.	No	Yes	Govt backed	To be used by external fund managers only subject to the guidelines and parameters agreed with them	<i>10 years including but also including the 10 year benchmark gilt</i>

<b><u>Investment</u></b>	<b><u>(A) Why use it?</u> <u>(B) Associated risks?</u></b>	<b><u>Share/ Loan Capital?</u></b>	<b><u>Repayable/ Redeemable within 12 months?</u></b>	<b><u>Security / Minimum credit rating **</u></b>	<b><u>Circumstance of use</u></b>	<b><u>Maximum maturity of investment</u></b>
<b>Forward deposits</b> with credit rated banks and building societies for periods > 1 year (i.e. negotiated deal period plus period of deposit)	(A) (i) Known rate of return over period the monies are invested ~ aids forward planning.  (B) (i) Credit risk is over the whole period, not just when monies are actually invested. (ii) Cannot renege on making the investment if credit rating falls or interest rates rise in the interim period.	No	No	<i>As per list of approved Counterparties</i>	In-house and by external fund managers subject to the guidelines and parameters agreed with them. Tracking of all forward deals to be undertaken and recorded.	<i>5 years</i>
<b>Deposits with unrated deposit takers (banks and building societies) but with unconditional financial guarantee from HMG or credit-rated parent institution : any maturity</b>	(A) Credit standing of parent will determine ultimate extent of credit risk	No	Yes	<i>As per list of approved Counterparties</i>	In-house and by external fund managers subject to the guidelines and parameters agreed with them	<i>1 year</i>