

## **2022/23 TREASURY MANAGEMENT STRATEGY, ANNUAL INVESTMENT STRATEGY, PRUDENTIAL AND TREASURY MANAGEMENT INDICATORS AND MINIMUM REVENUE PROVISION**

### **Synopsis of report:**

**The report sets out the Treasury Management Strategy, Prudential and Treasury Management Indicators, and Minimum Revenue Provision Statement for 2022/23.**

**This report should be read in conjunction with the Capital Strategy report set out elsewhere on this agenda**

### **Approved Recommendations:**

- i) The proposed 2022/23 Treasury Management Strategy encompassing the Annual Investment Strategy as set out in this report be approved**
- ii) The Prudential and Treasury Management Indicators for 2022/23 set out in this report be approved**
- iii) The revised Treasury Management Practices and Treasury Management Schedules set out in the Appendices be approved**
- iv) The authorised limit for external borrowing by the Council in 2022/23, be set at £720,710,000 (this being the statutory limit determined under Section 3 (1) of the Local Government Act 2003.**
- v) The Council's MRP statement for 2022/23 be agreed as follows:**

**“The Council will use the asset life method as its main method for calculating MRP.**

**In normal circumstances, MRP will be set aside from the date of acquisition. However, in relation to capital expenditure on property purchases and/or development, we will start setting aside an MRP provision from the date that the asset becomes operational and/or revenue income is generated”.**
- vi) Member training on Treasury Management be held every two years**

## **1. Context of report**

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

- 1.2 The second main function of the treasury management function is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.
- 1.3 The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.
- 1.4 The Council recognises that effective financial planning, option appraisal, risk management and governance processes are essential in achieving a prudent approach to capital expenditure, investment and debt. Therefore, all investment decisions (treasury and non-treasury) are taken in light of the Council's Corporate Business Plan, Medium Term Financial Strategy, Capital Strategy and Treasury Management Strategy.
- 1.5 The Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as:
- "The management of the local authority's borrowing, investments and cashflows, 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".
- 1.6 The Council has adopted both the CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes – 2017 Edition (the TM Code) and the Prudential Code (the Code) and this report fulfils the Council's legal obligation under the *Local Government Act 2003* to have regard to both the relevant CIPFA Codes and the Department for Levelling Up, Housing and Communities (DULHC – formerly the Ministry for Housing, Communities and Local Government – MHCLG) Guidance on Local Authority Investments. (DLUHC Investment Guidance).
- 1.7 The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals. These are:
- Prudential and Treasury Indicators and Treasury Management Strategy (this report)
  - A mid year Treasury Management Report
  - An annual Treasury Report
- 1.8 The Treasury Management Strategy (TMS) sets out the framework each year for the Council's treasury operations. It covers two main areas:
- Capital Issues:
- the capital expenditure plans and the associated prudential indicators;
  - the minimum revenue provision (MRP) policy.

Treasury management issues:

- Policy on the use of external service providers
- The economy and prospects for interest rates
- The current treasury position
- Borrowing strategy
- Policy on borrowing in advance of need
- Debt restructuring
- Annual investment strategy
- Treasury indicators which limit the risk and activities of the Council
- Other treasury matters (required under DLUHC Investment Guidance)

- 1.9 The Council has delegated responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Corporate Management Committee, and for the execution and administration of treasury management decisions to the Assistant Chief Executive, who will act in accordance with the Council's Treasury Policy Statement and Treasury Management Practices (TMP).
- 1.10 These reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Overview and Scrutiny Select Committee which will be considering this report at its meeting on 3 February 2022.
- 1.11 A glossary of treasury terms has been included at Appendix "C" to assist Members with some of the terms covered in this report.

## **2 Capital Strategy**

- 2.1 The 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 the associated risk is managed
  - the implications for future financial sustainability
- 2.2 The aim of this Capital Strategy is to ensure that all elected members on the full council fully understand the overall long-term policy objectives and resulting Capital Strategy requirements, governance procedures and risk appetite.
- 2.3 The Capital Strategy is reported separately from the Treasury Management Strategy Statement to ensure the separation of the core treasury function under security, liquidity and yield principles, and the policy and commercial investments usually driven by expenditure on an asset.
- 2.4 To demonstrate the proportionality between the treasury operations and the non-treasury operation, high-level comparators are shown throughout this TMS report.

## **3 Revised CIPFA Treasury Management Code and Prudential Code**

- 3.1 CIPFA published its revised Treasury Management and Prudential Codes on 20 December 2021 and has stated that formal adoption is not required until the 2023/24 financial year. The Council has to have regard to these codes of practice when it prepares the Treasury

Management Strategy Statement and Annual Investment Strategy, and also related reports during the financial year, which are taken to Full Council for approval.

3.2 DLUHC is proposing to tighten up regulations around local authorities financing capital expenditure on investments in commercial projects for yield and has already closed access to all PWLB borrowing if such schemes are included in an authority's capital programme. The new CIPFA codes have also adopted a similar set of restrictions to discourage further capital expenditure on commercial investments for yield.

3.3 The revised codes will have the following implications:

- a requirement for the Council to adopt a new debt liability benchmark treasury indicator to support the financing risk management of the capital financing requirement;
- clarify what CIPFA expects a local authority to borrow for and what they do not view as appropriate. This will include the requirement to set a proportionate approach to commercial and service capital investment;
- require implementation of a policy to review commercial property, with a view to divest where appropriate;
- create new Investment Practices to manage risks associated with non-treasury investment (similar to the current Treasury Management Practices);
- ensure that any long term treasury investment is supported by a business model;
- a requirement to effectively manage liquidity and longer term cash flow requirements;
- amendment to TMP1 (Treasury Management Practice 1) to address Environmental, Social and Governance (ESG) policy within the treasury management risk framework;
- amendment to the knowledge and skills register for individuals involved in the treasury management function - to be proportionate to the size and complexity of the treasury management conducted by each council;
- a new requirement to clarify reporting requirements for service and commercial investment, (especially where supported by borrowing/leverage).

3.4 The Prudential Code states that it applies with immediate effect, except authorities may defer introducing revised reporting requirements until the 2023/24 financial year. Officers have incorporated some of the new requirements in both the Capital and Treasury Management Strategies for next year and will look to enhance all future reports with the new reporting requirements once the associated guidance notes have been received. This will include any necessary updates of the Council's Treasury Management Policy Statement, Treasury Management Practices (TMPs) and Treasury Management Schedules (TMSs).

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

- 4.1 When a Council funds capital expenditure by borrowing, the costs are charged to the Council Tax payer in future years, reflecting the long-term use of the assets. Unlike a mortgage where amounts of principal are repaid each month, the borrowing undertaken by a Council is usually repayable on maturity at an agreed future date. The interest on borrowing is charged in the year it is payable.
- 4.2 To reflect this, the Council is required to pay off an element of the accumulated General Fund capital spend each year through a revenue charge (the Minimum Revenue Provision – MRP), although it is also allowed to undertake additional voluntary payments if required (Voluntary Revenue Provision – VRP). The MRP exists as a charge to revenue each year in order to have sufficient monies set aside to meet the future repayment of principle on any borrowing undertaken. There isn't an earmarked reserve for MRP, it is represented in the accounts as increased cash.
- 4.3 There is no requirement on the Housing Revenue Account (HRA) to make MRP.
- 4.4 Revised statutory guidance has been issued by the DLUHC which local authorities are required to have regard to which requires the full Council to approve an MRP Statement in advance of each year. The aim of the DLUHC Investment Guidance is to ensure that debt is repaid over a period that is commensurate with that over which the capital expenditure provides benefits. The guidance recommends 4 options for calculating a prudent MRP as follows:
1. Regulatory Method
  2. CFR Method
  3. Asset Life Method (repayment over the useful life of the asset on an asset life basis)
  4. Depreciation Method (cost less estimated residual value)

Options 1 and 2 should normally only be used for Government-supported borrowing with options 3 and 4 being used for self-financed borrowing.

- 4.5 In December 2014 the Council set an MRP Statement to relate to prudent provisions and the relevant useful lives of assets, these will be unique to each asset borrowed against and as such will not affect the overall method chosen for calculating MRP. The current MRP Policy is as follows:

*“The Council will use the asset life method as its main method for calculating MRP.*

*In normal circumstances, MRP will be set aside from the date of acquisition. However, in relation to capital expenditure on property purchases and/or development, we will start setting aside an MRP provision from the date that the asset becomes operational and/or revenue income is generated. Where schemes require interim financing by loan, pending receipt of an alternative source of finance (for example capital receipts) no MRP charge will be applied”.*

- 4.6 In November 2021, the Government began a consultation exercise on proposed amendments to the MRP regulations to take effect from 1 April 2023. The paper primarily covers concerns that the government has in respect of compliance with the duty to make a prudent revenue provision for all borrowing. It's intention is not to change policy, but to clearly set out in legislation the practices that authorities should already be following.
- 4.7 Whilst it is not something that the Council has ever done, part of the Council's current MRP Policy states that *“Where schemes require interim financing by loan, pending receipt of an alternative source of finance (for example capital receipts) no MRP charge will be*

*applied*". This would appear to be contrary to the amendments being consulted on. As this will have no effect on our current operations or plans, it is proposed to remove this line from the Policy for 2022/23 and the recommendations to the report have been worded accordingly.

- 4.8 Any charges made over the statutory MRP, VRP or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, the Council's MRP policy must disclose the cumulative overpayment made each year. Up until the 31 March 2021 the Council had made no such VRP overpayments.

## **5 Treasury Management Strategy (TMS)**

### Treasury management consultants and training

- 5.1 The Council recognises that there is value in employing external providers of treasury management services in order to secure access to specialist skills and resources. Link Asset Services (Link) provide this service to the Council, although responsibility for final decision making remains with the Council and its officers at all times.
- 5.2 The quality of this service is controlled by the Assistant Chief Executive assessing the quality of advice offered and other services provided by Link. In particular, the Assistant Chief Executive holds regular meetings with Link (normally 3 to 4 times a year) where, in addition to discussing treasury strategy, the performance of the consultants is reviewed.
- 5.3 The needs of the Council's treasury management staff for training in investment management are assessed every year as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change. Relevant training courses, seminars and conferences are provided by a range of organisations including Link and CIPFA.
- 5.4 The CIPFA Code requires the Assistant Chief Executive to ensure that Members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. Member training was last carried out by Link to 22 Members in November 2017. Further training was planned for November 2021 however CIPFA are now proposing a Treasury Management Knowledge and Skills Framework for officers and members in the latest treasury code updates including a learning needs analysis to support it so this training has been deferred until 2022 to ensure any new requirements are met.

### The economy and prospects for interest rates

- 5.5 The Council has appointed Link as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table and paragraph's gives Link's view on interest rates and the economy as at 20 December 2021.

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

- 5.6 Over the last two years, the coronavirus outbreak has done huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings until raising it to 0.25% at its meeting on 16th December 2021.
- 5.7 As shown in the forecast table above, the forecast for Bank Rate now includes four increases, one in December 2021 to 0.25%, then quarter 2 of 2022 to 0.50%, quarter 1 of 2023 to 0.75%, quarter 1 of 2024 to 1.00% and, finally, one in quarter 1 of 2025 to 1.25%.
- 5.8 It is not expected that Bank Rate will go up fast after the initial rate rise as the supply potential of the economy is not likely to have taken a major hit during the pandemic: it should, therefore, be able to cope well with meeting demand after supply shortages subside over the next year, without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the MPC's 2% target after the spike up to around 5%. The forecast includes four increases in Bank Rate over the three-year forecast period to March 2025, ending at 1.25%. However, it is likely that these forecasts will need changing within a relatively short timeframe for the following reasons: -
- We do not know how severe an impact Omicron could have on the economy and whether there will be another lockdown or similar and, if there is, whether there would be significant fiscal support from the Government for businesses and jobs.
  - There were already increasing grounds for viewing the economic recovery as running out of steam during the autumn and now into the winter. And then along came Omicron to pose a significant downside threat to economic activity. This could lead into stagflation, or even into recession, which would then pose a dilemma for the MPC as to whether to focus on combating inflation or supporting economic growth through keeping interest rates low.
  - Will some current key supply shortages spill over into causing economic activity in some sectors to take a significant hit?
  - Rising gas and electricity prices in October and next April and increases in other prices caused by supply shortages and increases in taxation next April, are already going to deflate consumer spending power without the MPC having to take any action on Bank Rate to cool inflation.
  - On the other hand, consumers are sitting on over £160bn of excess savings left over from the pandemic so when will they spend this sum, in part or in total?

- It looks as if the economy coped well with the end of furlough on 30<sup>th</sup> September. It is estimated that there were around 1 million people who came off furlough then and there was not a huge spike up in unemployment. The other side of the coin is that vacancies have been hitting record levels so there is a continuing acute shortage of workers. This is a potential danger area if this shortage drives up wages which then feed through into producer prices and the prices of services i.e., a second-round effect that the MPC would have to act against if it looked like gaining significant momentum.
- We also recognise there could be further nasty surprises on the Covid front beyond the Omicron mutation.
- If the UK invokes article 16 of the Brexit deal over the dislocation in trading arrangements with Northern Ireland, this has the potential to end up in a no-deal Brexit.

- 5.9 In summary, with the high level of uncertainty prevailing on several different fronts, we expect to have to revise our forecasts again - in line with whatever the new news is.
- 5.10 It should also be borne in mind that Bank Rate being cut to 0.25% and then to 0.10%, were emergency measures to deal with the Covid crisis hitting the UK. At any time, the MPC could decide to simply take away such emergency cuts on no other grounds than they are no longer warranted, and as a step forward in the return to normalisation. In addition, any Bank Rate under 1% is both highly unusual and highly supportive of economic growth.
- 5.11 **Forecasts for PWLB rates and gilt and treasury yields:** Since the start of 2021, we have seen a lot of volatility in gilt yields, and hence PWLB rates. As the interest forecast table for PWLB certainty rates above shows, there is forecast to be a steady, but slow, rise in both Bank Rate and gilt yields during the forecast period to March 2025, though there will doubtless be a lot of unpredictable volatility during this forecast period.
- 5.12 While monetary policy in the UK will have a major impact on gilt yields, there is also a need to consider the potential impact that rising treasury yields in America could have on our gilt yields. As an average since 2011, there has been a 75% correlation between movements in US 10-year treasury yields and UK 10-year gilt yields. This is a significant UPWARD RISK exposure to our forecasts for longer term PWLB rates. However, gilt yields and treasury yields do not always move in unison.
- 5.13 There are also possible DOWNSIDE RISKS from the huge sums of cash that the UK populace have saved during the pandemic; when savings accounts earn little interest, it is likely that some of this cash mountain could end up being invested in bonds and so push up demand for bonds and support their prices i.e., this would help to keep their yields down. How this will interplay with the Bank of England eventually getting round to not reinvesting maturing gilts and then later selling gilts, will be interesting to monitor.
- 5.14 As the US financial markets are, by far, the biggest financial markets in the world, any upward trend in treasury yields will invariably impact and influence financial markets in other countries. Inflationary pressures and erosion of surplus economic capacity look much stronger in the US compared to those in the UK, which would suggest that Fed rate increases eventually needed to suppress inflation, are likely to be faster and stronger than Bank Rate increases in the UK. This is likely to put upward pressure on treasury yields which could then spill over into putting upward pressure on UK gilt yields.



- 5.15 The forecasts are also predicated on an assumption that there is no break-up of the Eurozone or EU within the forecasting period, despite the major challenges that are looming up, and that there are no major ructions in international relations, especially between the US and Russia, China / North Korea and Iran, which have a major impact on international trade and world GDP growth.
- 5.16 One of the key results of the pandemic has been a fundamental rethinking and shift in monetary policy by major central banks like the Fed, the Bank of England and the ECB, to tolerate a higher level of inflation than in the previous two decades when inflation was the prime target to bear down on so as to stop it going above a target rate. There is now also a greater emphasis on other targets for monetary policy than just inflation, especially on 'achieving broad and inclusive "maximum" employment in its entirety' in the US, before consideration would be given to increasing rates.

The current treasury position and prospects for investment rates

- 5.17 Investment returns are expected to improve in 2022/23. However, while markets are pricing in a series of Bank Rate hikes, actual economic circumstances may see the MPC fall short of these elevated expectations. Borrowing interest rates fell to historically very low rates as a result of the COVID crisis and the quantitative easing operations of the Bank of England and still remain at historically low levels.
- 5.18 Based on the forecast rates in paragraph 5.5, the assumed investment earnings rates for returns on investments placed for periods up to about three months during each financial year, (based on a first increase in Bank Rate in quarter 2 of 2022), are as follows:

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

- 5.19 The Council's treasury portfolio position as at 31 December 2021 comprised of:

	31 Mar 21 £'000	31 Dec 21 £'000
<b>Borrowing</b>		
Fixed Rate - PWLB	627,292	602,292
Fixed Rate - Money Market	0	55,000
<b>TOTAL BORROWING</b>	<b>627,292</b>	<b>657,292</b>
<b>Specified Investments</b>		
Banking sector	12,000	22,000
Building societies	5,000	13,000
Local Authorities	33,000	29,500
Money Market Funds	12,490	23,000
<b>Unspecified Investments</b>		
Pooled Funds & Collective Investment Schemes	4,000	4,000
Funding Circle	206	154
<b>TOTAL INVESTMENTS</b>	<b>66,696</b>	<b>91,654</b>
<b>NET BORROWING</b>	<b>560,596</b>	<b>565,638</b>

- 5.20 All Investments are made with reference to the Council's core balances and cash flow requirements which are derived from the annual budget, the Medium Term Financial Strategy, the Capital Programme and Capital Strategy, and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash, 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.
- 5.21 It is important that the Council manages its treasury management activities to maximise investment income and reduce debt interest, whilst managing its exposure to risk and maintaining appropriate liquidity to meet its needs. Based on the above forecasts, the 2022/23 estimate for investment income and debt interest split between the General Fund and Housing Revenue Account (HRA) is as follows:

	General Fund £'000	HRA £'000	Total £'000
Gross external investment income	347	96	443
Interest on loans to RBC companies	1,862	0	1,862
Dividend income	120	0	120
Interest paid on deposits and other balances	(1)	0	(1)
<b>Net Investment Income</b>	<b>2,328</b>	<b>96</b>	<b>2,424</b>
Debt Interest	(13,480)	(3,379)	(16,859)
Management Expenses	(27)	0	(27)
<b>Net Investment Income / (Debt interest)</b>	<b>(11,179)</b>	<b>(3,283)</b>	<b>(14,462)</b>

- 5.22 The estimate is based on achieving the assumed interest rates set out in paragraph 5.18 using the level of revenue and capital reserves for 2022/23 as set out in the latest capital and revenue budgets contained in the Medium Term Financial Strategy.

#### Policy on charging interest to the Housing Revenue Account (HRA)

- 5.23 The Council operates a two-pooled approach to its loans portfolio, which means we separate HRA and General Fund long-term loans. Interest payable and other costs or income arising from long-term loans (for example premiums and discounts on early redemption) are charged or credited to the respective revenue account.
- 5.24 Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. We will calculate an average balance for the year and interest will be transferred between the General Fund and HRA at the Council's weighted average return on all its investments, adjusted for credit risk. This credit risk adjustment reflects the risk that any investment default will be a charge to the General Fund regardless of whether it was HRA cash that was lost.

#### Borrowing Strategy

- 5.25 The proposed new Prudential Code considers that legitimate examples of prudent borrowing include:

- a) financing capital expenditure primarily related to the delivery of a local authority's functions
- b) temporary management of cash flow within the context of a balanced budget
- c) securing affordability by removing exposure to future interest rate rises
- d) refinancing current borrowing, including replacing internal borrowing, to manage risk or reflect changing cash flow circumstances.

The Prudential Code determines certain acts or practices that are not prudent activity for a local authority and incurs risk to the affordability of local authority investment. To this extent the guidance states "An authority **must not** borrow to invest for the primary purpose of commercial return". These principles apply to prudential borrowing for capital financing, such as externalising internal borrowing for the primary purpose of commercial return.

- 5.26 Access to the PWLB is essential for the Council to ensure liquidity and cheap borrowing. The Government's new rules for access to PWLB lending introduced at the start of 2021 require statutory Chief Finance Officers to certify that their Council's capital spending plans do not include the acquisition of assets primarily for yield, reflecting the view that local authority borrowing powers are granted to finance direct investment in local service delivery (including housing, regeneration and local infrastructure) and for cash flow management rather than to add gearing to return-seeking investment activity. Local authorities should not borrow to finance acquisitions where obtaining commercial returns is a primary aim.
- 5.27 In general the Council will borrow for one of two purposes – to finance cash flow in the short term or to fund capital investment over the longer term. The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.
- 5.28 A key aim of the Treasury Management Strategy is to minimise the cost of the Council's loan portfolio whilst ensuring that the obligation to repay the loan is spread over a period of time. This reduces the impact on the revenue budget of interest payments.
- 5.29 The Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period which the funds are required. Against this background and the risks within the economic forecast, caution will be adopted with the 2022/23 treasury operations. The Assistant Chief Executive will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.
- 5.30 Short term borrowing is the cheapest option but leaves the Council exposed to refinancing risk, which can be divided into interest rate risk (the risk that rates will rise) and availability risk (the risk that no-one will lend to the Council).
- 5.31 The Council's strategy for long term borrowing is currently as follows:

Sources of borrowing

*The approved sources of long-term and short-term borrowing will be:*

- *Public Works Loan Board (PWLB)*
- *any institution approved for investments*

- *any other bank or building society approved by the Financial Conduct Authority*
- *UK public and private sector pension funds and Insurance Companies (except the Surrey Pension Fund)*
- *Capital market bond investors*
- *UK Municipal Bond Agency plc and other special purpose companies created to enable joint local authority bond issues (subject to committee report).*

#### Debt instruments

*Borrowing will be arranged by one of the following debt instruments:*

- *fixed term loans at fixed or variable rates of interest, subject to the limits in the treasury management indicators*
- *bonds*

5.32 Any proposed borrowing will only be undertaken on a phased basis in accordance with agreed plans and requirements at that time. The borrowing of money purely to invest or lend-on to make a return is unlawful.

#### Policy on Borrowing in Advance of Need

5.33 The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the sums borrowed. Any decision to borrow in advance will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

5.34 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. In determining whether borrowing will be undertaken in advance of need the Council will:

- Ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need.
- Ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered.
- Evaluate the economic and market factors that might influence the manner and timing of any decision to borrow.
- Consider the merits and demerits of alternative forms of funding.

5.35 The total amount borrowed will not exceed the authorised borrowing limit. The maximum period between borrowing and expenditure is expected to be no more than six months, although the Council does not link particular loans with particular items of expenditure.

#### Debt restructuring

5.36 From time to time there may be potential opportunities to generate savings by switching from long term debt to short term debt and vice versa. Any such debt restructuring will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

5.37 The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;

- to enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).
- 5.38 Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.
- 5.39 Restructuring of the Council’s current debt portfolio is unlikely to occur as there is still a very large difference between premature redemption rates and new borrowing rates. All rescheduling will be reported to the Council, at the earliest meeting following its action.

Annual Investment Strategy

- 5.40 The DLUHC and CIPFA have extended the meaning of ‘investments’ to include both financial and non-financial investments. This report deals solely with financial investments, (as managed by the treasury management team). Non-financial investments are held for two purposes, to generate income and to meet a strategic priority. These are entered into outside of normal treasury management activities, but nevertheless the TMS comes into play in their financing. The Council recognises that investment in other financial investments taken for non-treasury management purposes, requires careful investment management and all such investments are covered in the Capital Strategy (reported elsewhere on this agenda).
- 5.41 Local authorities must draw up an “Annual Investment Strategy” for the following financial year. This strategy may be revised at any time, but full Council must approve the revisions. Both the TM Code and the DLUHC Investment Guidance place a high priority on the management of risk and require the Council to invest its funds prudently and to have regard to the security and liquidity of its investments before seeking high returns (yield). This approach is inherent in our treasury management strategy.
- 5.42 In accordance with the above guidance, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration of risk.
- 5.43 The DLUHC Investment Guidance requires local authorities to cover a number of issues in their Annual Investment Strategy and the Council’s strategy fully complies with these requirements. The Council approved its Annual Investment Strategy for 2021/22 in February 2021 and an updated Strategy for 2022/23 is set out at Appendix A.
- 5.44 There are no major changes to the proposed strategy for next year. However, as a consequence of setting aside MRP, cash balances will increase over time as that money is set aside awaiting repayment of the loan. The knock-on effects of this is that there is more money to invest until the principal sums borrowed mature which means the Council will need to increase its counterparty limits and/or seek additional investment vehicles for its money. Estimated cumulative MRP balances built up over the next couple of years are anticipated to be as follows:

	<b>MRP cumulative balance at 31 March £’000</b>
2022/23	16,748

2023/24	21,334
2024/25	26,218

5.45 A close eye will be kept on the limits for each counterparty to ensure that the increasing balances held as a result of setting aside MRP can be adequately catered for and any required amendments will be brought back to this committee for approval.

## **6 Treasury Management Risks**

6.1 Treasury management activity involves risks which cannot be eliminated but need to be managed. Treasury management risks could be defined as: The ongoing activity of adjusting the authority's treasury exposures due to changing market or domestic circumstances, in order to manage risks and achieve better value in relation to the authority's objectives. The effective identification and management of these risks are integral to the Council's treasury management objectives. All treasury activity needs to be managed to maximise investment income and reduce debt interest whilst maintaining the Council's exposure to risk.

6.2 Overall responsibility for treasury management risk remains with the Council at all times. None of the regulations or guidance prescribes any particular treasury management strategy for local authorities to adopt. The Council's lending & borrowing list is regularly reviewed during the financial year and credit ratings are monitored throughout the year to minimise future risks.

6.3 The DLUHC issued revised statutory guidance on Local Government Investments in 2018, the DLUHC Investment Guidance, and this forms the structure of the Council's policies. The key intention of the DLUHC Investment Guidance is to maintain the current requirement for councils to invest prudently, and that priority is given to security and liquidity before yield. This means that first and foremost the Council must ensure the security of the principal sum invested (i.e. ensure the full investment is returned), then ensure that we have the liquidity we need (i.e. ensure we have the funds available when we need them), and only then should the yield on return be considered. In order to facilitate this objective, the DLUHC Investment Guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes (2017 Edition) (TM Code). The Council adopted the TM Code in March 2018 and applies its principles to all investment activity.

6.4 The Prudential and Treasury Codes set as a prime policy objective the security of funds, and the avoidance of exposing public funds to unnecessary or unqualified risk. All authorities should consider a balance between security, liquidity and yield which reflects their own appetite, but which prioritises security over yield.

6.5 In accordance with the TM Code, the key treasury risks are discussed in detail in the Council's Treasury Management Practices (TMPs) and in the Council's Statement of Accounts both of which can be found on the Council's website.

## **7 Non-Treasury Management Investment**

7.1 The new Prudential and Treasury codes state that all investments and investment income must be attributed to one of the following three purposes:

- Treasury Management

- Service Delivery
- Commercial return

7.2 Treasury Management income arises from the Council's cash flows or treasury risk management activity, this type of investment represents balances which are only held until the cash is required for use. Treasury investments may also arise from other treasury risk management activity which seeks to prudently manage the risks, costs or income relating to existing or forecast debt or treasury investments. This is what the Treasury Management Strategy is designed to cover. Explanations of the other two areas are set out below.

### Service Investments

- 7.3 The Council may lend money to its subsidiaries, its suppliers, local businesses, local charities or housing associations etc. to support local public services and stimulate local economic growth. Returns on this category of investment which are funded by borrowing are permitted only in cases where the income is "either related to the financial viability of the project in question or otherwise incidental to the primary purpose". Such loans are treated as capital expenditure for accounting purposes.
- 7.4 For any new loans, the Council will ensure that a full due diligence exercise is undertaken and adequate security is in place. The business case will balance the benefits and risks. All loans are agreed by the Section 151 Officer. All loans will be subject to regular monitoring
- 7.5 The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. Therefore, the Council will take security against assets to mitigate the risk of default.
- 7.6 Accounting standards require the Council to set aside loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Council's statement of accounts is shown net of this loss allowance. However, the Council makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments.

### Commercial Investments

- 7.7 Investments held primarily for financial return with no treasury management or direct service provision purpose. Risks on such investments should be proportionate to a council's financial capacity – i.e., that 'plausible losses' could be absorbed in budgets or reserves without unmanageable detriment to local services. "An authority must not borrow to invest primarily for financial return".
- 7.8 Although it has done so in the past, the Council no longer invests in new commercial property if it is held primarily to generate income. The Council will invest in the commercial property only where the main purposes are to regenerate areas of the borough, encourage private investment and to create or retain local jobs.
- 7.9 The Council assesses the risk of loss before entering into and whilst holding property investments by having clear, robust and transparent governance arrangements in place as set out in the Capital Strategy. This is critical in meeting the statutory guidance and ensuring an appropriate level of due diligence and scrutiny is applied, together with objective arms-length external advice where appropriate.

7.10 The risk of not achieving the desired income or an unexpected maintenance liability is partially covered by both an income equalisation reserve and a property maintenance reserve. Annual payments are deducted from the rental income each year to add to these reserves.

## **8. Prudential and Treasury Management Indicators 2022/23**

8.1 The Code requires all local authorities to look at capital expenditure and investment plans in light of the overall organisational strategy and resources and make sure that decisions are being made with sufficient regard to the long run financial implications and potential risks to the authority. The key objectives of the Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable; that treasury management decisions are taken in accordance with good professional practice; and that local strategic planning, asset management planning and proper option appraisal are supported.

8.2 The Council recognises that effective financial planning, option appraisal, risk management and governance processes are essential in achieving a prudent approach to capital expenditure, investment and debt. Therefore, all investment decisions (treasury and non-treasury) are taken in light of the Council's Corporate Business Plan, Medium Term Financial Strategy, Capital Strategy (including the Property Investment Strategy) and Treasury Management Strategy.

8.3 In setting or revising their prudential indicators, local authorities must have regard to:

- Service objectives e.g. strategic planning for the authority
- Stewardship of assets e.g. asset management planning
- Value for money e.g. option appraisal
- Prudence and sustainability e.g. implications for external borrowing
- Affordability e.g. implications for Council Tax and balances
- Practicality e.g. achievability of the forward plan.

8.4 To demonstrate that these objectives are being fulfilled the Code operates through the provision of prudential indicators which highlight particular aspects of capital expenditure planning. Each indicator is annually updated as part of the budget process and projected forward for the next three years. The Code requires that the Council approves certain mandatory prudential indicators.

8.5 Prudential Indicators are designed to support and record local decision making. They are not performance indicators and are not comparable between authorities, all of whom will have differing policies and debt positions. In addition, the indicators should not be taken individually; the benefit from monitoring will arise from following the movement in indicators and the year on year changes over time.

8.6 Both the Code and the TM Code set definitions for the terms used and the method of calculating the indicators. A complete set of all indicators, which are a mix of estimated and actual figures, ratios, and limits, is set out in Appendix "B".

### Changes for 2022/23

8.7 The main indicators are the Authorised Limit for external borrowing and the Capital Financing Requirement (CFR) which is essentially a measure of the Council's underlying borrowing need. A new indicator being introduced by the updated Prudential framework is



the Liability Benchmark. The Liability Benchmark is effectively the Net Borrowing Requirement of a local authority plus a liquidity allowance. In its simplest form, it is calculated by deducting the amount of investable resources available on the balance sheet (reserves, cash flow balances) from the amount of outstanding external debt and then adding the minimum level of investments required to manage day-to-day cash flow. This will be introduced into future reports once the guidance on its completion has been received.

- 8.8 All the indicators for 2022/23 include a provision for the effects of the introduction of International Financial Reporting Standard 16: Leases (IFRS16). This standard comes into effect on 1 April 2022 and brings all leases onto the Council's Balance Sheet as a debt liability for the first time. The inclusion of a provision into the indicators to account for leases is important as from 1 April 2022 it will be unlawful to enter into a lease if there is no headroom in the authorised limit for the new lease liability.

## **9 Legal Implications**

- 9.1 The powers for a local authority to borrow and invest are governed by the Local Government Act 2003 (LGA 2003) and associated Regulations. A local authority may borrow or invest for any purpose relevant to its functions, under any enactment, or for the purpose of the prudent management of its financial affairs. The Regulations also specify that authorities should have regard to the CIPFA Treasury Management Code and the DLUHC Investment Guidance when carrying out their treasury management functions.
- 9.2 Part 1 of the LGA 2003 established the legislative framework for the prudential capital finance system for local authorities.
- 9.3 The LGA 2003 requires each Council to set an affordable borrowing limit. The Full Council must carry out this duty; it cannot be delegated. Having set this limit the Council may not exceed it except for specified temporary purposes. However, the Council can make a new limit at any time.
- 9.4 Regulations require local authorities to have regard to The Prudential Code when carrying out their duties under Part 1 of the LGA 2003. The Code requires that all prudential indicators are set, and revised, only by the Full Council. This is because the need for Members to approve prudential indicators for capital finance is regarded as an important part of the governance responsibilities of a local authority.
- 9.5 The LGA 2003 provides the Government with reserve powers to set borrowing limits for local authorities that override their locally determined limits. This could be in the form of a national limit – this can only be imposed for national economic reasons – or a specific limit to prevent an individual authority borrowing more than it could afford.
- 9.6 The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (as amended) state:

*“A local authority shall determine for the current financial year an amount of minimum revenue provision which it considers to be prudent.”*

## **10. Environmental/Sustainability/Biodiversity implications**

- 10.1 Ethical or Sustainable investing is becoming a more commonplace discussion within the wider investment community. There are currently a small, but growing number of financial institutions

and fund managers promoting Environmental, Social and Governance (ESG) products however the types of products we can invest in are constrained to those set out in our Investment Strategy which is driven by investment guidance, both statutory and from CIPFA, making it clear that all investing must adopt SLY principles – security, liquidity and yield: ethical issues must play a subordinate role to those priorities.

- 10.2 ESG investing means different things to different people and can be highly subjective. For instance, some funds may invest in products that are known to be harmful, such as tobacco and alcohol but will not touch those that engage in other legal but morally ambiguous products. Likewise, gas or electricity companies may be shunned by a fund that does not like it's green credentials, but which may turn a blind eye and invest in companies that have a poor attitude to labour and the working process.
- 10.3 As well as establishing what funds invest in, before investing in an ESG product, one of the most important issues is to understand the ESG "risks" that an entity is exposed to and evaluating how well it manages these risks which is not something that officers have the experience or available capacity to undertake. This is why, the Council predominantly invests in fixed term deposits with banks, building societies and other local authorities and uses Money Market Funds that predominantly do the same but on a much larger scale. However, all the rating agencies are now extolling how they incorporate ESG risks alongside more traditional financial risk metrics when assessing counterparty ratings so to a certain extent you could argue that their incorporation is already being done, to an extent, by our use of rating agencies.

## **11. Conclusions**

- 11.1 The Council recognises that effective financial planning, option appraisal, risk management and governance processes are essential in achieving a prudent approach to capital expenditure, investment and debt. Therefore, all investment decisions (treasury and non-treasury) are taken in light of the Council's Corporate Business Plan, Medium Term Financial Strategy, Capital Strategy and Treasury Management Strategy.
- 11.2 We remain in a very difficult investment environment with several unknowns. Whilst counterparty risk appears to have eased, market sentiment has still been subject to bouts of, sometimes, extreme volatility and economic forecasts abound with uncertainty. You only need to look to 2020 to show just how quickly circumstances can change.
- 11.3 With interest rates having spent most of the last year close to, or actually returning, negative rates, it is easy to forget recent history, ignore market warnings and search for that extra return to ease revenue budget pressures. Any option in which an investor hopes to generate an elevated rate of return will almost always introduce a greater level of risk, this strategy ensures that any such risks are minimised and appropriately managed.
- 11.4 CIPFA issued the revised Treasury Management and Prudential Codes on 20 December 2021 with clear statement to say there is a soft launch with formal adoption for the 2023/24 financial year. The Prudential Code states that it applies with immediate effect, except authorities may defer introducing revised reporting requirements until 2023/24 financial year. Officers have incorporated some of the new requirements in both the Capital and Treasury Management Strategies for next year and will look to enhance all future reports with the new requirements once the associated guidance notes have been published.

**(To recommend to Full Council on 10 February 2022)**

## **Background Papers**

- Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes – 2017 Edition
- Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes – 2021 Edition
- The Prudential Code for finance in local authorities - 2017 Edition
- The Prudential Code for finance in local authorities - 2021 Edition
- Ministry for Housing, Communities and Local Government – MHCLG) Guidance on Local Authority Investments
- Local Authorities (Capital Finance and Accounting) (England) Regulations 2003

# Annual investment strategy for the 2022/23 financial year

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## Introduction

1. The Council's investment policy has regard to the DLUHC's Guidance on Local Government Investments (3<sup>rd</sup> Edition) ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes (2017 Edition) ("the TM Code"). The Council's investment priorities will be security first, liquidity second, then return.
2. This strategy applies to both in-house and externally managed funds. Where used, managers of External funds must confirm the acceptability of a counterparty before an investment is made.
3. The Council approved the Annual Investment Strategy for 2021/22 in February 2021.

## Investment Policy

4. In accordance with the above guidance from the DLUHC and CIPFA, and in order to minimise the risk to investments, the Council has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies with a full understanding of these reflected in the eyes of each agency. Using our treasury advisers ratings service, potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.
5. Further, the Council's Officers recognise that ratings should not be the sole determinant of the quality of an institution and that 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 this end the Council will engage with its advisers to maintain and monitor market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.
6. Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.
7. The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable diversification and thus avoidance of concentration of risk.
8. The intention of the strategy is to provide security of investment and minimisation of risk.

## Creditworthiness Policy

9. The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that:
  - It maintains a policy covering the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security; and
  - It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.
10. The Assistant Chief Executive will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These

## Annual investment strategy for the 2022/23 financial year

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criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties that are considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

11. The minimum rating criteria uses the lowest common denominator method of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance, if an institution is rated by two agencies and one meets the Council's criteria, and the other does not, the institution will fall outside the lending criteria. Credit rating information is supplied by Link Asset Services, the Council's treasury advisers, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to Officers almost immediately after they occur and this information is considered before dealing.
12. Additional requirements under the Code require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for Officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

### **Investment criteria and limits**

13. The Guidance defines specified investments as those expected to offer relatively high security and liquidity, and can be entered into with the minimum of formalities. The Guidance defines specified investments as those:
  - denominated in pounds sterling,
  - due to be repaid within 12 months of arrangement,
  - not defined as capital expenditure by legislation, and
  - invested with one of:
    - the UK Government,
    - a UK local authority, parish council or community council, or
    - a body or investment scheme of "high credit quality".

The Council defines the following as being of "high credit quality" (as per the Guidance), subject to the monetary and time limits shown.

## Annual investment strategy for the 2022/23 financial year

Specified investments				
	Paragraph (where applicable)	Fitch Long term Rating (or equivalent)	£ Limit	Duration
Banks 1	16	A+	£5.0m	364 days
		A	£4.0m	189 days
		A-	£3.0m	98 days
Banks 2 (Part nationalised)	17	N/A	£3.0m	364 days
Banks 3 (Council's own bankers)	18	N/A	£1.0m	1 business day
Building Societies	19	A+	£5.0m	364 days
		A	£4.0m	189 days
		A-	£3.0m	98 days
UK Central Government (DMADF – Debt Management Agency Deposit Facility)		UK sovereign rating	Unlimited	189 days
Local, Police, Fire, Civil Defence & Transport Authorities		N/A	£5.0m	364 days
Money Market Funds (CNAV / LVNAV)	20	AAA	£10.0m	Liquid
Government bonds (gilts) and treasury bills	21	N/A	No limit	364 days
Multinational Development Banks		AAA	£1.0m	364 days

14. Investments in any parent and its wholly owned subsidiaries are to be aggregated for the purpose of calculating the limit of investment to that parent or its subsidiaries.
15. With the exception of investments with the UK Government, no investment with any one provider/organisation will exceed £6m in total.

### Banks

16. **Banks 1** – Banks will be regarded as having high credit quality if they meet the following criteria:
- i) are UK banks (no country limit will apply to investments in the UK, irrespective of the sovereign credit rating); and/or
  - ii) are non-UK and domiciled in a country which has a minimum sovereign long term rating of AAA or AA+
- and have, as a minimum, the following Fitch, Moody's and Standard and Poors credit ratings (where rated):
- i) Short term – F1 / P-1 / A-1
  - ii) Long term – A- / A3 / A-

## Annual investment strategy for the 2022/23 financial year

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17. **Banks 2** – Part nationalised UK banks. These banks can be included if they continue to be part nationalised or they meet the ratings in Banks 1 above.
18. **Banks 3** – The Council's own banker for transactional purposes if the bank falls below the above criteria. This is because it is needed to facilitate short term liquidity requirements (overnight and weekend) and to provide business continuity.

### Building societies

19. The Council will use all building societies with assets in excess of £1bn which meet the ratings for banks outlined above.

### Money market funds

20. Money market funds are pooled investment vehicles consisting of instruments similar to those used by the Council. They have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager. Fees of between 0.10% and 0.20% per annum are deducted from the interest paid to the Council. The Council will only use Money Market Funds with a Constant or Low Volatility Net Asset Value (CNAV / LVNAV).

### Government bonds (gilts) and treasury bills (T-bills)

21. Conventional gilt is a liability of the Government which guarantees to pay the holder of the gilt a fixed cash payment (coupon) every six months until the maturity date, at which point the holder receives the final coupon payment and the return of the principal.
22. T-Bills are short term securities issued by HM Treasury on a discount basis. For example, a £100 coupon will be issued below its value to the investor and on maturity the investor will receive £100. The difference will be the capital gain received. The security can also be cashed before maturity in the active secondary market giving the lending party more freedom to cash in the T-bill before maturity date.

### Foreign countries

23. The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA+ from Fitch. This list will be added to, or deducted from, by Officers should ratings change in accordance with this policy.
24. Due care will be taken to consider the country, group and sector exposure of the Council's investments. In part, the country selection will be chosen by the credit rating of the sovereign state in Banks 1 (paragraph 17) above and will be limited to a maximum of £1 million to be placed with any non-UK country at any time;
25. Sovereign credit rating criteria and foreign country limits will not apply to investments in multilateral development banks (e.g. the European Investment Bank and the World Bank) or other supranational organisations (e.g. the European Union).

### Non-specified investments

26. Any investment not meeting the definition of a specified investment (see paragraph 13) is classed as non-specified. The Council does not intend to make any investments denominated in foreign currencies, nor any with low credit quality bodies. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement.
27. The limit on the amount that may be held in non-specified investments, these being long-term investments only, at any time in the financial year is £3 million (excluding any accrued interest).

## Annual investment strategy for the 2022/23 financial year

28. The advice of our treasury management consultants will be sought prior to making any long-term investment as to the appropriateness of the investment.

Non Specified investments				
	Paragraph (where applicable)	Fitch Long term Rating (or equivalent)	£ Limit	Duration
<b>Any bank or building society</b> (including forward deals in excess of one year from inception to repayment).	37	AAA	£1.0m	3 years
		AA+	£1.0m	3 years
		AA	£1.0m	3 years
		AA-	£1.0m	2 years
<b>Gilt edged securities.</b>	37	N/A	£1.0m	3 years
<b>Supranational bonds greater than 1 year to maturity</b> a) Multilateral development bank bonds b) A financial institution that is guaranteed by the United Kingdom Government	30, 37	AAA	£1.0m	3 years
		N/A	£1.0m	3 years
<b>Short Dated Bond Funds / Enhanced Cash Funds</b>	30, 37	N/A	£2.0m per fund  £6m in total	2 years
<b>Pooled Funds and Collective Investment Schemes</b>	31	N/A	£2.0m per fund  £6m in total	N/A
<b>UK Small &amp; Medium Sized Enterprises via the Funding Circle</b>	32	N/A	£5,000 per organisation (subject to an overall limit of £0.5m)	N/A
<b>Investment in Property</b>	33	Subject to the limits set out in the Capital Strategy		

### Supranational bonds

29. The Council will invest in two types of bonds:

- a) **Multilateral development bank bonds** are bonds defined as an international financial institution having as one of its objects economic development, either generally or in any region of the world (e.g. European Investment Bank etc.).
- b) **A financial institution that is guaranteed by the United Kingdom Government** (e.g. The Guaranteed Export Finance Company {GEFCO}). The security of interest and principal on maturity is on a par with the Government and so very secure. These bonds usually provide



## Annual investment strategy for the 2022/23 financial year

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returns above equivalent gilt edged securities. However the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.

### Short Dated Bond Funds / Enhanced Cash Funds

30. Short dated Bond Funds / Enhanced Cash Funds are pooled investment vehicles with an average duration of between 3 months and 2 years with a variable net asset value (NAV) meaning their values can go down as well as up. They have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager and should be looked at as short to medium term investments.

### Pooled Funds and Collective Investment Schemes

31. The Council will use pooled funds, for example pooled bond, equity and property funds that offer enhanced returns over the longer term but are potentially more volatile over the shorter term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued stability in meeting the Council's investment objectives will be monitored regularly.

### UK Small & Medium Sized Enterprises via the Funding Circle

32. The Council will make loans for periods of up to three years to small and medium sized enterprises (SME) in the UK that have been independently assessed as being of suitable credit quality. This will be done via the Funding Circle peer-to-peer lending platform. Nevertheless, it is anticipated that such companies will, on occasion, fail to repay the money lent. The Council will therefore ensure that the interest rate secured on such loans is high enough to cover the cost of defaults in all but the most exceptional circumstances.

### Non-Treasury Investments

33. In addition to traditional treasury investments, the Council may also invest in property and make loans and investments for financial return and/or for service or policy purposes. Such investments will be subject to the Council's normal approval processes for revenue and capital expenditure and controls around their use are included in the Council's Capital Strategy and therefore do not comply with this Treasury Management Strategy.

### Liquidity Management

34. Liquidity is defined by the CIPFA Treasury Code of Practice as "having adequate, though not excessive, cash resources, borrowing arrangements, overdrafts or standby facilities to enable the Council at all times to have the level of funds available to which are necessary for the achievement of its business/service objectives"
35. The proportion of the in-house portfolio that may be held in short-term and long-term investments will vary at any one time dependant on the cash flow position of the Council. The Council uses a manual cash book and spreadsheets to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a pessimistic basis, with receipts underestimated and payments over-estimated to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments.
36. Limits on long-term investments are set by reference to the Council's medium term financial plan and cash flow forecast.
37. The amount of investments (both managed in house and externally) that may be held in long-term investments will be, measured on a rolling basis, at any point in time:

## Annual investment strategy for the 2022/23 financial year

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- No more than £1 million of outstanding investments are to be over 3 years until maturity, and
- No more than £3 million of outstanding investments are to be over 1 year until maturity.

38. The maximum term of any one investment is 3 years with the exception of those loans invested via the Funding Circle (see paragraph 32).

### **Planned Investment Strategy for 2022/23**

39. 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). The cash flow forecast will be used to divide surplus funds into three categories:

- Short-term – cash required to meet known cash outflows in the next month, plus a contingency to cover unexpected cash flows over the same period.
- Medium-term – cash required to manage the annual seasonal cash flow cycle, including amounts to cover forecast shortages, planned uses of reserves, and a longer-term contingency.
- Long-term – cash not required to meet cash flows and therefore liquidity is of lesser concern and a greater yield can be achieved.

40. Short-term funds are required to meet cash flows occurring in the next month or so, and the preservation of capital and liquidity is therefore of paramount importance. Generating investment returns is of limited concern here, although it should not be ignored. Instant access AAA-rated money market funds and bank deposit accounts will be the main methods used to manage short-term cash.

41. Medium-term funds which may be required in the next one to twelve months will be managed concentrating on security, with less importance attached to liquidity but a slightly higher emphasis on yield. The majority of investments in this period will be in the form of fixed term deposits with banks and building societies. A wide spread of counterparties and maturity dates will be maintained to maximise the diversification of credit and interest rate risks; this may be achieved by the use of suitable medium-term money market funds. Deposits with lower credit quality names will be made for shorter periods only, while deposits with higher quality names can be made for longer durations.

42. Cash that is not required to meet any liquidity need can be invested for the longer term with a greater emphasis on achieving returns that will support spending on local authority services. Security remains important, as any losses from defaults will impact on the total return, but fluctuations in price and even occasional losses can be managed over the long term within a diversified portfolio. Liquidity is of lesser concern, although it should still be possible to sell investments, with due notice, if large spending commitments arise unexpectedly. A wider range of instruments, including structured deposits, certificates of deposit, gilts and corporate bonds will be used to diversify the portfolio. The Council will consider employing external fund managers that have the skills and resources to manage the risks inherent in a portfolio of long-term investments.

### **Forward deals up to one year**

43. Forward deals may be entered into with banks and building societies that meet the appropriate credit rating criteria for specified investments where the total period of the investment (i.e. negotiated deal period plus period of deposit) is less than one year.

### **Markets in Financial Instruments Directive (MiFID)**

44. The Council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the Section 151 Officer believes this to be the most appropriate status.

# Annual investment strategy for the 2022/23 financial year

## Annex A

### Credit ratings and definitions

The Council uses long-term credit ratings from the three main rating agencies Fitch Ratings Ltd, Moody's Investors Service Inc and Standard & Poor's Financial Services LLC to assess the risk of investment default.

<b>Table A: Comparison of long-term credit ratings</b>		
<b>Moody's</b>	<b>S&amp;P</b>	<b>Fitch</b>
<b>Investment grade</b>		
Aaa	AAA	AAA
Aa1	AA+	AA+
Aa2	AA	AA
Aa3	AA-	AA-
A1	A+	A+
A2	A	A
A3	A-	A-
Baa1	BBB+	BBB+
Baa2	BBB	BBB
Baa3	BBB-	BBB-
<b>Speculative grade</b>		
Ba1	BB+	BB+
Ba2	BB	BB
Ba3 and below	BB- and below	BB- and below

#### (Negative) Rating Watch – Fitch Ratings

Rating Watches indicate that there is a heightened probability of a rating change and the likely direction of such a change. These are designated as "Positive", indicating a potential upgrade, "Negative", for a potential downgrade, or "Evolving", if ratings may be raised, lowered or affirmed. However, ratings that are not on Rating Watch can be raised or lowered without being placed on Rating Watch first, if circumstances warrant such an action.

#### Review for possible downgrade – Moody's (Standard & Poor's is very similar)

Moody's uses the 'Watchlist' to indicate that a rating is under review for possible change in the short-term. A rating can be placed on review for possible upgrade (UPG), on review for possible downgrade (DNG), or more rarely with direction uncertain (UNC). A credit is removed from the Watchlist when the rating is upgraded, downgraded or confirmed.

#### (Negative) Rating Outlook – Fitch Ratings (Moody's and Standard & Poor's are similar)

Rating Outlooks indicate the direction a rating is likely to move over a one- to two-year period. They reflect financial or other trends that have not yet reached the level that would trigger a rating action, but which may do so if such trends continue. The majority of Outlooks are generally Stable, which is consistent with the historical migration experience of ratings over a one- to two-year period. Positive or Negative rating Outlooks do not imply that a rating change is inevitable and, similarly, ratings with Stable Outlooks can be raised or lowered without a prior revision to the Outlook, if circumstances warrant such an action. Occasionally, where the fundamental trend has strong, conflicting elements of both positive and negative, the Rating Outlook may be described as Evolving.

## PRUDENTIAL AND TREASURY MANAGEMENT INDICATORS 2022/23

### CAPITAL & AFFORDABILITY RELATED INDICATORS

The Council's capital expenditure plans are the key driver of treasury management activity. The Capital Programme is set out in detail in the Capital Strategy. 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.

- Capital Expenditure** – This prudential indicator is a summary of the Council's capital expenditure plans, and financing requirements which have been updated in line with the phased borrowing requirements of the new property investment plans. Any shortfall of resources results in a funding borrowing need.

	Actual 20/21	Probable 21/22	Estimate 22/23	Estimate 23/24	Estimate 24/25
	£000	£000	£000	£000	£000
<b>Capital Expenditure</b>					
Housing Revenue Account	911	10,156	15,350	15,600	13,800
General Fund	39,098	62,508	19,088	11,626	6,471
Non-Financial Investments	-	-	-	-	-
- Investment Properties	6,894	442	0	0	0
- Capital loans	150	6,445	6,200	0	0
	<b>47,053</b>	<b>79,551</b>	<b>40,638</b>	<b>27,226</b>	<b>20,271</b>
Financed by:					
Capital Receipts	2,029	15,606	14,943	5,440	5,339
Earmarked Reserves	2,847	3,430	1,374	934	1,000
Capital Grants & Contributions	199	4,986	652	652	652
Revenue	3,030	9,331	14,830	15,200	8,280
	<b>8,105</b>	<b>33,353</b>	<b>31,799</b>	<b>22,226</b>	<b>15,271</b>
<b>Net Financing Need for the Year</b>	<b>38,948</b>	<b>46,198</b>	<b>8,839</b>	<b>5,000</b>	<b>5,000</b>

\* Non-financial Investments relate to areas such as capital expenditure on Investment Properties, Loans to third parties etc. The net financing need for non-financial investments included in the above table against expenditure is shown below:

	Actual 20/21	Probable 21/22	Estimate 22/23	Estimate 23/24	Estimate 24/25
	£000	£000	£000	£000	£000
<b>Non-financial investments</b>					
Capital expenditure from above	7,044	6,887	6,200	0	0
Financing Costs met	150	6,445	6,200	0	0
<b>Net Financing Need for the Year</b>	<b>6,894</b>	<b>442</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Percentage of individual net financing need</b>	<b>98%</b>	<b>6%</b>	<b>0%</b>	<b>0%</b>	<b>0%</b>
<b>Percentage of total net financing need</b>	<b>18%</b>	<b>1%</b>	<b>0%</b>	<b>0%</b>	<b>0%</b>

- The Council's borrowing need (the Capital Financing Requirement)** – The Council's Capital Financing Requirement (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 underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

## PRUDENTIAL AND TREASURY MANAGEMENT INDICATORS 2022/23

The CFR does not increase indefinitely, as the Minimum Revenue Provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need 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 and so the Council is not required to separately borrow for these schemes. The Council currently has no such schemes.

The Council is asked to approve the CFR projections below:

	Actual 20/21	Probable 21/22	Estimate 22/23	Estimate 23/24	Estimate 24/25
	£000	£000	£000	£000	£000
<b>CFR at start of year</b>					
- HRA	101,956	101,956	100,000	100,000	100,000
- General Fund	106,009	143,881	191,122	198,872	202,625
- Non-financial investments	435,846	433,102	429,740	426,243	422,606
	<b>643,811</b>	<b>678,939</b>	<b>720,862</b>	<b>725,115</b>	<b>725,231</b>
<b>Net Financing Need for the Year</b>	<b>38,948</b>	<b>46,198</b>	<b>8,839</b>	<b>5,000</b>	<b>5,000</b>
Less MRP/VRP	-3,820	-4,275	-4,586	-4,884	-5,161
<b>CFR at end of year</b>	<b>678,939</b>	<b>720,862</b>	<b>725,115</b>	<b>725,231</b>	<b>725,070</b>

A key aspect of the regulatory and professional guidance is that elected members are aware of the size and scope of any commercial activity in relation to the authority's overall financial position. The capital expenditure figures shown in section 1 and the details above demonstrate the scope of this activity and, by approving these figures, consider the scale proportionate to the Authority's remaining activity.

- 3 Core funds and expected investment balances** – The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year end balances based on assumed cash movements in the MTFs and Capital Programme.

	Actual 20/21	Probable 21/22	Estimate 22/23	Estimate 23/24	Estimate 24/25
	£000	£000	£000	£000	£000
<b>Reserves / Balances</b>					
General Fund Balance	15,188	14,093	13,881	12,631	10,808
Housing Revenue Account	29,254	26,946	18,126	8,126	3,126
HRA Major Repairs Reserve	5,806	3,319	0	0	0
Earmarked reserves / other balances	22,591	15,982	12,418	10,021	10,988
Capital Receipts Reserve	7,572	5,479	2,580	11,877	7,900
Capital Grants Unapplied	5,820	2,910	0	0	0
<b>Expected Investments at year end</b>	<b>86,231</b>	<b>68,729</b>	<b>47,005</b>	<b>42,655</b>	<b>32,822</b>

- 4 Affordability Prudential Indicators** – The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are 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.

## PRUDENTIAL AND TREASURY MANAGEMENT INDICATORS 2022/23

- 5 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. The net revenue stream is a term used to describe the amount in the General Fund to be met from Government grant and local taxpayers. For the HRA it is the total HRA income shown in the accounts i.e. rent and other income.

	<b>Actual 20/21</b>	<b>Probable 21/22</b>	<b>Estimate 22/23</b>	<b>Estimate 23/24</b>	<b>Estimate 24/25</b>
	%	%	%	%	%
<b>Ratio of Net Financing Costs to Net Revenue Stream</b>	53.60%	85.91%	79.39%	90.36%	83.17%
<b>General Fund</b>	73.97%	212.48%	176.02%	251.54%	181.77%
<b>Housing Revenue Account</b>	30.99%	31.77%	29.96%	30.03%	30.22%

The General Fund percentage is high due to additional borrowing to fund the Property Investment Strategy and ongoing property developments. These costs are fully met by additional revenue income rather than Government grant and local taxpayers, however this income is not allowed to be included in this calculation. Including the income generated by the Property Investment Strategy in the calculations turns the General Fund figure into a negative figure (a net contributor).

- 6 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 upper limit for principal sums invested for longer than 365 days is set at:

	<b>2020/21 Actual £000s</b>	<b>2021/22 Probable £000s</b>	<b>2022/23 Estimate £000s</b>	<b>2023/24 Estimate £000s</b>	<b>2024/25 Estimate £000s</b>
Principal sums invested for longer than 365 days	0	3,000	3,000	5,000	10,000

- 7 Investment risk benchmarking** - The Council will use an investment benchmark to assess the investment performance of its investment portfolio of 7 day, 3, 6 or 12 month LIBID (The London Interbank Bid Rate – the rate at which a bank is willing to borrow from other banks).
- 8 Borrowing** – 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. 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.
- 9 Current Portfolio Position** – The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement – CFR), highlighting any over or under borrowing.

## PRUDENTIAL AND TREASURY MANAGEMENT INDICATORS 2022/23

	<b>Actual 20/21</b>	<b>Probable 21/22</b>	<b>Estimate 22/23</b>	<b>Estimate 23/24</b>	<b>Estimate 24/25</b>
	£000	£000	£000	£000	£000
<b>External Debt</b>					
Debt at 1 April	632,574	627,629	673,827	680,710	685,710
Expected Change in debt	- 4,945	46,198	6,883	5,000	5,000
<b>Actual gross debts at 31 March</b>	<b>627,629</b>	<b>673,827</b>	<b>680,710</b>	<b>685,710</b>	<b>690,710</b>
CFR	678,939	720,862	725,115	725,231	725,070
<b>Under / (Over) Borrowing</b>	<b>51,310</b>	<b>47,035</b>	<b>44,405</b>	<b>39,521</b>	<b>34,360</b>

The positive balances show that the Council is under borrowing (i.e. borrowing internally using cash balances).

Within the above figures the level of debt relating to non-financial investment is:

	<b>Actual 20/21</b>	<b>Probable 21/22</b>	<b>Estimate 22/23</b>	<b>Estimate 23/24</b>	<b>Estimate 24/25</b>
	£000	£000	£000	£000	£000
<b>Non-Financial Investment Debt</b>					
Overall Debt at 1 April	632,574	627,629	673,827	680,710	685,710
Outstanding Non-Financial Instrument Debt	435,846	433,102	429,740	426,243	422,606
<b>Percentage</b>	<b>69%</b>	<b>69%</b>	<b>64%</b>	<b>63%</b>	<b>62%</b>

Within the 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 2021/22 and the following three financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Assistant Chief Executive reports that the Council has so far 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 the budget report.

- 10 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.

	<b>Probable 21/22</b>	<b>Estimate 22/23</b>	<b>Estimate 23/24</b>	<b>Estimate 24/25</b>
	£000	£000	£000	£000
<b>Operational Boundary</b>				
General Fund	571,871	580,710	585,710	585,710
HRA	101,956	100,000	100,000	105,000
Other	15,000	15,000	15,000	15,000
<b>Operational Boundary</b>	<b>688,827</b>	<b>695,710</b>	<b>700,710</b>	<b>705,710</b>

## PRUDENTIAL AND TREASURY MANAGEMENT INDICATORS 2022/23

**11 The authorised limit for external debt** – A further key prudential indicator represents a control on the maximum level of borrowing. This represents a 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:

	<b>Probable 21/22</b>	<b>Estimate 22/23</b>	<b>Estimate 23/24</b>	<b>Estimate 24/25</b>
	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>
<b>Authorised Limit</b>				
General Fund	571,871	580,710	585,710	585,710
HRA	112,152	110,000	110,000	115,500
Other	30,000	30,000	30,000	30,000
<b>Authorised Limit</b>	<b>714,023</b>	<b>720,710</b>	<b>725,710</b>	<b>731,210</b>

This limit includes a “cushion” to allow for the non repayment of any borrowing at the required time and headroom for rescheduling of debts (i.e. borrowing new money in advance of repayment of existing). The “Other” column also includes a figure for the potential for new leases being brought onto the balance sheet,

## 12 Treasury Management Limits on Activity

There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments;
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates; and
- 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>Probable 21/22</b>	<b>Estimate 22/23</b>	<b>Estimate 23/24</b>	<b>Estimate 24/25</b>
	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>
<b>Interest Rate Exposure UPPER Limits</b>				
on <b>fixed</b> interest rates based on net debt	<b>669,744</b>	<b>693,570</b>	<b>707,333</b>	<b>717,494</b>
on <b>variable</b> interest rates based on net debt	-	-	-	-

The Upper Limit on fixed interest rates is calculated using the maximum allowed debt (The Authorised Borrowing Limit) less Fixed Term investments. The Council heavily uses Money Market Funds whose rates change on a daily basis therefore it has been assumed that of the Expected Investments balance shown above, £10m will be invested at variable rates, the rest as fixed term investments.



## PRUDENTIAL AND TREASURY MANAGEMENT INDICATORS 2022/23

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As the Council does not borrow at variable interest rates, the upper limit on this type of debt will always be nil.

<b>Maturity structure of interest rate borrowing 2022/23</b>				
	<b>FIXED interest</b>		<b>VARIABLE interest</b>	
	<b>Lower</b>	<b>Upper</b>	<b>Lower</b>	<b>Upper</b>
Under 12 months	0%	25%	0%	0%
12 months to 2 years	0%	25%	0%	0%
2 years to 5 years	0%	25%	0%	0%
5 years to 10 years	0%	50%	0%	0%
10 years and above	0%	100%	0%	0%
20 years to 30 years	0%	100%	0%	0%
30 years to 40 years	0%	100%	0%	0%
40 years to 50 years	0%	100%	0%	0%

This indicator is set to control the Council's net exposure (taking borrowings and investments together) to interest rate risk. Its intention is to ensure that the Council is not exposed to interest rate rises which could adversely impact the revenue budget. The upper limits proposed on fixed and variable rate interest rate exposures, expressed as the principal sums outstanding in respect of borrowing.

Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate. If it is not clear whether an instrument should be treated as fixed or variable rate, then it is treated as variable rate.

The variable rate upper limit of zero means that the Council is minimising its exposure to uncertain future interest rates on its debt. This will still allow a proportion of the debt to be taken as variable as fixed term investments maturing within one year are classified as variable for the purposes of this indicator.

## GLOSSARY OF TREASURY TERMS

Term	Definition
Basis Point	1/100 <sup>th</sup> of 1%, i.e. 0.01%
Call Accounts	Deposit accounts with banks and building societies that provide same day access to invested balances. Interest paid is usually linked to the level of the official base rate.
CFR – Capital Financing Requirement	The underlying need to borrow for capital purposes
CDs – Certificates of Deposit	Negotiable time deposits issued by banks and building societies which can pay either fixed or floating rates of interest. They can be traded on the secondary market, enabling the holder to sell the CD to a third party to release cash before the maturity date.
CPI – Consumer Price Index	This is a measure of the general level of price changes for consumer goods and services but excludes most owner occupier housing costs such as mortgage interest payments, council tax, dwellings insurance, rents etc.
Corporate bonds	Corporate bonds are those issued by companies. Generally, however, the term is used to cover all bonds other than those issued by governments. The key difference between corporate bonds and government bonds is the risk of default.
Cost of Carry	Costs incurred as a result of an investment position, for example the additional cost incurred when borrowing in advance of need, if investment returns don't match the interest payable on the debt.
Counterparties	These are the organisations responsible for repaying the Council's investment upon maturity and making interim interest payments.
CDS – Credit Default Swaps	A swap designed to transfer the credit exposure of fixed income products between parties. The buyer of a credit swap receives credit protection, whereas the seller of the swap guarantees the credit worthiness of the product. By doing this, the risk of default is transferred from the holder of the fixed income security to the seller of the swap.
DMADF – Debt Management Agency Deposit Facility	An investment facility run by part of the HM Treasury taking deposits at fixed rates for up to 6 months.
Diversification / diversified exposure	The spreading of investments among different types of assets or between markets in order to reduce risk.
Derivatives	Financial instruments whose value, and price, are dependent on one or more underlying assets. Derivatives can be used to gain exposure to, or to help protect against, expected changes in the value of the underlying investments. Derivatives may be traded.
DMO – Debt Management Office	An Agency of HM Treasury whose responsibility includes debt and cash management for the UK Government, lending to local authorities and managing certain public sector funds.

## GLOSSARY OF TREASURY TERMS

ECB – European Central Bank	Sets the central interest rates in the European Monetary Union area. The ECB determines the targets itself for its interest rate setting policy; this is to keep inflation within a band of 0 to 2%
EIP – Equal Instalments of Principal	A repayment method whereby a fixed amount of principal is repaid at regular intervals with interest being calculated on the principal outstanding.
Fixed Deposits	These are loans to banks, building societies or other local authorities which are for a fixed period and at a fixed rate of interest.
FRN – Floating Rate Notes	Debt securities with payments that are reset periodically against a benchmark rate, such as the three month London inter-bank offer rate (LIBOR). FRNs can be used to balance risks incurred through other interest rate instruments in an investment portfolio.
Gilts / Gilt Edged Securities	These are issued by the UK Government in order to finance public expenditure. Gilts are generally issued for a set period and pay a fixed rate of interest. At the end of the set period the investment is repaid (at face value) by the Government. However, during the life of a gilt it will often be traded (bought and sold) at a price decided by the market.
LIBID – London Interbank BID Rate	The interest rate at which London banks are willing to borrow from one another.
LIBOR – London Interbank Offer Rate	The interest rate at which London banks offer one another. Fixed every day by the British Bankers Association to five decimal places. This is due to be replaced by SONIA on 1 January 2022 (see below)
Maturity loans	A repayment method whereby interest is repaid throughout the period of the loan and the principal is repaid at the end of the loan period.
MMF – Money Market Funds	Externally managed pooled investment schemes investing in short term cash instruments.
MRP – Minimum Revenue Provision	The minimum amount which must be charged to an authority's revenue account each year and set aside towards repaying borrowing.
MPC – Monetary Policy Committee	Government body that sets the bank rate (commonly referred to as being base rate). Their primary target is to keep inflation within plus or minus 1% of a central target of 2.5% in two years time from the date of the monthly meeting of the Committee. Their secondary target is to support the Government in maintaining high and stable levels of growth and employment.
Multilateral Investment banks	International financial institutions that provide financial and technical assistance for economic development.
Municipal Bonds Agency	An independent body owned by the local government sector that seeks to raise money on the capital markets at regular intervals to on-lend to participating local authorities.
Pooled Funds	Investments made with an organisation who pool together investments from other organisations and apply the same investment strategy to the portfolio. Pooled fund investments benefit from economies of scale, which allows for lower

## GLOSSARY OF TREASURY TERMS

	trading costs per pound, diversification and professional money management.
Prudential Code	A governance procedure for the setting and revising of prudential indicators. Its aim is to ensure, within a clear framework, that the capital investment plans of the Council are affordable, prudent and sustainable and that treasury management decisions are taken in accordance with good practice.
PWLB – Public Works Loans Board	A central government agency which provides long- and medium-term loans to local authorities at interest rates only slightly higher than those at which the Government itself can borrow. Local authorities are able to borrow to finance capital spending from this source.
Repo – Reverse Repurchase Agreements	An agreement to purchase a security from a counterparty, typically a bank, and then sell the security back to the bank on a predetermined date for the principal amount plus interest. The security is collateral to be used in the event of a default by the counterparty.
SONIA – Sterling Overnight Index Average	SONIA is based on actual transactions and reflects the average of the interest rates that banks pay to borrow sterling overnight from other financial institutions and other institutional investors. SONIA replaces LIBOR from 1 January 2022
Supranational Bonds	These are very similar in nature to gilts except that rather than being issued by the UK Government they are issued by supranational bodies supported by more than one national government such as the European Investment Bank which is supported by all of the EU member states.
Treasury Bills	Tradable debt securities issued by the UK Government with a short term maturity (3 months to 1 year) issued at a discount. The income from these is in the form of a capital gain rather than interest income.
TMP – Treasury Management Practices	Schedule of treasury management functions and how those functions will be carried out.
TMS – Treasury Management Schedules	More detailed schedules supporting the TMP at a detailed operational level specifying the systems and routines to be employed and the records to be maintained in fulfilling the Council's treasury functions
VRP - Voluntary Revenue Provision	A voluntary amount charged to an authority's revenue account and set aside towards repaying borrowing.
Working Capital	Timing differences between income and expenditure (debtors and creditors).