North Devon Council

Report Date: 7th February 2022

Topic: Treasury Management Strategy Statement 2022/23

Report by: Director of Resources and Deputy Chief Executive

1 Introduction

This report sets out the Council's strategy for Treasury Management, Minimum Revenue Provision (MRP) and Investments for the forthcoming financial year.

2 Recommendations

The Committee is asked to recommend to full Council that:

2.1 The Treasury Management Strategy Statement, Minimum Revenue Provision Policy Statement and Annual Investment Statement 2022/2023, including the Treasury Management and Prudential Indicators for 2022/23 to 2024/25, be approved.

3 Reasons for Recommendations

3.1 The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (SI 2003/3146) requires the Council to have regard to the Treasury Management Code.

3.2 Under section 3(5) of the Local Government Act 2003 the Council is required to have regard to the Prudential Code when setting limits to the level of its affordable borrowing.

3.3 This Council is also required under the Code to give prior scrutiny of the treasury management reports by the Policy Development Committee before they are reported to the full Council.

4 Treasury Management

4.1 Background

Part of the treasury management operation is to ensure that 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.

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.

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.

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."

Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities, (arising usually from capital expenditure), and are separate from the day-to-day treasury management activities.

4.2. Reporting Requirements

The Council will receive and approve three main reports each year, which incorporate a variety of polices, 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.

These reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Policy Development Committee.

4.3 Treasury Management Strategy for 2022/23

The strategy for 2022/23 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 will 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, DLUHC Investment Guidance, DLUHC MRP Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code.

<u>CIPFA Treasury Management Code and Prudential Code – changes which will impact future TMSS reports and risk management framework</u>

CIPFA recently completed the second round of consultation on the proposed changes to the current editions of the Treasury Management Code and Prudential Code. The revised editions of these Codes were published on the 20th Dec 2021. The Council has to have to have regard to these codes of practice when we prepare the Treasury Management Strategy Statement and related in-year reports taken to Full Council for approval. CIPFA has agreed a soft launch approach with formal reporting requirements deferred until 2023/24 financial year. We will ensure that we implement these new requirements on or before the 1st April 2023.

As part of these changes, the Council is required to adopt a new Liability Benchmark treasury indicator to support Capital Financing Requirement financing risk management. There will also be further changes to clarify what CIPFA expect a local authority to borrow for and what they do not view as appropriate. This will include the requirement to set a proportionate approach to Commercial and Service capital investment; address ESG (Environmental, social & Governance) issues within Capital Strategy; require implementation of a policy to review Commercial Property with a view to divest where appropriate; create new Investment Practices to manage risks associated with non-Treasury investment (similar to current Treasury Management Practice approach); recommend that any long term treasury investment is supported by business model and requirement to effectively manage liquidity and longer term cash flow requirements; amendment to TMP1 to address ESG policy within the treasury management risk framework; amendment to Knowledge and Skills register for individuals involved in treasury management function (proportionate to size/complexity of organisation); a new requirement to clarify reporting requirements for Service and Commercial investment (especially where supported by borrowing/leverage).

Members will be updated on how these changes will impact our current approach and any changes required will be formally adopted within the 2023/24 TMSS and associated reports.

4.4 Training

The CIPFA Code requires the Chief Finance Officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. The training needs of treasury management officers are periodically reviewed.

4.5 Treasury Management Consultants

The Council uses Link Group, Link Treasury Services Ltd as its external treasury management advisors.

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers. All decisions will be undertaken with regards to all the available information, including, but solely, our treasury advisors.

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 subjected to regular review.

5 The Capital Prudential Indicators 2022/23

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

5.1 Capital Expenditure and financing

This prudential Indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts:

Capital Expenditure £000	**2020/21 Actual**	**2021/22 Estimate**	**2022/23 Estimate**	**2023/24 Estimate**	**2024/25 Estimate**
Customer Focus	280	100	946	*227	*460
Environmental Enhancement	4,032	10,616	2,050	0	0
Governance	21	13	0	0	0
Place & Regeneration	434	11,859	10,122	6,717	712
Planning, Housing & Health	1,404	1,218	2,715	*150	*150
Total	**6,171**	**23,806**	**15,833**	**7,094**	**1,322**

** Estimates as not yet approved by Members*

The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

Financing of Capital Expenditure **£000**	**2020/21** **Actual**	**2021/22** **Estimate**	**2022/23** **Estimate**	**2023/24** **Estimate**	**2024/25** **Estimate**
Capital receipts	157	200	150	150	150
Capital grants	5,115	4,793	8,994	3,262	0
Capital reserves	514	748	996	115	115
Net financing need for the year	**385**	**18,065**	**5,693**	**3,567**	**1,057**

Other long-term liabilities - the above financing need excludes other long-term liabilities, such as vehicle leasing arrangements that already include borrowing instruments.

5.2 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 historic 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 indebtedness and so it's underlying borrowing need. Any capital expenditure in the table above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

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 CFR includes any other long-term liabilities (e.g., PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of schemes include a borrowing facility by the PFI, PPP lease provider and so the Council is not required to separately borrow for these schemes. From October 2021 the Council entered a vehicle leasing programme with SFS and currently has circa £1.2m of finance leases within the CFR. These leased vehicles are replacing those previously included within the capital programme as capital purchases.

The Council is asked to approve the CFR projections below:

£000	2020/21 Actual	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Capital Financing Requirement					
Total CFR	**4,591**	**23,362**	**29,265**	**32,660**	**35,354**
Movement in CFR	**(155)**	**18,771**	**5,903**	**3,395**	**2,694**

Movement in CFR represented by:					
Net financing need for the year (above)	385	18,065	5,693	3,567	1,057
Financing Lease – Capital Costs	0	1,220	1.097	1,163	3,230
Less MRP/VRP	(540)	(514)	(734)	(1,045)	(1,158)
Finance Lease Principal Payments (MRP)	0	0	(153)	(290)	(435)
Movement in CFR	**(155)**	**18,771**	**5,903**	**3,395**	**2,694**

5.3 Core funds and expected investment balances

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year-end balances for each resource and anticipated day to day cash flow balances.

Year End Resources £000	2020/21 Actual	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Fund balances / reserves	11,362	10,134	5,700	4,950	4,650
Provisions	725	500	500	500	500
Total core funds	**12,087**	**10,634**	**6,200**	**5,450**	**5,150**
Working capital*	*15,848	3,500	500	500	500
Total cash to invest	**27,935**	**14,134**	**6,700**	**5,950**	**5,650**
(Under)/over borrowing	**(4,091)**	**(11,642)**	**(4,600)**	**(3,622)**	**(3,520)**
Expected external investments	**23,844**	**2,492**	**2,100**	**2,328**	**2,130**

*Working capital balances shown for 20/21 include Central Government grants for Covid-19.

5.4 Affordability Prudential Indicator

This prudential indicator is required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicator:

Ratio of financing costs to net revenue stream. This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

%	2020/21 Actual	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
General Fund	3.71%	3.87%	9.44%	15.61%	18.61%

The estimates of financing costs include current commitments and the proposals in this budget report.

5.5 Minimum revenue provision (MRP) policy statement

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

DLUHC regulations have been issued which require the full Council to approve **an MRP Statement** in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement:

From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be*:*

Asset Life Method – MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction).

This option provides for a reduction in the borrowing need over approximately the asset's life. MRP will always start in the financial year after the asset becomes operational. The principal repayments included in the annual finance lease payments will match the annual MRP for the debt associated with these items.

MRP Overpayments

A change introduced by the revised DLUHC 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 2022 the Council had made no voluntary revenue provision (VRP) overpayments.

6 Borrowing

The capital expenditure plans set out in Section 5, provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the the relevant professional codes, so that sufficient cash is available to meet this service activity and the Council's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

6.1 Current Portfolio Position

The overall treasury management cash portfolio as at 31 March 2021 and for the position as at 31st December 2021 are shown below for both borrowing and investments.

Treasury Portfolio £000	31/03/21 Actual	31/12/21 Actual
Investment with banks	23,844	37,068
Total investments managed in-house	**23,844**	**37,068**
Borrowing with PWLB	500	500
Total external borrowing	**500**	**500**
Net treasury investments / (borrowing)	23,344	36,568

** Investment figures are higher than usual in both years due to timing of monies to/from Central Government regarding Covid-19 support payments and business grants.*

The Council's forward projections for borrowing are summarised below. The table shows the actual external debt, against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

£000	2020/21 Actual	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
External Debt					
Debt at 1 April	1,250	500	11,720	24,665	29,038
Expected change in Debt	(750)	10,000	12,000	3,500	0
Expected change in OLTL	0	1,220	945	873	2,796
Actual gross debt at 31 March	**500**	**11,720**	**24,665**	**29,038**	**31,834**
The Capital Financing Requirement	**4,591**	**23,362**	**29,265**	**32,660**	**35,354**
(Under) / over borrowing	**(4,091)**	**(11,642)**	**(4,600)**	**(3,622)**	**(3,520)**

Within the range of prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its gross debt 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 2022/23 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 or speculative purposes.

The Chief Financial Officer reports that the Council 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.

6.2 Treasury Indicators: limits to borrowing activity

The operational boundary. This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

Operational boundary £000	**2021/22 Estimate**	**2022/23 Estimate**	**2023/24 Estimate**	**2024/25 Estimate**
Debt	15,000	25,200	28,200	28,400
Other long term liabilities	2,500	4,000	4,500	7,000
Total	**17,500**	**29,200**	**32,700**	**35,400**

The authorised limit for external debt. This is a key prudential indicator and represents a control on the maximum level of borrowing. This represents a legal limit beyond which external debt is prohibited, and this limit needs to be set or revised by the 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.

1. 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 this power has not yet been exercised.
2. The Council is asked to approve the following authorised limit:

Authorised limit £000	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Debt	33,000	33,000	33,000	33,000
Other long term liabilities	4,500	4,500	5,000	8,000
Total	**37,500**	**37,500**	**38,000**	**41,000**

6.3 Prospects for Interest Rates

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 20th December 2021. These are forecasts for certainty rates, gilt yields plus 80 bps. For more details on the interest forecast and economic conditions please see appendix C.

Link Group Interest Rate View 20.12.21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
BANK RATE	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25
3 month ave earnings	0.20	0.30	0.50	0.50	0.60	0.70	0.80	0.90	0.90	1.00	1.00	1.00	1.00	1.00
6 month ave earnings	0.40	0.50	0.60	0.60	0.70	0.80	0.90	1.00	1.00	1.10	1.10	1.10	1.10	1.10
12 month ave earnings	0.70	0.70	0.70	0.70	0.80	0.90	1.00	1.10	1.10	1.20	1.20	1.20	1.20	1.20
5 yr PWLB	1.40	1.50	1.50	1.60	1.60	1.70	1.80	1.80	1.80	1.90	1.90	1.90	2.00	2.00
10 yr PWLB	1.60	1.70	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10	2.20	2.30
25 yr PWLB	1.80	1.90	2.00	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.40	2.40	2.50	2.50
50 yr PWLB	1.50	1.70	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.20	2.20	2.30	2.30

Over the last two years, the coronavirus outbreak has done huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings until raising it to 0.25% at its meeting on 16th December 2021.

As shown in the forecast table above, the forecast for Bank Rate now includes four increases, one in December 2021 to 0.25%, then quarter 2 of 2022 to 0.50%, quarter 1 of 2023 to 0.75%, quarter 1 of 2024 to 1.00% and, finally, one in quarter 1 of 2025 to 1.25%.

Forecasts for PWLB rates and gilt and treasury yields

Since the start of 2021, we have seen a lot of volatility in gilt yields, and hence PWLB rates. As the interest forecast table for PWLB certainty rates above shows, there is forecast to be a steady, but slow, rise in both Bank Rate and gilt yields during the forecast period to March 2025, though there will doubtless be a lot of unpredictable volatility during this forecast period.

Investment and borrowing rates

Investment returns are expected to improve in 2022/23. However, while markets are pricing in a series of Bank Rate hikes, actual economic circumstances may see the MPC fall short of these elevated expectations.

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 and still remain at historically low levels. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years.

On 25.11.20, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates which had been increased by 100 bps in October 2019. The standard and certainty margins were reduced by 100 bps but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three-year capital programme. The current margins over gilt yields are as follows: -.

PWLB Standard Rate is gilt plus 100 basis points (G+100bps)
PWLB Certainty Rate is gilt plus 80 basis points (G+80bps)

Borrowing for capital expenditure. Link Asset's long-term (beyond 10 years), forecast for Bank Rate is 2.00%. As some PWLB certainty rates are currently below 2.00%, there remains value in considering long-term borrowing from the PWLB where appropriate. Temporary borrowing rates are likely, however, to remain near Bank Rate and may also prove attractive as part of a balanced debt portfolio.

While this authority will not be able to avoid borrowing to finance new capital expenditure there will be a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new borrowing that causes a temporary increase in cash balances.

6.4 Borrowing Strategy

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 2022/23 treasury operations. The Chief Financial Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *iif it was felt that there was a significant risk of a sharp FALL in borrowing rates,* then borrowing will be postponed.
- *if it was felt that there was a significant risk of a much sharper RISE in borrowing rates than that currently forecast,* perhaps arising from an acceleration

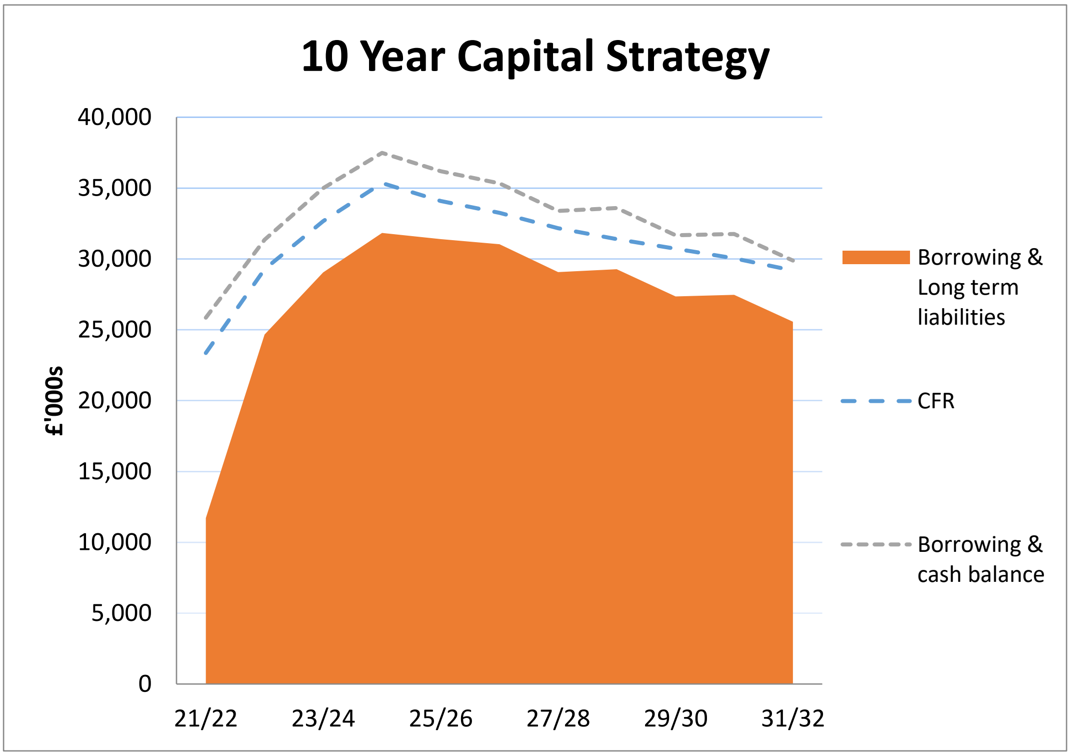
in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

Any decisions will be reported to the Leader and Lead Member for Resources and Commercialisation.

It is projected that external borrowing as at March 2022 could be circa £10.5m. A further £12m of external borrowing may be required in 2022/23 to support the approved capital programme, taking total projected external borrowing to £22.5m by March 2023. This still prudently assumes using £4.6m of internal borrowing from reserves and cash balances to fund the Capital Financing Requirement.

This increased borrowing reflects the funding requirements of the approved capital programme of circa £40m in 2021/22 and 2022/23, which includes large schemes such as the new Leisure Centre and the purchase of Green Lanes Shopping Centre.

Any further substantial increases to capital expenditure and/or decreases in the reserve balances within the forthcoming years may result in the need for additional external borrowing to ensure the Council holds sufficient cash balances to meet its day to day commitments. The graph below sets out the current borrowing strategy for the next ten years. For further details please refer to the Council's ten year capital strategy on this agenda.



6.5 Maturity structure 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.

The Council is asked to approve the following treasury indicators and limits:

Maturity Structure of fixed interest rate borrowing 2022/23		
	Lower	**Upper**
Under 12 months	0%	60%
12 months to 2 years	0%	60%
2 years to 5 years	0%	100%
5 years to 10 years	0%	100%
10 years and above	0%	95%
Maturity Structure of variable interest rate borrowing 2022/23		
	Lower	**Upper**
Under 12 months	0%	60%
12 months to 2 years	0%	60%
2 years to 5 years	0%	100%
5 years to 10 years	0%	100%
10 years and above	0%	95%

6.6 Control of interest rate exposures

The Council is asked to approve the following local indicator to reduce the impact of any adverse movement in interest rates, whilst not impairing opportunities to reduce costs / improve performance.

Interest rate Exposures	2022/23 £000	2023/24 £000	2024/25 £000
Limit on fixed interest rates: • **Debt only** • **Investments only**	100% 100%	100% 100%	100% 100%
Limit on variable interest rates: • **Debt only** • **Investments only**	30% 100%	30% 100%	30% 100%

Paragraphs 6.3, 6.4, 6.5 and 7.4 provide further details on the controls in place to limit and manage interest rate exposure in line with financial requirements, borrowing maturities and interest rate forecasts.

6.7 Policy on borrowing in advance of need

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.

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid year or annual reporting mechanism.

6.8 Debt rescheduling

Rescheduling of current borrowing in our debt portfolio is unlikely to occur. If rescheduling was done, it will be reported to the Leader and Lead Member for Resources and Commercialisation.

6.9 New financial institutions as a source of borrowing

Currently the PWLB Certainty Rate is set at gilts + 80 basis points. However, consideration may still need to be given to sourcing funding from the following if rates should be cheaper:

- Local authorities (primarily shorter dated maturities)
- Financial institutions (primarily insurance companies and pension funds but also some banks, out of forward dates)
- Municipal Bonds Agency (possibly still a viable alternative depending on market circumstances prevailing at the time)

Our advisors will keep us informed as to the relative merits of each of these alternative funding sources.

Given the relative scale of our external borrowing it is likely that the PWLB will remain the Council's best option as a source of borrowing.

6.10 Approved Sources of Long and Short term Borrowing

Members are asked to review and approve the following list of sources and types of funding:

On Balance Sheet	**Fixed**	**Variable**
PWLB	●	●
Municipal bond agency	●	●
Local authorities	●	●
Banks	●	●
Pension funds	●	●
Insurance companies	●	●
UK Infrastructure Bank	●	●
Market (long-term)	●	●
Market (temporary)	●	●
Market (LOBOs)	●	●
Stock issues	●	●
Local temporary	●	●
Local Bonds	●	
Local authority bills	●	●
Overdraft		●
Negotiable Bonds	●	●
Internal (capital receipts & revenue balances)	●	●
Commercial Paper	●	
Medium Term Notes	●	
Finance leases	●	●

7 Annual Investment Strategy

7.1 Investment Policy – management of risk

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

- DLUHC’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 Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the Council’s risk appetite. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs. However, the Council will also consider the value available in periods up to 12 months with high credit rated financial institutions

The above guidance from the DLUHC 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 financial 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. Appendix A list the instruments 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. The Council will consider using this category only for investments that would come under Specified, except that the maturities are greater than 1 year.

5. **Lending limits**, (amounts and maturity), for each counterparty will be set through applying the matrix table in paragraph 7.2.

6. **Transaction limits** are set for each type of investment in paragraph 7.2.

7. This authority will set a limit for the amount of its investments which are invested for **longer than 365 days**, (see paragraph 7.4).

8. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating**, (see paragraph 7.3).

9. This authority has engaged **external consultants**, (see paragraph 4.5), 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.

10. All investments will be denominated in **sterling**.

11. As a result of the change in accounting standards for 2022/23 under **IFRS 9**, this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund.

    However, this authority will also pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see paragraph 7.4). Regular monitoring of investment performance will be carried out during the year.

Changes in risk management policy from last year.

The above criteria is largely unchanged from last year.

7.2 Creditworthiness policy

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

- "watches" and "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, watches and outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads. 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 durational bands*:*

- Dark pink 5 years for Ultra-Short Dated Bond Fund with a credit score of 1.25
- Light pink 5 years for Ultra-Short Dated Bond Fund with a credit score of 1.5
- Yellow 5 years (UK Government debt)
- Purple 2 years
- 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

The Link creditworthiness service uses a wider array of information other than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance 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 F1 and a long term rating A-. 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 weekly. The Council is alerted to changes to ratings of all three agencies through its use of the Link 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 Eurpoean Financials benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link. 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 any external support for banks to help support its decision making process.

	Colour (and long term rating where applicable)	Money Limit	Time Limit
Banks	**yellow**	**£1m**	**5 yrs**
Banks	**purple**	**£1m**	**2 yrs**
Banks	**orange**	**£4m**	**1 yr**
Banks – part nationalised	**blue**	**£4m**	**1 yr**
Banks	**red**	**£3.5m**	**6 mths**
Banks	**green**	**£3.5m**	**100 days**
Banks	**No colour**	**Not to be used**	
Other institutions limit	**-**	**£2m**	**1yr**
DMADF	**UK sovereign rating**	**Unlimited**	**6 months**
Local authorities	**n/a**	**£2m**	**1yr**
	Fund rating*	**Money Limit**	**Time Limit**
Money market funds CNAV	**AAA**	**£3m**	**liquid**
Money market funds LVNAV	**AAA**	**£3m**	**liquid**

Money market funds VNAV	**AAA**	**£3m**	**liquid**
Ultra-Short Dated Bond Fund with a credit score of 1.25	**Dark pink / AAA**	**£1m**	**liquid**
Ultra-Short Dated Bond Fund with a credit score of 1.5	**Light pink / AAA**	**£1m**	**liquid**

- *fund ratings are different to individual counterparty ratings, coming under specific MMF rating criteria*

No limit will be set on placing funds with the Council's own bank due to the volatility / fluctuations in day to day cash flows. Should the Council's bank have no colour then funds will be kept instant access.

Group limits where a number of institutions are under one ownership is a maximum of £6m.

Creditworthiness

Significant levels of downgrades to Short- and Long-Term credit ratings have not materialised since the crisis in March 2020. In the main, where they did change, any alterations were limited to Outlooks. However, as economies are beginning to reopen, there have been some instances of previous lowering of Outlooks being reversed

7.3 Country limits

The Council has determined that it will mainly use approved counterparties from within the United Kingdom.

However, the Council may consider counterparties from outside the United Kingdom providing the country has a minimum sovereign credit rating of AA- from Fitch or equivalent.

7.4 Investment Strategy

In-house funds. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.

- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

Investment returns expectations.

The current forecast shown in section 6.3, includes a forecast for a first increase in Bank Rate in May 2022, though it could come in February.

The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows:

Average earnings in each year	
2022/23	0.50%
2023/24	0.75%
2024/25	1.00%
2025/26	1.25%
Long term later years	2.00%

For its cash flow generated balances, the Council will seek to utilise its business reserve instant access, notice accounts and short-dated deposits, (overnight to 100 days), in order to benefit from the compounding of interest.

Investment treasury indicator and limit - total principal funds invested for greater than 365 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

The Council is asked to approve the treasury indicator and limit: -

Upper limit for principal sums invested for longer than 365 days			
£m	**2022/23**	**2023/24**	**2024/25**
Principal sums invested for longer than 365 days	£1m	£1m	£1m

The Council currently has no investments in excess of one year.

Investment risk benchmarking.

This Council will use an investment benchmark to assess the investment performance of its investment portfolio of 7 day SONIA compounded rate. (Sterling Overnight Index Average which is the risk-free rate for sterling markets administered by the Bank of England)

The Chief Financial Officer will monitor the current and trend position of the treasury function and amend the operational strategy to manage risk, as interest rates and counterparty conditions change. Performance results will be reported through the Quarterly Performance and Financial Management, Mid-Year and Annual Treasury reports to Strategy and Resources Committee.

7.5 Non-Treasury Investments

The Council will not borrow to invest primarily for financial gain and will generanlly adopt a low risk approach to non-treasury (commercial) investments in line with the investment categories and authorised limits set out in Appendix B.

Under the new PWLB lending terms, the PWLB will no longer lend to local authorities that plan to buy commercial assets primarily for yield.

Given the above, the Council may consider opportunities within the Council boundary, but where the main purpose of the scheme is regeneration.

8 Resource Implications

8.1 As detailed in the report.

9 Equalities Assessment

9.1 There are not any equalities implications anticipated as a result of this report, as the purpose of this report is to present the Council's financial position only.

10 Environmental Assessment

10.1 There are not any environmental implications anticipated as a result of this report, as the purpose of this report is to present the Council's financial position only

11 Corporate Priorities

11.1 The Treasury management function supports the delivery of the Councils capital programme and ensures cash flows meets the day to day requirements for service delivery.

12 Constitutional context

12.1 Part 4 Financial Procedure Rules (Article 13.8) / Article 4.4

12.2 Delegated power

13 Statement Of Confidentiality

13.1 This report contains no confidential or exempt information under the provisions of Schedule 12A of 1972 Act.

14 Statement Of Internal Advice

14.1 The author (below) confirms that advice has been taken from all appropriate Councillors and Officers.

Jon Triggs, Director of Resources and Deputy Chief Executive