



## North Devon Council

Report Date: 6<sup>th</sup> February 2023

Topic: Treasury Management Strategy Statement 2023/24

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 2023/2024, including the Treasury Management and Prudential Indicators for 2023/24 to 2025/26, be approved.
- 2.2 That the updated Treasury Management Practices in Appendix A, 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 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.

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

In addition to the three major reports detailed above, from 2023/24 quarterly reporting (end of June / End of December) will also be required. These reports will include the updated Treasury/Prudential Indicators and this will be incorporated into the current Performance and Financial Management Reports to Strategy and Resources, Policy Development Committee and Full Council.

#### 4.3 Treasury Management Strategy for 2023/24

The 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 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.

#### 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.

Furthermore, the Code states that they expect all organisations to have a formal and comprehensive knowledge and skills or training policy for the effective acquisition and retention of treasury management knowledge and skills for those responsible for management, delivery, governance and decision making.

The scale and nature of this will depend on the size and complexity of the organisation's treasury management needs. Organisations should consider how to assess whether treasury management staff and board/council members have the required knowledge and skills to undertake their roles and whether they have been able to maintain those skills and keep them up to date.

Treasury Management training will be provided to Members after the district elections in May 2023. 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 2023/24 – 2025/26

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:

<b>Capital Expenditure £000</b>	<b>2021/22 Actual</b>	<b>2022/23 Estimate</b>	<b>2023/24 Estimate</b>	<b>2024/25 Estimate</b>	<b>2025/26 Estimate</b>
Customer Focus	43	255	185	130	70
Environmental Enhancement	9,018	3,220	742	2,659	0
Governance	7	0	0	0	0
Place & Regeneration	11,301	4,816	16,730	905	25
Planning, Housing & Health	1,385	1,215	3,590	1,630	0
<b>Total</b>	<b>21,754</b>	<b>9,506</b>	<b>21,247</b>	<b>5,324</b>	<b>95</b>

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.

<b>Financing of Capital Expenditure £000</b>	<b>2021/22 Actual</b>	<b>2022/23 Estimate</b>	<b>2023/24 Estimate</b>	<b>2024/25 Estimate</b>	<b>2025/26 Estimate</b>
Capital receipts	278	320	150	150	150
Capital grants	4,371	4,966	11,313	626	
Capital reserves	374	1,546	1,234	297	70
<b>Net financing need for the year</b>	<b>16,731</b>	<b>2,674</b>	<b>8,550</b>	<b>4,251</b>	<b>(125)</b>

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 £1.7m of finance leases shown within the CFR.

The Council is asked to approve the CFR projections below:

£000	2021/22	2022/23	2023/24	2024/25	2025/26
	Actual	Estimate	Estimate	Estimate	Estimate
<b>Capital Financing Requirement</b>					
<b>Total CFR</b>	<b>21,699</b>	<b>24,482</b>	<b>33,323</b>	<b>38,608</b>	<b>37,112</b>
Movement in CFR	<b>17,108</b>	<b>2,783</b>	<b>8,841</b>	<b>5,285</b>	<b>(1,496)</b>

<b>Movement in CFR represented by:</b>					
Net financing need for the year (above)	16,731	2,674	8,550	4,251	(125)
Financing Lease – Capital Costs	891	974	1,270	2,489	373
Less MRP/VRP	(514)	(733)	(747)	(1,045)	(1,059)
Finance Lease Principal Payments (MRP)		(132)	(232)	(410)	(685)
<b>Movement in CFR</b>	<b>17,108</b>	<b>2,783</b>	<b>8,841</b>	<b>5,285</b>	<b>(1,496)</b>

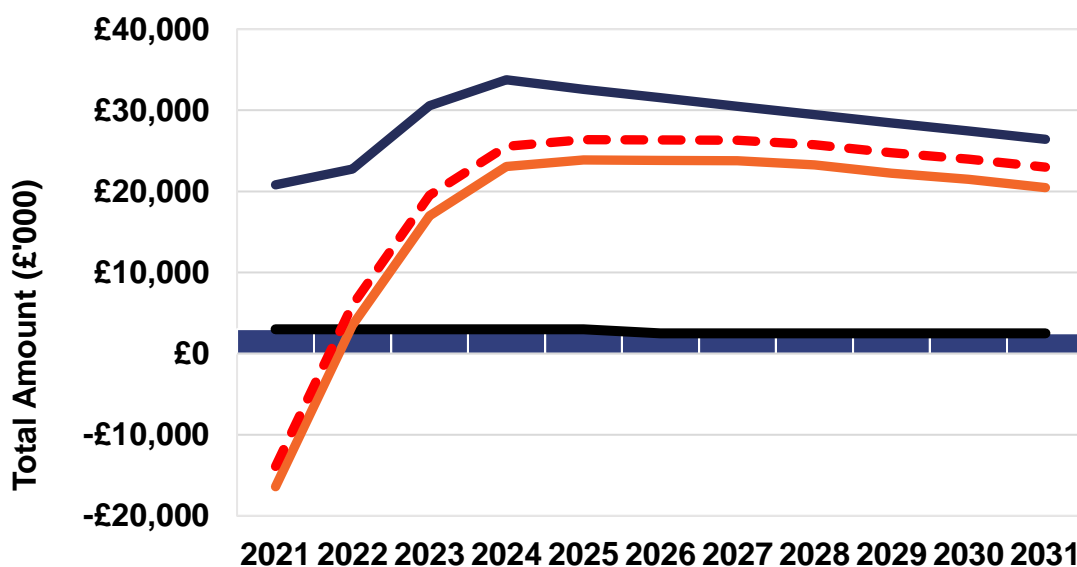
### 5.3 Liability Benchmark

A third and new prudential indicator for 2023/24 is the Liability Benchmark (LB). The Authority is required to estimate and measure the LB for the forthcoming financial year and the following two financial years, as a minimum but CIPFA strongly recommend that the LB is produced for at least 10 years or covering the full debt maturity profile.

There are four components to the LB: -

1. **Existing loan debt outstanding:** the Authority's existing loans that are still outstanding in future years.
2. **Loans CFR:** this is calculated in accordance with the loans CFR definition in the Prudential Code and projected into the future based on approved prudential borrowing and planned MRP.
3. **Net loans requirement:** this will show the Authority's gross loan debt less treasury management investments at the last financial year-end, projected into the future and based on its approved prudential borrowing, planned MRP and any other major cash flows forecast.
4. **Liability benchmark (or gross loans requirement):** this equals net loans requirement plus short-term liquidity allowance.

#### North Devon Liability Benchmark



- Existing Loan Debt Outstanding
- Net Loans Requirement (forecast net loan debt)
- Loans CFR
- - Liability Benchmark (Gross Loans Requirement)

The Liability benchmark above (red dotted line) is a projection of our external borrowing requirement. External borrowing should rarely exceed the LB, however for 21/22 the Council had excessive year-end cash due to central government covid-19 grants which caused a temporary fall in the LB.

#### 5.4 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.

<b>Year End Resources</b> <b>£000</b>	<b>2021/22</b> <b>Actual</b>	<b>2022/23</b> <b>Estimate</b>	<b>2023/24</b> <b>Estimate</b>	<b>2024/25</b> <b>Estimate</b>	<b>2025/26</b> <b>Estimate</b>
Fund balances / reserves	13,510	10,619	7,305	5,700	5,200
Provisions	688	600	500	500	500
<b>Total core funds</b>	<b>14,198</b>	<b>11,219</b>	<b>7,805</b>	<b>6,200</b>	<b>5,700</b>
Working capital*	23,012	8,500	5,750	4,500	3,000
<b>Total cash to invest</b>	<b>37,210</b>	<b>19,719</b>	<b>13,555</b>	<b>10,700</b>	<b>8,700</b>
(Under)/over borrowing	<b>(17,808)</b>	<b>(17,749)</b>	<b>(11,552)</b>	<b>(8,758)</b>	<b>(6,074)</b>
<b>Expected external investments</b>	<b>19,402</b>	<b>1,970</b>	<b>2,003</b>	<b>1,942</b>	<b>2,626</b>

\*Working capital balances shown for 21/22 include Central Government grants for Covid-19.

#### 5.5 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.



%	2021/22	2022/23	2023/24	2024/25	2025/26
	Actual	Estimate	Estimate	Estimate	Estimate
General Fund	3.91	5.62	10.12	15.93	17.75

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

## 5.6 Minimum revenue provision (MRP) policy statement

Under Regulation 27 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, where the Authority has financed capital expenditure by borrowing it is required to make a provision each year through a revenue charge (MRP).

The Authority is required to calculate a prudent provision of MRP which ensures that the outstanding debt liability is repaid over a period that is reasonably commensurate with that over which the capital expenditure provides benefits. The MRP Guidance (2018) gives four ready-made options for calculating MRP, but the Authority can use any other reasonable basis that it can justify as prudent.

The MRP policy statement requires full council approval in advance of each financial year. 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 (Straight line)** – MRP will be based on the estimated life of the assets.

Capital expenditure incurred during 2022/23 will not be subject to an MRP charge until 2023/24, or in the year after the asset becomes operational

The Authority will apply the asset life method for any expenditure capitalised under a Capitalisation Direction.

MRP in respect of assets acquired under Finance Leases or PFI will be charged at an amount equal to the principal element of the annual repayment.

For capital expenditure on loans to third parties where the principal element of the loan is being repaid in annual instalments, the capital receipts arising from the principal loan repayments will be used to reduce the CFR instead of MRP.

Where no principal repayment is made in a given year, MRP will be charged at a rate in line with the life of the assets funded by the loan

## MRP Overpayments

Under the MRP guidance, any charges made in excess of the statutory MRP can be made, known as voluntary revenue provision (VRP).

VRP can be reclaimed in later years if deemed necessary or prudent. In order for these amounts to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year.

No VRP overpayments have been made to date.

## 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 appropriate 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 2022 and for the position as at 31<sup>st</sup> December 2022 are shown below for both borrowing and investments.

<b>Treasury Portfolio</b>	<b>31/03/22</b>	<b>31/12/22</b>
<b>£000</b>	<b>Actual</b>	<b>Actual</b>
Investment with banks	19,402	20,860
<b>Total investments managed in-house</b>	<b>19,402</b>	<b>20,860</b>
Borrowing with PWLB	3,000	3,000
<b>Total external borrowing</b>	<b>3,000</b>	<b>3,000</b>
Net treasury investments / (borrowing)	16,402	17,860

\* 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	2021/22	2022/23	2023/24	2024/25	2025/26
	Actual	Estimate	Estimate	Estimate	Estimate
<b>External Debt</b>					
Debt at 1 April	500	3,891	6,733	21,771	29,850
Expected change in Debt	2,500	2,000	14,000	6,000	1,500
Expected change in OLTL	891	842	1,038	2,079	(312)
<b>Actual gross debt at 31 March</b>	<b>3,891</b>	<b>6,733</b>	<b>21,771</b>	<b>29,850</b>	<b>31,038</b>
<b>The Capital Financing Requirement</b>	<b>21,699</b>	<b>24,482</b>	<b>33,323</b>	<b>38,608</b>	<b>37,112</b>
<b>(Under) / over borrowing</b>	<b>(17,808)</b>	<b>(17,749)</b>	<b>(11,552)</b>	<b>(8,758)</b>	<b>(6,074)</b>

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 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 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	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Debt	5,000	22,000	28,000	29,500
Other long term liabilities	2,500	3,500	6,000	6,000
<b>Total</b>	<b>7,500</b>	<b>25,500</b>	<b>34,000</b>	<b>35,500</b>

The Boundary is increasing to reflect the higher CFR and borrowing need over this period.

**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	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Debt	33,000	33,000	36,000	36,000
Other long term liabilities	4,500	4,500	7,000	7,000
<b>Total</b>	<b>37,500</b>	<b>37,500</b>	<b>43,000</b>	<b>43,000</b>

### 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 19th December 2022. These are forecasts for certainty rates, gilt yields plus 80 bps.



Link Group Interest Rate View	19.12.22												
	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
<b>BANK RATE</b>	3.50	4.25	4.50	4.50	4.50	4.00	3.75	3.50	3.25	3.00	2.75	2.50	2.50
3 month ave earnings	3.60	4.30	4.50	4.50	4.50	4.00	3.80	3.30	3.00	3.00	2.80	2.50	2.50
6 month ave earnings	4.20	4.50	4.60	4.50	4.20	4.10	3.90	3.40	3.10	3.00	2.90	2.60	2.60
12 month ave earnings	4.70	4.70	4.70	4.50	4.30	4.20	4.00	3.50	3.20	3.10	3.00	2.70	2.70
5 yr PWLB	4.20	4.20	4.20	4.10	4.00	3.90	3.80	3.60	3.50	3.40	3.30	3.20	3.10
10 yr PWLB	4.30	4.40	4.40	4.30	4.10	4.00	3.90	3.80	3.60	3.50	3.40	3.30	3.30
25 yr PWLB	4.60	4.60	4.60	4.50	4.40	4.20	4.10	4.00	3.90	3.70	3.60	3.50	3.50
50 yr PWLB	4.30	4.30	4.30	4.20	4.10	3.90	3.80	3.70	3.60	3.50	3.30	3.20	3.20

The above forecast reflects a view that the MPC will be keen to demonstrate its anti-inflation credentials by delivering a succession of rate increases. This has happened throughout 2022, but the new Government's policy of emphasising fiscal rectitude will probably mean Bank Rate does not now need to increase to further than 4.5%.

Further down the road, we anticipate the Bank of England will be keen to loosen monetary policy when the worst of the inflationary pressures have lessened – but that timing will be one of fine judgment: cut too soon, and inflationary pressures may well build up further; cut too late and any downturn or recession may be prolonged

As there are so many variables at this time, caution must be exercised in respect of all interest rate forecasts.

### PWLB RATES

Yield curve movements have become less volatile under the Sunak/Hunt government. PWLB 5 to 50 years Certainty Rates are, generally, in the range of 3.75% to 4.50%. The medium to longer part of the yield curve is currently inverted (yields are lower at the longer end of the yield curve compared to the short to medium end).

We view the markets as having built in, already, nearly all the effects on gilt yields of the likely increases in Bank Rate and the poor inflation outlook but markets are volatile and further whipsawing of gilt yields across the whole spectrum of the curve is possible.

### The balance of risks to the UK economy: -

The overall balance of risks to economic growth in the UK is to the downside. Indeed, the Bank of England projected two years of negative growth in their November Quarterly Monetary Policy Report.

**Borrowing advice:** Our long-term (beyond 10 years) forecast for Bank Rate stands at 2.5%. As all PWLB certainty rates are now above this level, borrowing strategies will need to be reviewed in that context. Better value can generally be obtained at the shorter end of the curve and short-dated fixed LA to LA monies should be considered. Temporary borrowing rates are likely, however, to remain near Bank Rate and may also prove attractive whilst the market waits for inflation, and therein gilt yields, to drop back later in 2023.

## 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 medium and longer dated borrowing rates are expected to fall from their current levels once prevailing inflation concerns are addressed by tighter near-term monetary policy. That is, Bank Rate increases over the remainder of 2022 and the first half of 2023.

Against this background and the risks within the economic forecast, caution will be adopted with the 2023/24 treasury operations. The Chief Financial Officer 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 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, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.*

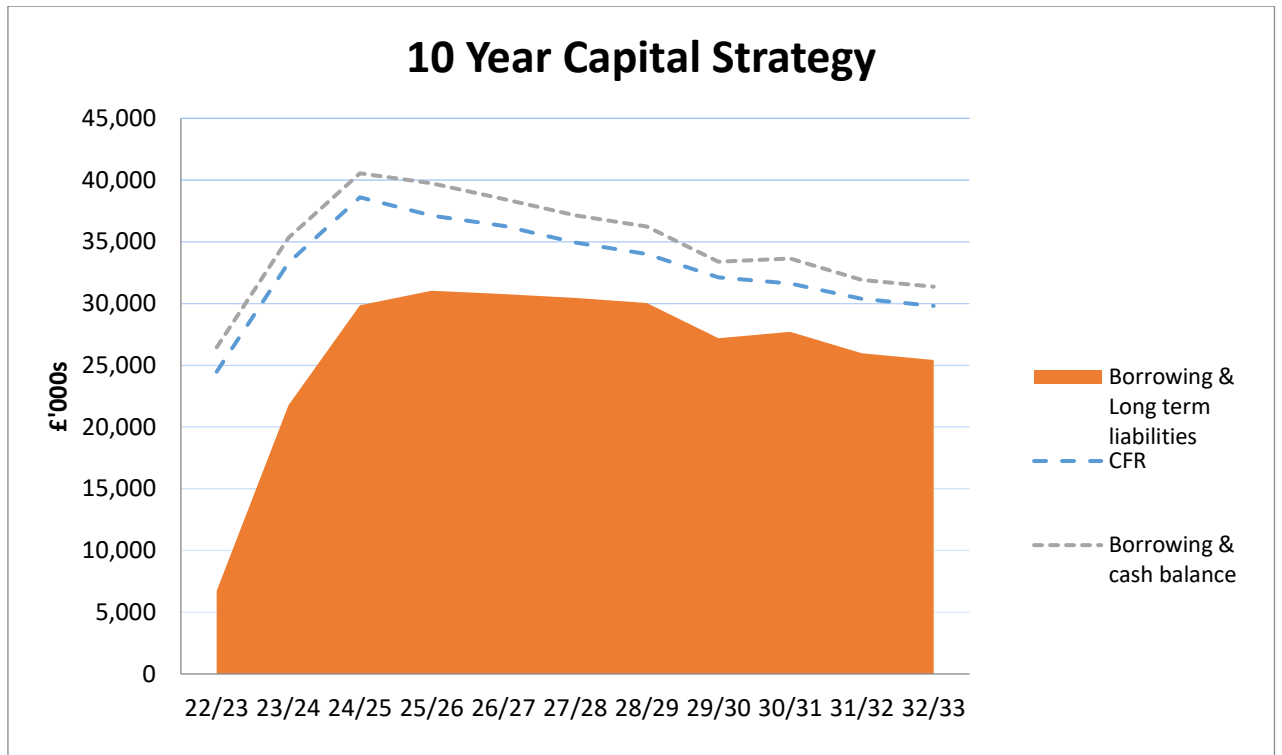
Any decisions will be reported to the Leader and Lead Member for Resources and Commercialisation.

It is projected that external borrowing as at March 2023 could be circa £5m. A further £14m of external borrowing may be required in 2023/24 to support the approved capital programme, taking total projected external borrowing to £19m by March 2024. This still prudently assumes using £11.5m of internal borrowing from reserves and cash balances to fund the Capital Financing Requirement.

This increased borrowing reflects the funding requirements of large capital schemes such as the new Leisure Centre, Green Lanes Shopping Centre and the Future High Street project.

Given the interest rate forecasts, borrowing will be kept short term so that the Council can benefit from lower borrowing rates on maturity.

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:

<b>Maturity Structure of fixed interest rate borrowing 2023/24</b>		
	<b>Lower</b>	<b>Upper</b>
Under 12 months	0%	60%
12 months to 2 years	0%	85%
2 years to 5 years	0%	100%
5 years to 10 years	0%	100%
10 years and above	0%	95%
<b>Maturity Structure of variable interest rate borrowing 2022/23</b>		
	<b>Lower</b>	<b>Upper</b>
Under 12 months	0%	60%
12 months to 2 years	0%	85%
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	2023/24	2024/25	2025/26
<b>Limit on fixed interest rates:</b>			
• Debt only	100%	100%	100%
• Investments only	100%	100%	100%
<b>Limit on variable interest rates:</b>			
• Debt only	30%	30%	30%
• Investments only	100%	100%	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 out to 3 years or so – generally still cheaper than the Certainty Rate )
- 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 Department of Levelling Up, Housing and Communities (DLUHC) and CIPFA have extended the meaning of ‘investments’ to include both financial and non-financial investments. This section deals solely with treasury (financial) investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets and service investments, are covered in section 8 only.

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 2021 (“the Code”)
- CIPFA Treasury Management Guidance Notes 2021

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 maintain a degree of liquidity to cover cash flow needs but to also consider “laddering” investments for periods up to 12 months with high credit rated financial institutions, whilst investment rates remain elevated.

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 utilising 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 European Senior 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.

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

	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 either specific MMF or Bond Fund 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, more recently the UK sovereign debt rating has been placed on Negative Outlook by the three major rating agencies in the wake of the Truss/Kwarteng unfunded tax-cuts policy. Although the Sunak/Hunt government has calmed markets, the outcome of the rating agency reviews is unknown at present, but it is possible the UK sovereign debt rating will be downgraded. Accordingly, when setting minimum sovereign debt ratings, this Authority will not set a minimum rating for the UK

### 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. The current shape of the yield curve suggests that is the case at present, but there is the prospect of Bank Rate peaking in the first half of 2023 and possibly reducing as early as the latter part of 2023 so an agile investment strategy would be appropriate to optimise returns.

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.

### **Investment returns expectations.**

The current forecast shown in section 6.3, includes a forecast for Bank Rate to reach 4.5% in Q2 2023.

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 (remainder)	3.95%
2023/24	4.40%
2024/25	3.30%
2025/26	2.60%
2026/27	2.50%
Years 6 to 10	2.80%
Years 10+	2.80%

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: -



<b>Upper limit for principal sums invested for longer than 365 days</b>			
<b>£m</b>	<b>2023/24</b>	<b>2024/25</b>	<b>2025/26</b>
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.

## **8 Non-Treasury Investments**

The PWLB will no longer lend to local authorities that plan to buy commercial assets primarily for yield. Therefore the Council will not undertake any such commercial investments within this context.

The Council will consider service investments that relate to a specific council objectives approved directly through a committee, such as schemes in relation to economic regeneration. Service investment items are covered by the capital programme and associated risk framework rather than non-treasury practices.

## **9 Resource Implications**

9.1 As detailed in the report.

## **10 Equalities Assessment**

10.1 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.



## 11 Environmental Assessment

11.1 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

## 12 Corporate Priorities

12.1 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.

## 13 Constitutional context

Part 3 Annexe 1, para 1(c) – delegated power

Article 4.5.26 and Part 4 (Financial Procedure Rules) para 13.8 - referred power

## 14 Statement of Confidentiality

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

## 15 Statement of Internal Advice

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

Jon Triggs, Director of Resources and Deputy Chief Executive