Executive **9 February 2023**

Report of the Chief Finance Officer
Portfolio of the Executive Member for Finance & Major Projects

Treasury Management Strategy Statement and Prudential Indicators for 2023/24 to 2027/28

Report Summary

1. The purpose of this report is to seek the recommendation of Executive to Full Council for the approval of the treasury management strategy and prudential indicators for the 2023/24 financial year.

Recommendations

2. Executive are asked to recommend that Council approve:
   - The proposed treasury management strategy for 2023/24 including the annual investment strategy and the minimum revenue provision policy statement;
   - The prudential indicators for 2023/24 to 2027/28 in the main body of the report;
   - The specified and non-specified investments schedule (annex B)
   - The scheme of delegation and the role of the Section 151 officer (annex D)

   Reason: To enable the continued effective operation of the treasury management function and ensure that all Council borrowing is prudent, affordable and sustainable.

Background

3. On 20th December 2021 CIPFA published the revised Treasury Management Code and Prudential Code with changes which come into effect for, and are formally adopted within the 2023/24 Treasury Management Strategy Statement (TMSS). The Council has to have regard to these codes of practice when it prepares the Treasury Management Strategy Statement and Annual Investment Strategy, as well as the related reports during the financial year, which are taken to full Council for approval. As part of the updated code the Council is required to ensure that it has appropriate risk, investment, governance and reporting processess in place.

1. A new debt liabiity benchmark treasury indicator to support the financing risk management of the capital financing requirement (CFR) is introduced, and is included in this report.
2. There is a renewed emphasis that increases in CFR and borrowing should only be undertaken where related to the functions of the Council; any returns related to the financial viability of an asset or scheme should be incidental to the primary purpose.
3. Capital and investments plans should be affordable and proportionate with all borrowing and other long-term liabilities within prudent and sustainable levels.
4. All Treasury Management decisions should be made in accordance with good professional practice and the Council should have access to the appropriate level of expertise across all areas of investments and capital expenditure in order to make properly informed decisions.

4. The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. The first function 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.

5. The second main function of the treasury management service is funding of the Council's capital programme. The capital programme provides 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 any debt previously drawn may be restructured to meet Council risk or cost objectives.

6. The contribution the treasury management function makes to the Council 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.

7. 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.

8. CIPFA (Chartered Institute of Public Finance and Accountancy) 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. "

Reporting requirements – Capital Strategy

9. The CIPFA revised 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

10. 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.

11. This capital strategy is reported separately from the Treasury Management Strategy Statement; non-treasury investments will be reported through the former. This ensures the separation of the core treasury function under security, liquidity and yield principles, and the policy and commercialism investments usually driven by expenditure on an asset. The capital strategy will show:
    - The corporate governance arrangements for these types of activities;
    - Any service objectives relating to the investments;
    - The debt related to the activity and the associated interest costs;
    - The payback period (MRP policy);
    - The risks associated with each activity.

12. Where a physical asset is being bought, details of market research, advisers used, ongoing costs and investment requirements will be disclosed, including the ability to sell the asset and realise the investment cash.

13. Where the Council has borrowed to fund any non-treasury investment, there should also be an explanation of why borrowing was required and why the DLUHC Investment Guidance and CIPFA Prudential Code have not been adhered to.

14. If any non-treasury investment sustains a loss during the final accounts and audit process, the strategy and revenue implications will be reported through the same procedure as the capital strategy.

Reporting requirements – Treasury Management

15. The Council is currently required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of polices, estimates and actuals. The three reports are:
    - **Treasury mangement strategy statement and prudential indicators report** (this report) – which covers the capital plans including prudential indicators, the minimum revenue provision policy, the treasury managment strategy and the annual investment strategy;
    - **Mid year treasury management report** – updates members as to whether the treasury activities are meeting the strategy, whether any policies require revision, amending prudential indicators if necessary;
    - **Annual treasury report** – updates on treasury activity/ operations for the year and compares actual prudential indicators with estimates in the strategy.

16. These reports are required to be scrutinised before being recommended to the Council. This scrutiny role is undertaken by Audit & Governance Committee.

17. The 2021 Prudential Code and Treasury Management Codes introduce a new requirement that monitoring of the treasury management and prudential indicators should be reported quarterly as part of the Council's general revenue and capital monitoring. While it is not a requirement for these quarterly prudential indicators to be reported to full Council they will be reported to the Audit and Governace Committee.

18. The CIPFA 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. The training needs of treasury management officers is also periodically reviewed.

Treasury management strategy for 2023/24

19. The treasury managment strategy for 2023/24 covers two main areas:

    Capital issues

    - the capital programme and prudential indicators;
    - minimum revenue provision (MRP) policy.

    Treasury management issues

    - prudential indicators which will limit the treasury management risk and activities of the Council;
    - the current treasury position;
    - prospects for interest rates;
    - the borrowing strategy;
    - policy on borrowing in advance of need;
    - debt rescheduling;
    - creditworthiness policy;
    - investment strategy;
    - policy on use of external service providers;
    - scheme of delegation and the role of the S151 officer

20. These elements cover the statutory and regulatory requirements of the Local Government Act 2003, the CIPFA Prudential Code and the CIPFA Treasury Management Code, the Department of Levelling Up, Housing and Communities (DLUHC) Minimum Revenue Provision (MRP) Guidance, and the DLUHC Investment Guidance.

Treasury management consultants

21. The Council uses the Link Group, Treasury solutions as its external treasury management advisors.
22. The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.
23. It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

The capital prudential indicators 2023/24 – 2027/28

24. The Council's capital expenditure plans are the key driver of treasury management activity and are the subject of a separate report on this agenda. The output of the capital programme is reflected in the capital prudential indicators, which are designed to assist member's overview of the Council's capital programme to ensure that the capital expenditure plans are affordable, sustainable and prudent.

25. The capital prudential indicators along with the treasury management prudential indicators are included throughout the report:

    PI 1: Capital expenditure
    PI 2: Capital financing requirement
    PI 3: Liability Benchmark
    PI 4: Ratio of financing cost to net revenue stream
    PI 5: External debt
    PI 6a: Authorised limit for external debt
    PI 6b: Operational boundary for external debt
    PI 7: Maturity structure of debt
    PI 8: Funds invested >364 days

26. **Prudential indicator 1 - capital expenditure**. This prudential Indicator is a summary of the Council's capital expenditure plans forming part of this budget cycle. Detailed information on the individual schemes is provided in the capital monitor 3 and capital strategy report.

Capital Expenditure	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m	2026/27 Estimate £m	2027/28 Estimate £m
General Fund (Non HRA)	85.8	181.9	66.5	24.9	23.2	23.7
Housing Revenue Account (HRA)	41.6	52.8	38.2	32.8	24.6	12.1
Sub Total	**127.4**	**234.7**	**104.7**	**57.7**	**47.8**	**35.8**
Other Long Term Liabilities	0.0	0.0	3.4	0.5	0.5	0.5
Total	**127.4**	**234.7**	**108.1**	**58.2**	**48.3**	**36.3**

Table 1: Capital expenditure

27. Table 1 details the capital expenditure of the Council, based on the capital programme strategy report, including other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments. There are no new PFI schemes forecast to be entered into in 2023/24. On the 8th April 2022 the Financial Reporting Advisory Board approved

CIPFA's deferral of the IFRS 16 standard until 1st April 2024 (which will form part of the 2024/25 Code). This means that for existing leases which were previously off balance sheet, these will be brought onto the balance sheet at 1st April 2024. The Prudential Indicators for Capital Financing Requirement and External debt make an estimate within Other long-term liabilities for this increase, as do the Authorised Limit and Operational Boundary.

28. Further details on this capital expenditure, and how it is funded, are included within the Capital Programme report elsewhere on this agenda.

29. **Prudential indicator 2 - the capital financing requirement (CFR) (Council's borrowing need).** The second prudential indicator is the Council's capital financing requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

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

31. The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases currently, and leases on balance sheet from 1st April 2024 under IFRS 16). Whilst these increase the CFR, and therefore the Council's overall borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. As set out in paragraph 49 table 5 the projected level of debt is significantly below the CFR over the 5 year period.

32. Table 2 below, shows the capital financing requirement, including other long term liabilities:

Capital Financing Requirement	**2022/23 Estimate £m**	**2023/24 Estimate £m**	**2024/25 Estimate £m**	**2025/26 Estimate £m**	**2026/27 Estimate £m**	**2027/28 Estimate £m**
General Fund (Non HRA)	305.4	392.8	405.5	408.8	413.8	421.5
Housing Revenue Account (HRA)	146.4	146.4	149.8	153.4	153.4	153.4
Other Long Term Liabilities*	42.8	41.7	44.1	42.9	41.7	40.6
Total CFR	**494.6**	**580.9**	**599.4**	**605.1**	**608.9**	**615.5**

*Other Long Term is for PFI/PPP & Leases

Table 2: Capital financing requirement (CFR)

Minimum revenue provision (MRP) policy statement

33. In accordance with the Local Government Act 2003 the Council is required to pay off an element of the accumulated general fund capital expenditure each year (the CFR) through a revenue charge (the minimum revenue provision - MRP) as well as being allowed to undertake additional voluntary payments (voluntary revenue provision - VRP) should the Council wish to do so.
34. The Council is required to determine a level of MRP it considers to be prudent, whilst having regard to the current MRP Guidance issued in 2018. The overriding requirement of the Guidance is to set a prudent provision which ensures that debt is repaid over a period that is reasonably commensurate with that over which the capital expenditure provides benefits.
35. DLUHC regulations require full Council to approve an MRP statement in advance of each year. The Policy may be revised during the year by full Council or the appropriate body of Members where required.
36. The regulations allow the Council to review its policy every year and set a policy that it considers prudent at that time. The impact of a revised MRP policy will be kept under regular review in order to ensure that the annual provision is prudent.
37. Full Council is recommended to approve the following MRP statement for the 2023/24 financial year:

    1. For supported borrowing MRP will be calculated using an Asset Life annuity basis on the remaining average life of the overall asset base.

    2. For all unsupported borrowing MRP will be calculated using an Asset Life annuity basis. Estimated asset life periods will be determined under delegated powers.

    3. MRP in respect of PFI contracts will be calculated by the amount that writes down the balance sheet liability unless the asset life is considerably longer than the PFI contract, where MRP will be calculated on an asset life basis.

    4. MRP in respect of finance leases will equal the repayment amount for the year.

5. There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made (although there are transitional arrangements in place).

6. The DLUHC MRP Guidance allows any charges made in excess of the statutory MRP, i.e. voluntary revenue provision (VRP) or overpayments, to be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year. To date, cumulative VRP overpayments are £0m. In 2022/23 so far, no VRP has been made and none is expected to be made. No VRP is planned for 2023/24. However, VRP will be kept under review, and should it be deemed prudent to make any VRP this will be the decision of the S.151 Officer and reported to Executive and Audit & Governance Committee at the next available opportunity.

7. MRP will generally commence in the financial year following the one in which the expenditure was incurred. However, for long life assets, the authority will postpone the commencement of MRP until the financial year following the one in which the asset becomes operational

8. The Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

38. **Prudential indicator 3 - Liability Benchmark.** A third and new prudential indicator for 2023/24 is the Liability Benchmark. The Liability Benchmark, based on current capital plans and cash flow assumptions, therefore gives the Council an indication of how much it needs to borrow, when it is likely to need to borrow, and where to match maturities to its planned borrowing needs. The liability benchmark makes no assumption about the level of future prudential borrowing in unknown capital budgets. There are four components that make up the Liability Benchmark:

    1. Existing loan debt outstanding: the Councils existing loans that are still outstanding in future years.

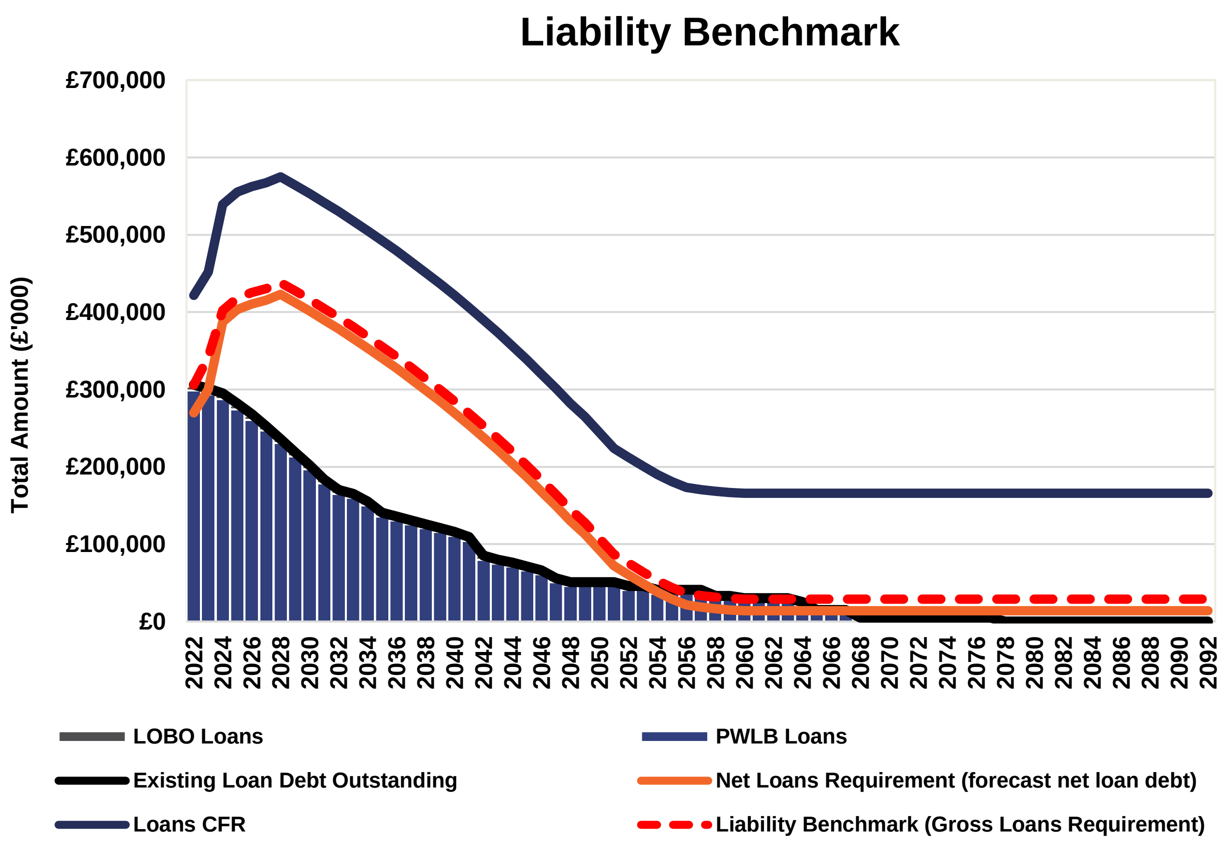
    2. CFR: as per Prudential indicator 2, this is calculated in accordance with the loans CFR definition in the Prudential Code and projected into the future based on approved prudential borrowing and planned MRP.

    3. Net loans requirement: this will show the Councils gross loan debt less treasury management investments at the last financial year-end, projected into the future and based on its approved

prudential borrowing, planned MRP and any other major cash flows forecast.

4. Liability benchmark (or gross loans requirement): this equals net loans requirement plus short-term liquidity allowance.

39. The purpose of this prudential indicator is to compare the authority's existing loans outstanding against its future need for loan debt; the liability benchmark (the red dotted line). If the loans outstanding are below the liability benchmark (the red dotted line), the existing debt outstanding is less than the loan debt required, and the authority will need to borrow in the future to meet the shortfall. If the loans outstanding are above the liability benchmark (the red dotted line), the authority will have more debt than it needs based on current plans and the excess will have to be invested.



Graph 1: Liability Benchmark

40. As can be seen from the Council's liability benchmark graph, the loans outstanding, CFR, liability benchmark and net loans requirement broadly follow the same trend lines. Based on the CFR position and loans outstanding at 31st March 2022 we see the Council's current under borrowed position. In the next 5 years the CFR increases in line with prudential borrowing expectations to fund increases to the capital programme before gradually starting to decrease. The liability benchmark and net loans requirement also increase to indicate the additional

borrowing need before gradually starting to decrease. Existing loans start to decrease as maturities occur and loans are paid back. Taking into account the current under borrowed position and with no assumptions on future borrowing requirements beyond the current capital programme, the gap between the CFR and loans outstanding remain broadly similar over the term indicted on the liability benchmark graph. When taking into account the liability benchmark and net loans requirement this gives an indication of how much future loan debt may need be taken and on what maturity term to assist with long term planning and reduce risk. Actual future debt taken may not exactly follow the liability benchmark as this is only a guide at a specific point in time, and one of several considerations when drawing down long term debt, to be determined by the S.151 Officer.

Affordability prudential indicators

41. The prudential indicators mentioned so far in the report cover the overall capital programme and the control of borrowing through the capital financing requirement (CFR), but within this framework prudential indicators are required to assess the affordability of capital investment plans. These provide an indication of the impact of the capital programme investment plans on the Council's overall finances.

42. **Prudential indicator 4 - ratio of financing costs to net revenue stream.** This indicator identifies the trend in the cost of capital (borrowing net of investment income and excluding other long term liabilities) and compares it to the Council's net revenue stream.

Financing Costs	2022/23 Estimate %	2023/24 Estimate %	2024/25 Estimate %	2025/26 Estimate %	2026/27 Estimate %	2027/28 Estimate %
General Fund (Non HRA)	**8.51**	**13.29**	**14.14**	**14.43**	**14.85**	**14.54**
Housing Revenue Account (HRA)	**11.42**	**10.94**	**10.69**	**10.55**	**10.41**	**10.27**
Total	**9.07**	**12.85**	**13.51**	**13.73**	**14.07**	**13.80**

Table 3: Ratio of financing costs to net revenue stream

43. The estimates of financing costs include current commitments and the proposals in the capital budget report considered elsewhere on this agenda.

44. The capital prudential indicators set out above ensure that the Council's capital expenditure plans are affordable, sustainable and prudent. The treasury management function ensures that cash is available to meet the Council's requirements in accordance with the Local Government Act 2003 and relevant professional codes.

45. The treasury management function involves both the forecasting of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the prudential / treasury indicators, the current and projected debt positions and the annual investment strategy.

Current portfolio position

46. The Council's treasury portfolio position at 31st December 2022 is detailed below in table 4:

Institution Type	Principal	Average Rate
Public Works Loan Board PWLB (61) – Money borrowed from the Debt Management Office (Treasury Agency)	£295.6m	3.21%
Market Loans LOBO Loans (1) – Lender Option Borrower Option	£5.0m	3.88%
West Yorkshire Combined Authority WYCA (4) – Zero interest loans the purpose of which are to help to fund York Central infrastructure projects	£2.4m	0.00%
Total Gross Borrowing (GF & HRA)	**£303.0m**	**3.21%**
Total Investments	**£41.8m**	**1.69%**

Table 4: Current position at 31st December 2022

47. The Council had £303.0m of fixed interest rate debt, of which £146.4m was HRA and £156.6m general fund. The cash balance available for investment was £41.8m. Over the long term as the capital programme progresses the level of cash available for investment is gradually decreasing as expected as the Council is using previously held balances to fund the programme. The level of cash balances available is largely dependent on the timing of the Council's cash flow as a result of precept payments, receipt of grants, receipt of developers contributions,

borrowing for capital purposes, payments to its suppliers of goods and services and spend progress on the Capital Programme. Cash held compared with this time last year has increased slightly due to the timing of these cash flows and the cash balances are therefore only available on a temporary basis.

48. Within the prudential indicators, there are a number of key indicators to ensure that the Council operates its activities within well-defined limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. One of these is that the Council needs to ensure that its total gross debt does not, except in the short term, exceed the total of the capital financing requirement (CFR) in the preceding year plus the estimates of any additional CFR for 2023/24 and the following two financial years. This allows the flexibility to borrow in advance of need but ensures that borrowing is not undertaken for revenue purposes.

49. **Prudential indicator 5 – external debt** Table 5 shows that the estimated gross debt position of the Council does not exceed the underlying capital borrowing need. The Chief Finance Officer (S.151 Officer) confirms that the Council complies with this prudential indicator and does not envisage difficulties for the future.

	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m	2026/27 Estimate £m	2027/28 Estimate £m
Gross projected debt*	**379.7**	**472.5**	**499.2**	**514.0**	**527.4**	**544.1**
Total CFR	**494.6**	**580.9**	**599.4**	**605.1**	**608.9**	**615.5**
Under/(over) borrowed	**Under**	**Under**	**Under**	**Under**	**Under**	**Under**

*Gross projected debt includes Other Long Term Liabilities such as PFI/PPP & Leases

Table 5: External debt< capital financing requirement

50. Table 5 shows a gap between actual and estimated borrowing and the CFR (driven by the use of internal funds to finance capital expenditure). The decision as to whether to continue to do this will take into account current assumptions on borrowing rates and levels of internal reserves and balances held by the Council. The figures above show a decrease in the gap between CFR and external debt as borrowing is taken to support capital expenditure, however this will be determined by the S.151 officer and the figure above is a current broad assumption. Actual borrowing will be determined by the circumstances that prevail at the time on borrowing rates and levels of cash balances.

Prudential indicators: limits on authority to borrow

51. **Prudential indicator 6A – authorised borrowing limit** - It is a statutory duty under Section 3 (1) of the Local Government Act 2003 and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. This amount is termed the “authorised borrowing limit” and represents a control on the maximum level of debt. This is 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 a short term period of 12 months, but is not sustainable in the longer term.

Authorised Limit	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m	2026/27 Estimate £m	2027/28 Estimate £m
Gross projected debt	**379.7**	**472.5**	**499.2**	**514.0**	**527.4**	**544.1**
Total CFR	**494.6**	**580.9**	**599.4**	**605.1**	**608.9**	**615.5**
Operational Boundary	**525.0**	**590.9**	**609.4**	**615.1**	**618.9**	**625.5**
Other long term liabilities	30.0	30.0	30.0	30.0	30.00	30.00
Total	**555.0** (£555.0m set at 2022/23 Strategy)	**620.9** (Based on current CFR projection)	**639.4** (Based on current CFR projection)	**645.1** (Based on current CFR projection)	**648.9** (Based on current CFR projection)	**655.5** (Based on current CFR projection)

Table 6: Authorised borrowing limit

52. **Prudential indicator 6B – operational boundary**. In addition to the “authorised borrowing limit”, the operational boundary is the maximum level of debt allowed for on an ongoing operational purpose. 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.

Operational boundary	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m	2025/26 Estimate £m	2026/27 Estimate £m	2027/28 Estimate £m
Gross projected debt	**379.7**	**472.5**	**499.2**	**514.0**	**527.4**	**544.1**
Total CFR	**494.6**	**580.9**	**599.4**	**605.1**	**608.9**	**615.5**

Short term liquidity	30.4	10.0	10.0	10.0	10.0	10.0
Total	**525.0** (£525.0m set at 2022/23 Strategy)	**590.9** (Based on current CFR projection)	**609.4** (Based on current CFR projection)	**615.1** (Based on current CFR projection)	**618.9** (Based on current CFR projection)	**625.5** (Based on current CFR projection)

Table 7: Operational boundary

Prospects for interest rates

53. Current interest rates and the future direction of both long term and short term interest rates have a major influence on the overall treasury management strategy and affects both investment and borrowing decisions. To facilitate treasury management officers in making informed investment and borrowing decisions, the Council has appointed the Link Group as its treasury adviser. Part of their service is to assist the Council in formulating a view on interest rates. Table 9 below gives Link's central view. These are forecasts for certainty rates, gilt yields plus 80 bps. (See also Annex A):

	Bank rate %	**PWLB borrowing rates % (including certainty rate adjustment)**		
		5 year	**25 year**	**50 year**
Dec 2022	3.50	4.20	4.60	4.30
Mar 2023	4.25	4.20	4.60	4.30
Dec 2023	4.50	4.00	4.40	4.10
Mar 2024	4.00	3.90	4.20	3.90
Dec 2024	3.25	3.50	3.90	3.60
Mar 2025	3.00	3.40	3.70	3.50
Dec 2025	2.50	3.10	3.50	3.20

Table 8 – Link's interest rate forecast as at 19th December 2022

54. Market expectations remain for Bank Rate to peak at 4.5% by mid-2023, and the Chancellor's Budget will take place on 15 March 2023, accompanied by analysis from the Office for Budget Responsibility. The overall balance of risks to economic growth in the UK is to the downside and these downside risks for the UK gilt market and PWLB rates include labour and supply shortages, the impact of interest rates rises coming too quickly or going too far, trade flows and trade arrangements, and geopolitical risks. Upside risks include interest rate rises coming too late or not going far enough leading to further inflationary pressures building, government policy on the public finances, a weaker pound, and impacts of US treasury policy. As there are many variables at this time, caution must be exercised in respect of all interest rate forecasts.

Investment and borrowing rates

55. Investment returns have improved in 2022/23 due to increases in the Bank of England Base Rate and with further increases expected in 2023/24 this trend should continue. However, this is dependent on the level of cash held for investment purposes, cash backed reserves and cash flow requirements (see paragraphs 46 - 47). The policy of avoiding new borrowing by running down spare cash balances to fund the capital programme has served well over the last few years, and as such it may be that, as cash is kept in more liquid short term investments, returns are not as high as market averages.

56. In March 2020, the Government started a consultation process for reviewing PWLB borrowing terms for different types of local authority capital expenditure. Revised guidance was published in November 2020 and updated in May 2022. Capital spending committed to from 26th November 2020 has to comply with the revised borrowing terms which provides permissible categories of capital spending in line with the prudential system and denies access to borrowing from the PWLB for any local authority which has purchase of investment assets for yield in its three year capital programme.

57. Link's long-term (beyond 10 years) forecast for Bank Rate is 2.50%. Currently all PWLB certainty rates are now above this level. Where greater value can be obtained in borrowing for shorter maturity periods the Council will assess its risk appetite in conjunction with budgetary pressures to reduce total interest costs. Temporary borrowing rates, including inter authority borrowing, are likely to remain near Bank Rate and are another borrowing option whilst the market waits for inflation, and therein gilt yields, to drop back later in 2023. Longer-term borrowing could also be undertaken for the purpose of certainty, where that is desirable, or for flattening the profile of a heavily unbalanced maturity profile.

58. While the Council will not be able to avoid borrowing to finance new capital expenditure, to replace maturing debt and the rundown of reserves, there will be a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

Borrowing strategy

59. The borrowing strategy takes into account the borrowing requirement, the current economic and market environments and is also influenced by the

interest rate forecast. 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 can be seen on the Liability Benchmark graph as shown by the gap between the loans outstanding and CFR (See paragraph 41 and graph 1 Liability Benchmark).

60. This strategy remains prudent as medium and longer dated borrowing rates are currently at elevated levels but expected to fall as inflation decreases from the effects of a tightening of near-term monetary policy as there are increases in Base Rate. Investment returns for short term liquid investments are still below borrowing rates and counterparty risk is still an issue that needs to be considered. Consideration will also be given to the maturity profile of the debt portfolio so the Council is not overly exposed to the concentration of debt being in any one year.

61. Against this background and the risks within the economic forecast, caution will be adopted with the treasury operations. The S.151 officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

    - If it was felt that there was a significant risk of a sharp fall in long and short term borrowing rates, then long term borrowing will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered in the interim period.
    - If it was felt that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn down whilst interest rates are lower than they are projected to be in the next few years.

62. The HRA strategy for borrowing will be the same as the borrowing strategy described above for the whole Council. The HRA Business Plan will guide and influence the overall HRA borrowing strategy.

63. All decisions will be reported to the appropriate decision making body (Executive and Audit & Governance Committee) at the next available opportunity.

Prudential Indicator 6 – Maturity of borrowing

64. Officers will monitor the balance between variable and fixed interest rates for borrowing and investments to ensure the Council is not exposed to adverse fluctuations in fixed or variable interest rate movements. This is likely to reflect higher fixed interest rate borrowing if the borrowing need is high or fixed interest rates are likely to increase, or a higher variable rate exposure if fixed interest rates are expected to fall.

Conversely if shorter term interest rates are likely to fall, investments may be fixed earlier, or kept shorter if short term investment rates are expected to rise.

65. The balance between variable rate debt and variable rate investments will be monitored as part of the overall treasury function in the context of the overall financial instruments structure and any under or over borrowing positions. The Council does not currently have any variable rate debt.

66. The upper and lower limits for the maturity structure of fixed rate borrowing are set out below (with actual split for the current financial year included for comparison). This gross limit is set to reduce the Council's exposure to large fixed rate sums falling due for refinancing in a confined number of years.

Maturity structure of borrowing				
	Lower	**Upper**	**2022/23 Debt (%)**	**2022/23 Debt (£)**
Under 12 months	0%	30%	4%	£10.7m
12 months to 2 years	0%	30%	2%	£7.2m
2 years to 5 years	0%	40%	13%	£40.9m
5 years to 10 years	0%	40%	28%	£84.2m
10 years and above	30%	90%	53%	£160.0m
Total Borrowing			**100%**	**£303.0m**

Table 9: Maturity structure of borrowing at 31st December 2022

Policy on borrowing in advance of need

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

68. Borrowing in advance will be made within the constraints of the CIPFA Prudential Code that:

- It will be limited to no more than 50% of the expected increase in borrowing need (CFR) over the three year planning period; and
- The authority would not look to borrow more than 36 months in advance of need

69. 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.

Debt rescheduling

70. Debt rescheduling of current Public Works Loan Board (PWLB) borrowing in our debt portfolio is unlikely to occur as there is still a very large difference between the premature repayment rates and new borrowing rates provided by the PWLB. When in a low interest rate environment this would mean the cost of prematurely repaying any PWLB loans would come with higher premium costs to exit any loans. Debt rescheduling opportunities will be monitored and debt rescheduling will be considered if market conditions mean the difference between premature redemption rates and new borrowing rates are such that it is prudent to do so.

71. If rescheduling was done, it will be reported to the Executive / Audit & Governance Committee at the earliest meeting following its action.

Municipal Bond Agency

72. The establishment of the UK Municipal Bonds Agency was led by the Local Government Association (LGA) following the 2010 Autumn Statement which resulted in higher PWLB rates, greatly increasing the cost of new borrowing and refinancing. The purpose of the Agency is to deliver cheaper capital finance to local authorities. It will do so via periodic bond issues and by facilitating greater inter-authority lending. The Agency is wholly owned by 56 local authorities and the LGA. The Council will make use of this source of borrowing as and when appropriate.

Other borrowing sources

73. Currently the PWLB Certainty Rate is set at gilts + 80 basis points for both HRA and non-HRA borrowing. However, consideration may still need to be given to sourcing funding from other sources such as Local Authorities, Banks and other Financial Institutions. 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

74. The Department of Levelling Up, Housing and Communities (DLUHC) and CIPFA have extended the meaning of ‘investments’ to include both financial and non-financial investments. This report deals solely with financial investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy, (a separate report).

75. The Council's investment policy has regard to the following:

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

76. The Council's investment priorities will be security first, portfolio liquidity second and then yield (return), and finally Ethical, Social & Governance critieria using the FTSE4GOOD index, or any suitable alternative responsible investment index or information to be decided by the S.151 officer, to ensure that Ethical, Social and Governance issues are considered as a fourth critieria.

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

i. 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.

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

iii. 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.

iv. This Council has defined the list of types of investment instruments that the treasury management team are authorised to use. There are two lists in Annex B under the categories of 'specified' and 'non-specified' investments.

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

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

v. Lending limits, (amounts and maturity), for each counterparty will be set through applying the matrix tables in Annex B.

vi. Transaction limits are set for each type of investment (see Annex B).

vii. Investments will only be placed with counterparties from countries with a specified minimum sovereign rating, (see Annex C).

viii. This authority has engaged external consultants, (see paragraphs 21 to 23), 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.

ix. All investments will be denominated in sterling.

x. As a result of the change in accounting standards for 2022/23 under IFRS 9, this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, the Ministry of Housing, Communities and Local Government, (MHCLG), concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years ending 31.3.23).

78. However, this Council will also pursue value for money in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see paragraph 89). Regular monitoring of investment performance will be carried out during the year. In the current economic climate, it is considered appropriate to maintain a degree of liquidity to cover cash flow needs, which may result in lower investment returns due to lower rates being offered for short term investments.

Creditworthiness policy

79. This Council applies the creditworthiness service provided by the Link Group. This service employs a sophisticated modeling approach with credit ratings from the three main credit rating agencies - Fitch, Moody’s

and Standard and Poor’s. The credit ratings of counterparties are supplemented with the following overlays:

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

80. This modelling approach combines credit ratings, credit watches, and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS (Credit Default Swap) spreads for which the end product is a series of colour code bands, which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council to determine the duration for investments. The Council will therefore use counterparties within the following durational bands:

- Yellow 5 years*
- Dark pink 5 years (for Ultra-Short Dated Bond Funds with a credit score of 1.25)
- Light pink 5 years (for Ultra-Short Dated Bond Funds with a credit score of 1.5)
- Purple 2 years
- Blue 1 year (only applies to nationalised or part nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 100 days
- No colour not to be used

**The yellow category is for UK Government debt or its equivalent (government backed securities), and money market funds.*

81. The Link creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue weighting to just one agency’s ratings.

82. Typically the minimum credit ratings criteria the Council use will be a short term rating (Fitch or equivalents) of F1 and Long Term rating A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

83. All credit ratings are monitored on a daily basis. The Council is alerted to changes to ratings of all three agencies through its use of the Link Group creditworthiness service:

- If a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- In addition to the use of credit ratings the Council will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a daily basis by Link. Extreme market movements may result in downgrade of an institution or removal from the Councils lending list.

84. Although sole reliance is not placed on the use of this external service, as the Council uses market data and market information, as well as information on external and government support for banks (and the credit ratings of that supporting government), the suitability of each counterparty is based heavily on advice from Link.
85. Whilst the Council has determined that it will not limit investments to UK banks, due care will be taken to consider the country, group and sector exposure of the Council's investments. The Council has determined that it will only use approved counterparties from countries with a minimum sovereign rating of AA- (excluding the UK) from Fitch (or equivalent). The list of countries that qualify using this credit criteria as at the date of this report are shown in Annex C. This list will be added to or deducted from by officers should ratings change in accordance with this policy.

Investment strategy

86. 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 obtainableby investing for longer periods. While most cash balances are required in order to manage 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.
87. If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments short term or variable. Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.
88. For its cash flow generated balances, the Council will seek to use a combination of business reserve instant access and notice accounts (call accounts), short dated fixed term deposits and Money Market Funds. In addition, the Council will look for investment opportunities in longer dated term deals with specific counterparties that offer enhanced rates for

Local Authority investment. All investment will be undertaken in accordance with the creditworthiness policy set out above.

89. The Council will use an investment benchmark to assess the performance of its investment portfolio of average SONIA (Sterling Overnight Index Average) rate. The benchmark is a simple guide with the purpose to allow officers to monitor the curent and trend position and amend the operational stategy of investments while maintaining compliance with the investment priorities set out in paragraphs 74 - 78.

90. **Prudential indicator 8** - total principal investment funds invested for greater than 364 days. This limits is set with regards to the Council's liquidity requirements and are based on the availability of funds after each year-end. A maximum principal sum to be invested for greater than 364 days is £15m.

	2022/23 Estimate £m	**2023/24 Estimate £m**	**2024/25 Estimate £m**	**2025/26 Estimate £m**	**2026/27 Estimate £m**	**2027/28 Estimate £m**
Maximum limit per year for Investments > 364 days	**15.0**	**15.0**	**15.0**	**15.0**	**15.0**	**15.0**
Current investments as at 31/12/22 in excess of 364 days maturing in each year	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**

Table 10: Investments over 364 days

91. At the end of the financial year, the Council will report on its investment activity as part of its annual treasury report. It should be noted that the Investment policy, creditworthiness policy and investment startegy are applicable to the Council's overall surplus funds and are also applicable to the HRA.

Consultation and options

92. At a strategic level, there are a number of treasury management options available that depend on the Council's stance on interest rate movements. The treasury management function of any business is a highly technical area, where decisions are often taken at very short notice in reaction to the financial markets. Therefore, to enable effective treasury management, all operational decisions are delegated by the Council to the Chief Finance Officer, who operates within the framework set out in this strategy and through the treasury management policies

and practices. In order to inform sound treasury management operations the Council works with its treasury management advisers, the Link Group. Link offers the Council a comprehensive information and advisory service that facilitates the Council in maximising its investment returns and minimise the costs of its debts.

93. Treasury Management strategy and activity is influenced by the capital investment and revenue spending decisions made by the Council. Both the revenue and capital budgets have been through a corporate process of consultation and consideration by the elected politicians. The revenue budget and capital budget proposals are included within this agenda.

Council Plan

94. The Treasury Management Strategy Statement and Prudential Indicators are aimed at ensuring the Council maximises its return on investments and minimises the cost of its debts whilst operating in a financial environment that safeguards the Councils funds. This will allow more resources to be freed up to invest in the Council's priorities, values and imperatives, as set out in the Council Plan.

Implications

Financial

95. The financial implications of the Treasury Strategy are set out in the Financial Strategy and Capital Strategy reports also on this agenda.

Human Resources (HR)

96. There are no HR implications as a result of this report

Equalities

97. There are no equalities implications as a result of this report

Legal Implications

98. Treasury management activities have to conform to the Local Government Act 2003, the Local Authorities (Capital; Finance and Accounting) (England) Regulations 2003 (SI 2003/3146), which specifies that the Council is required to have regard to the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice and also the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 (SI 2008/414), which clarifies the requirements of the Minimum Revenue Provision guidance.

Other implications

99. There are no crime and disorder, information technology or property implications as a result of this report

Risk management

100. The Treasury Management function is a high-risk area because of the volume and level of large money transactions. As a result of this the Local Government Act 2003 (as amended), supporting regulations, the CIPFA Prudential Code and the CIPFA Treasury Management in the Public Services Code of Practice (the code) are all adhered to as required.

<table>
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For further information please contact the author(s) of the report

Background papers

none

Annexes

Annex A – Interest rate forecast
Annex B – Specified and non-specified investments categories schedule
Annex C – Approved countries for investments
Annex D – Scheme of delegation and the role of the Section 151 officer