**TREASURY MANAGEMENT STRATEGY 2024/25**

**Cabinet – 8 February 2024**

**Report of:** Deputy Chief Executive and Chief Officer – Finance and Trading

**Status:** For Decision

**Also considered by:**

- Finance and Investment Advisory Committee – 11 January 2024 (replaced table at paragraph 79)
- Council – 20 February 2024

**Key Decision:** No

**Executive Summary:**

The Local Government Act 2003 (the Act) and supporting regulations requires the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by investment guidance issued subsequent to the Act). This sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

The Annual Investment Strategy remains largely the same as for 2023/24

**This report supports the Key Aim of:** efficient management of the Council's resources.

**Portfolio Holder:** Cllr. Kevin Maskell

**Contact Officer(s):** Jessica Booth, Ext. 7436

**Recommendation to Finance and Investment Advisory Committee:**

That the report be noted and comments forwarded to Cabinet.

**Recommendation to Cabinet:**

That, subject to the comments of the Finance & Advisory Committee, Cabinet recommend that Council approve the Treasury Management Strategy for 2024/25.

**Recommendation to Council:**

That the Treasury Management Strategy for 2024/25 be approved.

**Reason for recommendation:** To ensure that an appropriate and effective Treasury Management Strategy is drawn up in advance of the forthcoming year, which meets both legislative and best practice requirements.

**Introduction and Background**

1 The Authority is required to operate a balanced revenue 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 Authority's low risk appetite, providing adequate liquidity initially before considering investment return.

2 The second main function of the treasury management service is the funding of the Authority's capital plans. These capital plans provide a guide to the borrowing need of the Authority, essentially the longer-term cash flow planning, to ensure that it 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 risk or cost objectives.

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.

4 The Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as:

*"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."*

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

Reporting requirements – Capital Strategy

6 The CIPFA 2021 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

**7** The aim of the strategy is to ensure that all the Authority's elected members fully understand the overall long-term policy objectives and resulting Capital Strategy requirements, governance procedures and risk appetite.

Reporting Requirements – Treasury Management

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

a. Prudential and treasury indicators and treasury strategy (this report)
The first and most important report is forward looking and covers:-

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

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

c. An annual treasury report

This is a backward-looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

9 The above reports are required to be adequately scrutinised before being recommended to the Full Council. This role is undertaken by the Finance and Investment Advisory Committee.

10 In addition, Treasury performance should be reported quarterly. This is included in the quarterly budget monitoring.

Treasury Management Strategy for 2024/25

11 The strategy for 2024/25 covers two main areas:

*Capital Issues*

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

*Treasury Management Issues*

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

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

Training

13 The CIPFA Treasury Management Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny.

14 Furthermore, pages 47 and 48 of the Code state that they expect "all organisations to have a formal and comprehensive knowledge and skills or training policy for the effective acquisition and retention of treasury management knowledge and skills for those responsible for management, delivery, governance and decision making.

15 The scale and nature of this will depend on the size and complexity of the organisation's treasury management needs. Organisations should consider

how to assess whether treasury management staff and board/ council members have the required knowledge and skills to undertake their roles and whether they have been able to maintain those skills and keep them up to date.

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

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

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

18 Training for members has been scheduled for 3rd January 2024 and further training will be arranged as required.

19 The training needs of treasury management officers are periodically reviewed.

Treasury Management Consultants

20 The Authority uses Link Group, Link Treasury Services Limited as its external treasury management advisors.

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

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

**The Capital Prudential Indicators 2024/25 – 2026/27**

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

Capital Expenditure and Financing

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

| Capital expenditure | 2022/23 Actual £000 | 2023/24 Estimate £000 | 2024/25 Estimate £000 | 2025/26 Estimate £000 | 2026/27 Estimate £000 |
|---|---|---|---|---|---|
| Services | **12,618** | **5,004** | **33,719** | **27,584** | **18,077** |
| **Total** | **12,618** | **5,004** | **33,719** | **27,584** | **18,077** |

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

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

| Financing of capital expenditure | 2022/23 Actual £000 | 2023/24 Estimate £000 | 2024/25 Estimate £000 | 2025/26 Estimate £000 | 2026/27 Estimate £000 |
|---|---|---|---|---|---|
| Capital receipts | 6,787 | 4,629 | 591 | - | - |
| Capital grants | 2,194 | 375 | 1,128 | 1,128 | 1,128 |
| Capital reserves | 517 | - | 582 | 582 | 582 |
| Mixed Funding | - | - | 500 | 500 | 500 |
| Revenue | - | - | - | - | - |
| **Net financing need for the year** | 3,119 | - | 30,918 | 25,374 | 15,867 |

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

27 The second prudential indicator is the Authority's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Authority's indebtedness and so its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

28 The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the indebtedness in line with each asset's life, and so charges the economic consumption of capital assets as they are used.

29 The CFR includes any other long-term liabilities (e.g., PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Authority's borrowing requirement, these types of schemes include a borrowing facility by the PFI, PPP lease provider and so the Authority is not required to separately borrow for these schemes. The Authority currently has £0m of such schemes within the CFR.

30 The Authority is asked to approve the CFR projections below:

| | 2022/23 Actual £000 | 2023/24 Estimate £000 | 2024/25 Estimate £000 | 2025/26 Estimate £000 | 2026/27 Estimate £000 |
|---|---|---|---|---|---|
| **Capital Financing Requirement** | | | | | |
| **Total CFR** | 51,318 | 50,993 | 81,247 | 105,951 | 121,142 |
| **Movement in CFR** | 2,661 | (325) | 30,254 | 24,704 | 15,191 |

| | | | | | |
|---|---|---|---|---|---|
| **Movement in CFR represented by** | | | | | |
| Net financing need for the year (above) | 3,119 | - | 30,918 | 25,374 | 15,867 |
| Less MRP/VRP and other financing movements | (458) | (325) | (664) | (670) | (676) |
| **Movement in CFR** | 2,661 | (325) | 30,254 | 24,704 | 15,191 |

| External borrowing | 2022/23 Actual £000 | 2023/24 Estimate £000 | 2024/25 Estimate £000 | 2025/26 Estimate £000 | 2026/27 Estimate £000 |
|---|---|---|---|---|---|
| Service spend | 12,297 | 11,820 | 11,334 | 10,837 | 10,331 |
| Regeneration | | | 30,918 | 56,292 | 72,159 |
| **TOTAL** | 12,297 | 11,820 | 42,252 | 67,129 | 82,490 |

| External borrowing | 2022/23 Actual £000 | 2023/24 Estimate £000 | 2024/25 Estimate £000 | 2025/26 Estimate £000 | 2026/27 Estimate £000 |
|---|---|---|---|---|---|
| Treasury Management | 1,500 | 3,000 | 0 | 0 | 0 |

Liability Benchmark

31 A third and new prudential indicator for 2023/24 is the Liability Benchmark (LB). The Council is required to estimate and measure the LB for the forthcoming financial year and the following two financial years, as a minimum. This is set out in Appendix H.

32 There are four components to the LB:

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

Core Funds

33 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.).

Minimum Revenue Provision (MRP) Policy Statement

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

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

36 The MRP policy statement requires full council approval (or closest equivalent level) in advance of each financial year.

37 The Council is recommended to approve the following MRP statement

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

a. 4% reducing balance (CFR method) – MRP will be calculated as 4% of the opening GF CFR balance;

From 1 April 2008 for all unsupported borrowing the MRP policy will be

b. Asset life method (annuity) – MRP will be based on the estimated life of the assets;

38 Capital expenditure incurred during 2023/24 will not be subject to an MRP charge until 2024/25, or in the year after the asset becomes operational.

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

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

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

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

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

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

45 Up to 31 March 2023 the total VRP overpayments have been nil.

**The Borrowing Strategy**

46 The capital expenditure plans set out in paragraphs 24 to 26 provide details of the service activity of the Authority. The treasury management function ensures that the Authority's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity and the Authority's Capital Strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions, and the Annual Investment Strategy.

<u>Current Portfolio Position</u>

47 The overall treasury management portfolio as at 31 March 2023 and for the position as at 30 November 2023 are shown below for both borrowing and investments.

| TREASURY PORTFOLIO | | | | |
|---|---|---|---|---|
| | actual | actual | current | current |
| | 31.3.23 | 31.3.23 | 30.11.23 | 30.11.23 |
| **Treasury investments** | £000 | % | £000 | % |
| Banks | 779 | 10% | 380 | 2% |
| Building societies - unrated | 0 | 0% | 0 | 0% |
| Building societies - rated | 0 | 0% | 0 | 0% |
| Local authorities | 0 | 0% | 3,000 | 17% |
| DMADF (H.M.Treasury) | 0 | 0% | 0 | 0% |
| Money Market Funds | 2,150 | 27% | 9,700 | 54% |
| Certificates of Deposit | 0 | 0% | 0 | 0% |
| **Total managed in house** | 2,929 | 37% | 13,080 | 72% |
| Multi Asset Income Funds | 5,000 | 63% | 5,000 | 28% |
| **Total managed externally** | 5,000 | 63% | 5,000 | 28% |
| **Total treasury investments** | 7,929 | 100% | 18,080 | 100% |

| | | | | |
|---|---|---|---|---|
| **Treasury external borrowing** | | | | |
| Local Authorities | 1,500 | 11% | 2,600 | 18% |
| PWLB | 12,297 | 89% | 11,820 | 82% |
| **Total external borrowing** | 13,797 | 100% | 14,420 | 100% |
| **Net treasury investments / (borrowing)** | (5,868) | 0 | 3,660 | 0 |

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

| | 2022/23 Actual £000 | 2023/24 Estimate £000 | 2024/25 Estimate £000 | 2025/26 Estimate £000 | 2026/27 Estimate £000 |
|---|---|---|---|---|---|
| **External Debt** | | | | | |
| Debt at 1 April | 12,597 | 12,297 | 11,820 | 42,252 | 67,129 |
| Expected change in Debt | (300) | (477) | 30,431 | 24,878 | 15,361 |
| Actual gross debt at 31 March | 12,297 | 11,820 | 42,252 | 67,129 | 82,490 |
| The Capital Financing Requirement | 51,318 | 50,993 | 81,247 | 105,951 | 121,142 |
| Under / (over) borrowing | 39,020 | 39,173 | 38,995 | 38,882 | 38,652 |

49 Within the range of prudential indicators there are several 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 2024/25 and the following two financial years. This allows some flexibility for limited early borrowing for future years but ensures that borrowing is not undertaken for revenue or speculative purposes.

50 The Deputy Chief Executive and Chief Officer - Finance & Trading reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes account of current commitments, existing plans and the proposals in this budget report.

Treasury Indicators: Limits to Borrowing Activity

The Operational Boundary

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

| **Operational Boundary** | **2023/24 Estimate £000** | **2024/25 Estimate £000** | **2025/26 Estimate £000** | **2026/27 Estimate £000** |
|---|---|---|---|---|
| Debt | 40,000 | 50,000 | 75,000 | 90,000 |
| Total | 40,000 | 50,000 | 75,000 | 90,000 |

The Authorised Limit for external debt

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

53 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 local authority plans, or those of a specific authority, although this power has not yet been exercised.

54 The Council is asked to approve the following Authorised Limit:

| **Authorised Limit** | **2023/24 Estimate £000** | **2024/25 Estimate £000** | **2025/26 Estimate £000** | **2026/27 Estimate £000** |
|---|---|---|---|---|
| Debt | 45,000 | 55,000 | 80,000 | 95,000 |
| Total | 45,000 | 55,000 | 80,000 | 95,000 |

## Prospects for Interest Rates

55 The Council has appointed Link Group as its treasury advisor and part of their service is to assist the Authority to formulate a view on interest rates. Link provided the following forecasts on 07 November 2023. These are forecasts for Bank Rate, average earnings and Public Works Loan Board (PWLB) certainty rates, gilt yields plus 80 bps.

| Link Group Interest Rate View 07.11.23 | Dec-23 | Mar-24 | Jun-24 | Sep-24 | Dec-24 | Mar-25 | Jun-25 | Sep-25 | Dec-25 | Mar-26 | Jun-26 | Sep-26 | Dec-26 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| BANK RATE | 5.25 | 5.25 | 5.25 | 5.00 | 4.50 | 4.00 | 3.50 | 3.25 | 3.00 | 3.00 | 3.00 | 3.00 | 3.00 |
| 3 month ave earnings | 5.30 | 5.30 | 5.30 | 5.00 | 4.50 | 4.00 | 3.50 | 3.30 | 3.00 | 3.00 | 3.00 | 3.00 | 3.00 |
| 6 month ave earnings | 5.60 | 5.50 | 5.40 | 5.10 | 4.60 | 4.10 | 3.60 | 3.40 | 3.10 | 3.10 | 3.10 | 3.10 | 3.10 |
| 12 month ave earnings | 5.80 | 5.70 | 5.50 | 5.20 | 4.70 | 4.20 | 3.70 | 3.50 | 3.30 | 3.30 | 3.30 | 3.30 | 3.30 |
| 5 yr PWLB | 5.00 | 4.90 | 4.80 | 4.70 | 4.40 | 4.20 | 4.00 | 3.80 | 3.70 | 3.60 | 3.50 | 3.50 | 3.50 |
| 10 yr PWLB | 5.10 | 5.00 | 4.80 | 4.70 | 4.40 | 4.20 | 4.00 | 3.80 | 3.70 | 3.70 | 3.60 | 3.60 | 3.50 |
| 25 yr PWLB | 5.50 | 5.30 | 5.10 | 4.90 | 4.70 | 4.50 | 4.30 | 4.20 | 4.10 | 4.10 | 4.00 | 4.00 | 4.00 |
| 50 yr PWLB | 5.30 | 5.10 | 4.90 | 4.70 | 4.50 | 4.30 | 4.10 | 4.00 | 3.90 | 3.90 | 3.80 | 3.80 | 3.80 |

56 Appendix A draws together a number of current City views on the prospects for short term and longer fixed interest rates. Appendix B contains Link Group's latest economic background report and the risks for interest rates as at December 2023.

## Borrowing Strategy

57 The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need, (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Authority's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as medium and longer dated borrowing rates are expected to fall from their current levels once prevailing inflation concerns are addressed by tighter near-term monetary policy. That is, Bank Rate remains elevated through to the second half of 2024.

58 However, this strategy results in a reduction in the level of investment balances the Council is able to hold and therefore reduces investment income. It is therefore proposed that interest may be charged against projects which are funded from internal borrowing.

59 Against this background and the risks within the economic forecast, caution will be adopted with the 2024/25 treasury operations. The Director of Finance will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

a. if it was felt that there was a significant risk of a sharp FALL in borrowing rates, then borrowing will be postponed.
b. if it was felt that there was a significant risk of a much sharper RISE in borrowing rates than that currently forecast, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

60 Any decisions will be reported to the appropriate decision-making body at the next available opportunity.

Policy on Borrowing in Advance of Need

61 The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates and will be considered carefully to ensure that value for money can be demonstrated and that the Authority can ensure the security of such funds.

62 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.

Rescheduling

63 Rescheduling of current borrowing in our debt portfolio is unlikely to occur as there is still a large difference between premature redemption rates and new borrowing rates.

64 If rescheduling is to be undertaken, it will be reported to Cabinet at the earliest meeting following its action.

New Financial Institutions as a Source of Borrowing

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

a. Local authorities

b. Financial institutions (e.g., insurance companies, pension funds, banks, Municipal Bonds Agency, UK Infrastructure Bank etc)

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

**Annual Investment Strategy**

Investment Policy – Management of Risk

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

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

a. DLUHC's Guidance on Local Government Investments ("the Guidance")
b. CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2021 ("the Code")
c. CIPFA Treasury Management Guidance Notes 2021

69 The Council's investment priorities will be security first, portfolio liquidity second and then yield (return). The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with regard to its risk appetite.

70 In the current economic climate, it is considered appropriate to maintain a degree of liquidity to cover cash flow needs but to also consider "laddering" investments for periods up to 12 months with high credit rated financial institutions, whilst investment rates remain elevated, as well as wider range fund options.

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

a. Minimum acceptable credit criteria are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short-term and long-term ratings.

b. Other information: ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Authority will engage with its advisors to maintain a monitor on market pricing such as “credit default swaps” and overlay that information on top of the credit ratings.

c. Other information sources used will include the financial press, share price and other such information pertaining to the financial sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

d. This Authority has defined the list of types of investment instruments that the treasury management team are authorised to use. There are two lists in Appendix D under the categories of ‘specified’ and ‘non-specified’ investments.

e. Specified investments are those with a high level of credit quality and subject to a maturity limit of one year or have less than a year left to run to maturity, if originally they were classified as being non-specified investments solely due to the maturity period exceeding one year.

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

g. Non-specified and loan investment limits. The Authority has determined that it will set a limit to the maximum exposure of the total treasury management investment portfolio to non-specified treasury management investments of 50%.

h. Lending limits, (amounts and maturity), for each counterparty will be set using the criteria set out on paragraph 80.

i. Transaction limits are set for each type of investment in 84.

j. This Authority will set a limit for its investments which are invested for longer than 365 days, (see table at paragraph 92).

k. Investments will only be placed with counterparties from countries with a specified minimum sovereign rating (see paragraph 84).

l. This Authority has engaged external consultants, (see paragraphs 20-22), to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this Authority in the context of the expected level of cash balances and need for liquidity throughout the year.

m. All investments will be denominated in sterling.

n. As a result of the change in accounting standards for 2023/24 under IFRS 9, this Authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. In November 2018, the MHCLG, concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years ending 31 March 2023. More recently, a further extension to the over-ride to 31 March 2025 has been agreed by Government.

72 However, this Authority will also pursue value for money in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance. Regular monitoring of investment performance will be carried out during the year.

Changes in risk management policy from last year

73 The above criteria are unchanged from last year.

Creditworthiness Policy

74 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: -

a. It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and

b. 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.

75 The Deputy Chief Executive and Chief Officer – Finance and Trading will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Full Council for approval as necessary. These 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 considered high quality which The Council may use, rather than defining what types of investment instruments are to be used.

76 Credit rating information is supplied by Link Group, our treasury advisors, 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 the longer-term bias outside the central rating view) are provided to officers almost immediately after they occur, and this information is considered before dealing. For instance, a negative rating Watch applying to a counterparty at the minimum Authority criteria will be suspended from use, with all others being reviewed in light of market conditions.

77 The criteria for providing a pool of high-quality investment counterparties, (both specified and non-specified investments) is:

- Banks 1 - good credit quality **–** The Council will only use banks which:
    i. are UK banks; and/or
    ii. are non-UK and domiciled in a country which has a minimum sovereign Long-Term rating of AA-

  and have, as a minimum, the following Fitch, Moody's and Standard & Poor's credit ratings (where rated):

    i. Short Term – F1
    ii. Long Term – A-
- Banks 2 – Part nationalised UK bank – Royal Bank of Scotland ring-fenced operations. This bank can be included provided they continue to be part nationalised or meet the ratings in Banks 1 above.
- Banks 3 – The Council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time invested.
- Bank subsidiary and treasury operation -. The Council will use these where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above.
- Building societies The Council will use all societies which: -
    i. Meet the ratings for banks outlined above;
    ii. Have assets in excess of £3bn;

  or meet both criteria.

- Money Market Funds (MMFs) CNAV – *AAA*
- Money Market Funds (MMFs) LNVAV – *AAA*
- Bond, Property, Equity and Multi-Asset Funds
- UK Government (including gilts, Treasury Bills and the DMADF)

- Local authorities, housing associations, parish councils etc.

78 Additional requirements under the Code require The Council to supplement credit rating information. Whilst the above criteria rely 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, rating Watches/Outlooks) will be applied to compare the relative security of differing investment opportunities.

79 The time and monetary limits for institutions on The Council's counterparty list are as follows (these will cover both specified and non-specified investments):

| | Fitch Long Term Rating (or equivalent) | Money and/or % Limit<br><br>£000 | Time Limit |
|---|---|---|---|
| Banks 1 (i) (UK) | A- | 7,000 | 2 years |
| Banks 1(ii) (Non UK based on sovereign rating AA-) | A- | 5,000 | 2 years |
| Banks 2 (Part Nationalised) | N/A | 7,000 | 2 years |
| Banks 3 (Authorities own bank if not meeting Banks 1(i)) | N/A | 7,000 | 1 day |
| Bank subsidiaries (with parent guarantee) | A- | 7,000 | 2 years |
| Rated building societies (assets over £3bn) | N/A | 5,000 | 2 years |
| Unrated building societies (assets over £3bn) | N/A | 3,000 | 1 year |
| Money Market Funds (CNAV) | AAA | 5,000 (per Fund) | Liquid |
| Money Market Funds (LVNAV) | AAA | 5,000 (per Fund) | Liquid |
| Bond, Property, Equity & Multi-Asset Funds | N/A | 5,000 (per Fund) | Liquid |
| UK Government DMADF | UK sovereign rating | 5,000 | 6 months |
| Local authorities, housing associations etc | N/A | 5,000 (each) | 2 years |

80 The proposed criteria for specified and non-specified investments are shown in Appendix D for approval.

Creditworthiness Issues

81 Significant levels of downgrades to Short and Long-Term credit ratings have not materialised since the crisis in March 2020. In the main, where they did change, any alterations were limited to Outlooks. Nonetheless, when setting minimum sovereign debt ratings, this Authority will not set a minimum rating for the UK.

82 Although bank CDS prices, (these are market indicators of credit risk), spiked upwards during the days of the Truss/Kwarteng government in the autumn of 2022, they have returned to more average levels since then. However, sentiment can easily shift, so it will remain important to undertake continual monitoring of all aspects of risk and return in the current circumstances. Link monitor CDS prices as part of their creditworthiness service to local authorities and the Authority has access to this information via its Link-provided Passport portal.

Limits

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

a. Non-specified treasury management investment limit. The Authority has determined that it will limit the maximum total exposure of treasury management investments to non-specified treasury management investments as being 50% of the total treasury management investment portfolio.

b. Country limit. The Council has determined that it will only use approved counterparties from the UK and from countries with a minimum sovereign credit rating of AA- from Fitch or equivalent. The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix E. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

c. Other limits. In addition: -

- no more than 15% will be placed with any non-UK country at any time;
- limits in place above will apply to a group of companies;
- sector limits will be monitored regularly for appropriateness.

Investment Strategy

84 Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e., rates for

investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. The current shape of the yield curve suggests that is the case at present, but there is the prospect of Bank Rate having peaked in the second half of 2023 and possibly reducing as early as the second half of 2024 so an agile investment strategy would be appropriate to optimise returns.

85 Accordingly, while most cash balances are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer-term investments will be carefully assessed.

86 The current forecast shown in paragraph 89, includes a forecast for Bank Rate to have peaked at 5.25% in Q4 2023.

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

**Average earnings in each year**

| | |
|---|---|
| 2023/24 (residual) | 5.30% |
| 2024/25 | 4.70% |
| 2025/26 | 3.20% |
| 2026/27 | 3.00% |
| 2027/28 | 3.25% |
| Years 6 to 10 | 3.25% |
| Years 10+ | 3.25% |

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

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

90 There are no changes proposed to the investment strategy for 2024/25.

91 Members are asked to note the following treasury indicator and limit. These limits are set with regard to the Council’s liquidity requirements and to reduce the need for an early sale of an investment. They are based on the availability of funds after each year-end.

| | 2024/25<br><br>£000 | 2025/26<br><br>£000 | 2026/27<br><br>£000 |
|---|---|---|---|
| Principal sums invested for longer than 365 days | 10,000 | 10,000 | 10,000 |
| Current investments as at *01 Dec 23* in excess of 1 year maturing in each year | 5,000 | 5,000 | 5,000 |

Investment Performance/Risk Benchmarking

92 This Authority will use an investment benchmark to assess the investment performance of its investment portfolio of SONIA (Sterling Overnight Index Average).

End of Year Investment Report.

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

Scheme of Delegation

94 The guidance notes accompanying the revised Code also require that a statement of the Council's scheme of delegation in relation to treasury management is produced as part of the Annual Investment Strategy. This appears at Appendix F.

Revision of the treasury management and prudential codes and the role of the Section 151 officer

95 As with the scheme of delegation mentioned in the previous paragraph, a statement of the role of the Section 151 officer is also required. This appears at Appendix G.

**Key Implications**

Financial

The management of the Council's investment portfolio and cash-flow generated balances plays an important part in the financial planning of the authority. The security of its capital and liquidity of its investments is of paramount importance.

Legal Implications and Risk Assessment Statement.

Under Section 151 of the Local Government Act 1972, the Section 151 Officer has statutory duties in relation to the financial administration and stewardship of the authority, including securing effective arrangements for treasury management.

This treasury management strategy report fulfils the requirements of The Chartered Institute of Public Finance & Accountancy's Code of Practice on Treasury Management 2021.

Treasury management has two main risks :

- Fluctuations in interest rates can result in a reduction in income from investments; and
- A counterparty to which the Council has lent money fails to repay the loan at the required time.

Consideration of risk is integral in our approach to treasury management. The movement in previous years towards having a restricted lending list of better quality institutions but higher individual limits with those institutions has reduced the chances of a default. But if a default did occur, the potential loss would be greater.

These risks are mitigated by the annual investment strategy which has been prepared on the basis of achieving the optimum return on investments commensurate with proper levels of security and liquidity. However, Members should recognise that in the current economic climate, these remain significant risks and that the strategy needs to be constantly monitored.

Equality Assessment

The decisions recommended through this paper have a remote or low relevance to the substance of the Equality Act. There is no perceived impact on end users.

Net Zero Implications

The decisions recommended through this paper have a remote or low relevance to the council's ambition to be Net Zero by 2030. There is no perceived impact regarding either an increase or decrease in carbon emissions in the district, or supporting the resilience of the natural environment.

## Conclusions

The effect of the proposals set out in this report is to allow the Council to effectively and efficiently manage cash balances.

In line with the revised CIPFA Code of Practice on Treasury Management, the Annual Treasury Strategy Statement must be considered by Council and this is planned for its meeting on 20 February 2024.

**Appendices**

Appendix A – Prospects for Interest Rates

Appendix B – Economic background and interest rate risks

Appendix C – Investment and Loan portfolio at 30 November 2023

Appendix D – Specified and non-specified investments

Appendix E – Approved countries for investments

Appendix F – Treasury management scheme of delegation

Appendix G – The treasury management role of the S151 officer

Appendix H – The Liability Benchmark

**Background Papers**

None

**Adrian Rowbotham**

**Deputy Chief Executive and Chief Officer – Finance & Trading**