

## Appendix 3

### **TREASURY MANAGEMENT STRATEGY AND ANNUAL INVESTMENT STRATEGY 2023/24**

#### **1. Introduction**

##### **1.1 Background**

The council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the council's low risk appetite, providing adequate liquidity initially before considering investment return.

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.”*

This authority has not engaged in any commercial investments and has no non-treasury investments.

## **1.2 Reporting requirements**

### **1.2.1 Capital Strategy**

The 2021 CIPFA Prudential and Treasury Management Codes require all local authorities to prepare a capital strategy report which will provide the following:

- A high-level long term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- An overview of how associated risk is managed
- The implication for future sustainability

The aim of this capital strategy is to ensure that all elected members on full council fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

### **1.2.2 Treasury Management Reporting**

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

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

- The first, and most important report is forward looking and covers:
- The capital plans (including prudential indicators);
- A minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- The treasury management strategy, (how the investments and borrowing are to be organised) including treasury indicators; and
- An investment strategy (the parameters on how investments are to be managed).

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

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

### **1.2.3 Scrutiny**

The above reports are required to be adequately scrutinised before being recommended to the council. This role is undertaken by the Overview and Scrutiny Committee.

### **1.2.4 Quarterly reports**

In addition to the three major reports detailed above, from 2023/24 quarterly reporting of our prudential indicators is also required. However, these additional reports do not have to be reported to Full Council but do need to be adequately scrutinised. This role is undertaken by Overview and Scrutiny Committee based on reports to Cabinet.

## **1.3 Treasury Management Strategy for 2023/24**

The strategy for 2023/24 covers two main areas:

### **1.3.1 Capital issues**

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

### **1.3.2 Treasury management issues**

- The current treasury position;
- Treasury indicators which limit the treasury risk and activities of the council;
- Prospects for interest rates;
- The borrowing strategy;
- Policy on borrowing in advance of need;
- Debt rescheduling;
- The investment strategy;
- Creditworthiness policy; and
- The policy on use of external service providers.

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

## **1.4 Training**

The CIPFA Treasury Management Code requires the responsible 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, pages 47 and 48 of the Code state 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 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.

As a minimum, authorities should carry out the following to monitor and review knowledge and skills:

- Record attendance at training and ensure action is taken where poor attendance is identified.
- Prepare tailored learning plans for treasury management officers and members.
- Require treasury management officers and members to undertake self-assessment against the required competencies (as set out in the schedule that may be adopted by the organisation).
- Have regular communication with officers and members, encouraging them to highlight training needs on an ongoing basis.”

In further support of the revised training requirements, CIPFA’s Better Governance Forum and Treasury Management Network have produced a ‘self-assessment by members responsible for the scrutiny of treasury management’, which is available from the CIPFA website to download.

In February 2022 all members were offered Treasury Management Training from Link Asset Services. The equivalent training will be offered following the borough elections in May.

The training needs of treasury management officers are periodically reviewed.

## **1.5 Treasury management consultants**

The council uses Link Group, Treasury Solutions 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 the services of our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.

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.

## **2. The Capital Prudential Indicators 2023/24 – 2027/28**

The council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans. The Prudential Indicators, capital expenditure plans and how these plans are being financed by capital or revenue resources were approved by Cabinet at its meeting on 11 January 2023.

### **2.1 Capital Expenditure**

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.

Capital expenditure	2021/22 Actual £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000	2025/26 Estimate £000	2026/27 Estimate £000	2027/28 Estimate £000
TOTAL	4,271	17,344	18,420	17,833	15,055	3,550	2,387

Other long-term liabilities – The above financing need excludes other long-term liabilities, such as PFI and leasing arrangement that already include borrowing instruments (not currently applicable to Wyre).

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.

	2021/22 Actual £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000	2025/26 Estimate £000	2026/27 Estimate £000	2027/28 Estimate £000
Capital Receipts	0	-2,121	-14	0	-7	0	0
Capital Grants and Contributions	-4,141	-11,674	-18,256	-17,530	-14,833	-3,145	-2,080
Revenue/Reserves	-130	-3,549	-150	-303	-215	-405	-307
Total	-4,271	-17,344	-18,420	-17,833	-15,055	-3,550	-2,387
Net financing need for the year	0	0	0	0	0	0	0

## 2.2 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 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 asset's 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 scheme include a borrowing facility by the PFI, PPP lease provider and so the council is not required to separately borrow for these schemes. The council does not currently have any such schemes within the CFR.

	2021/22 Actual £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000	2025/26 Estimate £000	2026/27 Estimate £000	2027/28 Estimate £000
Total CFR	11,166	11,070	10,974	10,878	10,788	10,709	10,630
Movement in CFR	-96	-96	-96	-90	-79	-79	-79

Movement in CFR represented by:

	2021/22 Actual £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000	2025/26 Estimate £000	2026/27 Estimate £000	2027/28 Estimate £000
MRP and other financing movements	-96	-96	-96	-90	-79	-79	-79

## 2.3 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.

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.

## 2.4 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.

	2021/22 Actual £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000	2025/26 Estimate £000	2026/27 Estimate £000	2027/28 Estimate £000
Fund balances/ reserves	35,319	30,556	30,822	26,981	23,038	17,788	14,209
Capital receipts	869	4,384	4,370	4,370	4,363	4,363	4,363
Provisions	2,364	2,364	2,364	2,364	2,364	2,364	2,364
Other	-	-	-	-	-	-	-
Total core funds	38,552	36,514	36,766	32,925	28,975	23,725	20,146
Working capital*	3,000	3,000	3,000	3,000	3,000	3,000	3,000
Expected Investments	41,552	39,514	39,766	35,925	31,975	26,725	23,146

\*Working capital balances shown are estimated year-end; these may be higher mid-year.

## **2.5 Minimum Revenue Provision 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 (or closest equivalent level) in advance of each financial year.

The Council is recommended to approve the following MRP Statement.

For expenditure incurred before 1 April 2008 which forms part of supported capital expenditure, the MRP policy will be:

- 4% reducing balance (regulatory method) - MRP will follow the historical practice outlined in former regulations as 4% of the opening GF CFR balance less adjustment A.

From 1 April 2008 for all unsupported borrowing 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.

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.

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.

### 3. Borrowing

The capital expenditure plans set out in Section 2 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 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.

**3.1** The overall treasury management portfolio as at 31 March 2022 and for the position as at 10 February 2023 are shown below for both borrowing and investments.

Treasury Portfolio				
Treasury Investments	Actual 31/03/2022 £000	Actual 31/03/2022 %	Current 10/02/2023 £000	Current 10/02/2023 %
Banks	32,984	64%	26,942	45%
Money Market Funds	18,800	36%	33,000	55%
<b>Total Treasury Investments</b>	<b>51,784</b>		<b>59,942</b>	
External Borrowing	-1,552		-	
<b>Net Treasury Investments</b>	<b>50,232</b>		<b>59,942</b>	

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.

	2021/22 Actual £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000	2025/26 Estimate £000	2026/27 Estimate £000	2027/28 Estimate £000
External Debt at 1 April	1,552	1,552	0	0	0	0	0
Expected change in External Debt	0	-1,552	0	0	0	0	0
Other Long Term Liabilities (OLTL)	10	50	50	50	50	50	50
Expected change in OLTL	0	0	0	0	0	0	0

Actual Gross Debt at 31 March	1,562	50	50	50	50	50	50
Capital Financing Req.	11,166	11,070	10,974	10,878	10,788	10,709	10,630
Under/(over) Borrowing	9,604	11,020	10,924	10,828	10,738	10,659	10,580

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 Corporate Director of Resources 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.

### 3.2 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.

	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000	2025/26 Estimate £000	2026/27 Estimate £000	2027/28 Estimate £000
Borrowing	13,452	13,452	13,452	13,452	13,452	13,452
Other Long Term Liabilities (Deferred Liabilities)	50	50	50	50	50	50
Total Operational Boundary	13,502	13,502	13,502	13,502	13,502	13,502

**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 it 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 council's 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:

	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000	2025/26 Estimate £000	2026/27 Estimate £000	2027/28 Estimate £000
Borrowing	20,000	20,000	20,000	20,000	20,000	20,000
Other Long Term Liabilities	100	100	100	100	100	100
Total Authorised Limit	20,100	20,100	20,100	20,100	20,100	20,100

### 3.3 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. The following table gives their central view.

Annual Average % as at the quarter ending:	Bank Rate %	PWLB Rates % as at December 2022			
		5 year	10 year	25 year	50 year
Dec 2022	4.00	4.20	4.30	4.60	4.30
March 2023	4.25	4.20	4.40	4.60	4.30
June 2023	4.50	4.20	4.40	4.60	4.30
Sept 2023	4.50	4.10	4.30	4.50	4.20
Dec 2023	4.50	4.00	4.10	4.40	4.10
March 2024	4.00	3.90	4.00	4.20	3.90
June 2024	3.75	3.80	3.90	4.10	3.80
Sept 2024	3.50	3.60	3.80	4.00	3.70
Dec 2024	3.25	3.50	3.60	3.90	3.60
March 2025	3.00	3.40	3.50	3.70	3.50
June 2025	2.75	3.30	3.40	3.60	3.30
September 2025	2.50	3.20	3.30	3.50	3.20
December 2025	2.50	3.10	3.30	3.50	3.20

Our central forecast for interest rates reflected a view that the MPC would be keen to further demonstrate its anti-inflation credentials by delivering a succession of rate increases. Bank Rate stands at 4.0% currently but is expected to reach a peak of 4.5% in the first half of 2023.

Further down the road, we anticipate the Bank of England will be keen to loosen monetary policy when the worst of the inflationary pressures are behind us – 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.

The CPI measure of inflation looks to have peaked at 11.1% in Q4 2022. Despite the cost-of-living squeeze that is still taking shape, the Bank will want to see evidence that wages are not spiralling upwards in what is evidently a very tight labour market.

Regarding the plan to sell £10bn of gilts back into the market each quarter (Quantitative Tightening), this has started and will focus on the short, medium and longer end of the curve in equal measure, now that the short-lived effects of the Truss/Kwarteng unfunded dash for growth policy are firmly in the rear-view mirror.

In the upcoming months, our forecasts will be guided not only by economic data releases and clarifications from the MPC over its monetary policies and the Government over its fiscal policies, but the on-going conflict between Russia and Ukraine. More recently, the heightened tensions between China/Taiwan/US also have the potential to have a wider and negative economic impact.

On the positive side, consumers are still estimated to be sitting on over £160bn of excess savings left over from the pandemic so that will cushion some of the impact of the above challenges. However, most of those are held by more affluent people whereas lower income families already spend nearly all their income on essentials such as food, energy and rent/mortgage payments.

### **PWLB rates**

- The yield curve movements have become less volatile of late and PWLB 5 to 50 years Certainty Rates are, generally, in the range of 4.10% to 4.80%.
- 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 elevated inflation outlook.

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

- The overall balance of risks to economic growth in the UK is to the downside.

### **Downside risks to current forecasts for UK gilt yields and PWLB rates include:**

- Labour and supply shortages prove more enduring and disruptive and depress economic activity (accepting that in the near-term this is also an upside risk to inflation and, thus, rising gilt yields).
- The Bank of England acts too quickly, or too far, over the next year to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- UK / EU trade arrangements – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.
- Geopolitical risks, for example in Ukraine/Russia, China/Taiwan/US, Iran, North Korea and Middle Eastern countries, which could lead to increasing safe-haven flows.

## Upside risks to current forecasts for UK gilt yields and PWLB rates:

- The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly and for a longer period within the UK economy, which then necessitates Bank Rate staying higher for longer than we currently project or even necessitates a further series of increases in Bank Rate.
- The Government acts too quickly to cut taxes and/or increases expenditure in light of the cost-of-living squeeze.
- The pound weakens because of a lack of confidence in the UK Government's fiscal policies, resulting in investors pricing in a risk premium for holding UK sovereign debt.
- Longer term US treasury yields rise strongly and pull gilt yields up higher than currently forecast.
- Projected gilt issuance, inclusive of natural maturities and QT, could be too much for the markets to comfortably digest without higher yields consequently.

**Borrowing advice:** Our long-term (beyond 10 years) forecast for Bank Rate stands at 2.5%. As all PWLB certainty rates are currently 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 Local Authority to Local Authority 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.

Our suggested budgeted earnings rates for investments up to about three months' duration in each financial year are rounded to the nearest 10bps as follows:

Average earnings in each year	
2022/23 (remainder)	4.00%
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%

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

Our interest rate forecast for Bank Rate is in steps of 25 bps, whereas PWLB forecasts have been rounded to the nearest 10 bps and are central forecasts within bands of + / - 25 bps. Naturally, we continue to monitor events and will update our forecasts as and when appropriate.

### **3.4 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 Authority'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 Corporate Director of Resources will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- if it was felt that there was a significant risk of a sharp fall in 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 Council at the next available opportunity.

The council doesn't have any plans in the short to medium term to undertake any further borrowing.

### **3.5 Policy on borrowing in advance of need**

The Authority 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 Authority 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.

### 3.6 Debt rescheduling

The council is debt free and so this doesn't currently apply.

### 3.7 New Financial institutions as a source of borrowing and/or types 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 sources for the following reasons:

- 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 where the objective is to avoid a “cost of carry” or to achieve refinancing certainty over the next few years).

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

### 3.8 Approved Sources of Long and Short-term Borrowing

On Balance Sheet	Fixed	Variable
PWLB	●	●
UK 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	●	●

## **4. Annual Investment Strategy**

### **4.1 Investment policy – management of risk**

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

The council's investment policy has regard to the following:

- 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, as well as wider range fund options.

The above guidance from the DLUHC and CIPFA places 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 Authority 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 and are listed in Treasury Management Practices (TMP) Schedule 1 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 or have less than a year left to run to maturity, if originally they were classified as being non-specified investments solely due to the maturity period exceeding one year.

**Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.

5. Non-specified and loan investment limits. The Authority has determined that it will set a limit to the maximum exposure of the total treasury management investment portfolio to non-specified treasury management investments of Y%.
6. Lending limits, (amounts and maturity), for each counterparty will be set through applying the matrix table in paragraph 4.2.
7. Transaction limits are set for each type of investment in 4.2.
8. This Council will set a limit for its investments which are invested for longer than 365 days (see paragraph 4.4).
9. Investments will only be placed with counterparties from countries with a specified minimum sovereign rating (see paragraph 4.3).
10. This Authority has engaged external consultants (see paragraph 1.5), to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this Authority in the context of the expected level of cash balances and need for liquidity throughout the year.
11. All investments will be denominated in sterling.
12. 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. (In November 2018, the MHCLG, concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five

years ending 31.3.23. At the current juncture it has not been determined whether a further extension to the over-ride will be agreed by Government).

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 4.5). Regular monitoring of investment performance will be carried out during the year.

## 4.2 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, Moody's and Standard & Poor's. The credit ratings of counterparties are supplemented with the following overlays:

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

This modelling approach combines credit ratings and any assigned Watches and Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads. The end product of this 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:

Yellow	5 years (only local authorities)
Dark pink	5 years for Ultra-Short Dated Bond Funds with a credit score of 1.25
Light pink	5 years for Ultra-Short Dated Bond Funds with a credit score of 1.5
Purple	2 years
Blue	1 year (only applies to nationalised or part 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 Authority uses will be a short-term rating (Fitch or equivalents) of F1 and a long-term rating of 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 monthly. The Authority 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 Authority's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Authority 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 Authority's lending list.

Sole reliance will not be placed on the use of this external service. In addition, this Authority will also use market data and market information, as well as information on any external support for banks to help support its decision-making process.

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

The amount invested per institution will be £6m or 20% of investment balance per individual counterparty or 25% per whole counterparty group whichever is higher.

	Colour (and long-term rating where applicable)	Time limit
Banks *	Yellow	5 yrs
Banks	Purple	2 yrs
Banks	Orange	1 yr
Banks – part nationalised	Blue	1 yr
Banks	Red	6 mths
Banks	Green	100 days
Banks	No Colour	
DMADF	UK sovereign rating	6 months
Local authorities	Yellow	5 yrs
Housing associations	Colour bands	As per colour band
	<b>Fund rating**</b>	<b>Time Limit</b>
Money Market Funds CNAV	AAA	liquid
Money Market Funds LVNAV	AAA	liquid
Money Market Funds VNAV	AAA	liquid
Ultra-Short Dated Bond Funds with a credit score of 1.25	Dark Pink / AAA	liquid
Ultra-Short Dated Bond Funds with a credit score of 1.50	Light Pink / AAA	liquid

## 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 Council will not set a minimum rating for the UK.

## CDS prices

Although bank CDS prices, (these are market indicators of credit risk), spiked upwards during the days of the Truss/Kwarteng government, they have returned to more average levels since then. However, sentiment can easily shift, so it will remain important to undertake continual monitoring of all aspects of risk and return in the current circumstances. Link monitor CDS prices as part of their creditworthiness service to local authorities and the Council has access to this information via its Link-provided Passport portal.

## 4.3 Limits

Due care will be taken to consider the exposure of the Authority's total investment portfolio to non-specified investments, countries, groups and sectors.

- a. **Non-specified treasury management investment limit.** The Authority has determined that it will limit the maximum total exposure of treasury management investments to non-specified treasury management investments as being \_% of the total treasury management investment portfolio. (Consider whether to also put in limits for loans and non-financial investments held for yield as part of the total investment portfolio.)
- b. **Country limit.** The Authority has determined that it will only use approved counterparties from the UK and from countries with a minimum sovereign credit rating of AA- from Fitch. The list of countries that qualify using this credit criteria as at the date of this report are shown in Annex 1. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

Other limits. In addition: -

- no more than XX% will be placed with any non-UK country at any time;
- limits in place above will apply to a group of companies/institutions;
- sector limits will be monitored regularly for appropriateness.

## 4.4 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.

Accordingly, 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 paragraph 3.3, 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)	4.00%
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%

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

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

## 4.5 Investment treasury indicator

There are currently no plans for funds to be invested for a period greater than 364 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. For its cash flow generated balances, the council will seek

to utilise its instant access and notice accounts, money market funds, short dated deposits (overnight to 100 days) and 6 month deposits in order to benefit from compounding of interest.

#### **4.6 Investment Performance / Risk Benchmarking**

This council will use an investment benchmark to assess the investment performance of its investment portfolio of overnight, 7 day, 1, 3, 6 or 12 month compounded / Sterling Overnight Index Average (SONIA).

#### **4.6 End of year investment report**

At the end of the financial year, the council will report on its investment activity as part of its Annual Treasury Report.

#### **4.7 Non-treasury investments**

This council recognises that investment in other financial assets and property primarily for financial return, taken for non-treasury management purposes, requires careful investment management. Such activity includes loans supporting service outcomes, investments in subsidiaries and investment property portfolios. This council does not currently have any such investments. However it will ensure that all of its investments are covered in the capital programme, investment strategy or equivalent and will set out, where relevant, the council's risk appetite and specific the risk appetite for these activities may differ from that of treasury management. The council will maintain a schedule setting out a summary of existing material investments, subsidiaries, joint ventures and liabilities including financial guarantees and the council's risk exposure where applicable.

#### **4.8 Environmental, Social & Governance (ESG)**

The council will take a balanced approach to Environmental, Social & Governance (ESG) ensuring that the principle of security, liquidity and yield is the core investment strategy. All the main agencies are now incorporating ESG risks alongside more traditional financial risk metrics when assessing counterparty ratings. Given their incorporation is already being done by the use of mainstream rating agencies the council will use this as the basis for assessment until we are advised otherwise by our treasury consultants.

## **Annex 1**

### **Approved Countries for Investments (as at 19/12/2022)**

This list is based on those countries which have sovereign ratings of AA- or higher, (we show the lowest rating from Fitch, Moody's and S&P) and also, (except - at the time of writing - for Hong Kong and Luxembourg), have banks operating in sterling markets which have credit ratings of green or above in the Link creditworthiness service.

Based on lowest available rating

#### AAA

- Australia
- Denmark
- Germany
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

#### AA+

- Canada
- Finland
- U.S.A.

#### AA

- Abu Dhabi (UAE)
- France

#### AA-

- Belgium
- Qatar
- U.K.