

# Treasury Management Strategy (TMS) for 2023/24

1. The Local Government Act 2003 (the Act) and supporting regulations require the Council to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.
2. The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy; this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments. There is also the requirement to produce a Capital Strategy – also for determination by full Council.
3. The Treasury Management strategy covers two main areas:
  - (i) Capital issues
    - the capital plans (in summarised form) and the prudential indicators;
    - the Minimum Revenue Provision (MRP) policy.
  - (ii) 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
    - policy on use of external service providers.
4. These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, DLUHC MRP Guidance, the CIPFA Treasury Management Code and DLUHC Investment Guidance.
5. The strategy for 2023/24 in respect of the following aspects of the treasury management function is based upon the Council officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury advisor, Link Group.

## Revisions to the Prudential Code and Treasury Management Code

6. CIPFA published the revised Codes on 20th December 2021 and has stated that revisions need to be included in the reporting framework from the 2023/24 financial year. The Council, therefore, has to have regard to these Codes of Practice when it prepares the Treasury Management Strategy Statement and Annual Investment Strategy, and also related reports during the financial year, which are taken to full Council for approval.
7. The revised Treasury Management Code requires all investments and investment income to be attributed to one of the following three purposes: -

### Treasury management

Arising from the organisation's cash flows or treasury risk management activity, this type of investment represents balances which are only held until the cash is required for use. Treasury investments may also arise from other treasury risk management activity which

seeks to prudently manage the risks, costs or income relating to existing or forecast debt or treasury investments.

### **Service delivery**

Investments held primarily and directly for the delivery of public services including housing, regeneration and local infrastructure. Returns on this category of investment which are funded by borrowing are permitted only in cases where the income is “either related to the financial viability of the project in question or otherwise incidental to the primary purpose”.

### **Commercial return**

Investments held primarily for financial return with no treasury management or direct service provision purpose. Risks on such investments should be proportionate to an authority’s financial capacity – i.e., that ‘plausible losses’ could be absorbed in budgets or reserves without unmanageable detriment to local services. An authority must not borrow to invest primarily for financial return.

8. The revised Treasury Management Code will requires an authority to implement the following: -
  1. **Adopt a new liability benchmark treasury indicator** to support the financing risk management of the capital financing requirement; this is to be shown in chart form for a minimum of ten years, with material differences between the liability benchmark and actual loans to be explained;
  2. **Long-term treasury investments**, (including pooled funds), are to be classed as commercial investments unless justified by a cash flow business case;
  3. **Pooled funds** are to be included in the indicator for principal sums maturing in years beyond the initial budget year;
  4. Amendment to the **knowledge and skills register** for officers and members involved in the treasury management function - to be proportionate to the size and complexity of the treasury management conducted by each authority;
  5. **Reporting to members is to be done quarterly**. Specifically, the Chief Finance Officer (CFO) is required to establish procedures to monitor and report performance against all forward-looking prudential indicators at least quarterly. The CFO is expected to establish a measurement and reporting process that highlights significant actual or forecast deviations from the approved indicators. However, monitoring of prudential indicators, including forecast debt and investments, is not required to be taken to full Council and should be reported as part of the authority’s integrated revenue, capital and balance sheet monitoring;
  6. **Environmental, social and governance (ESG)** issues to be addressed within an authority’s treasury management policies and practices (TMP1).
9. The main requirements of the Prudential Code relating to service and commercial investments are: -
  1. The risks associated with service and commercial investments should be proportionate to their financial capacity – i.e. that plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services;
  2. An authority must not borrow to invest for the primary purpose of commercial return;

3. It is not prudent for local authorities to make any investment or spending decision that will increase the CFR, and so may lead to new borrowing, unless directly and primarily related to the functions of the authority, and where any commercial returns are either related to the financial viability of the project in question or otherwise incidental to the primary purpose;
  4. An annual review should be conducted to evaluate whether commercial investments should be sold to release funds to finance new capital expenditure or refinance maturing debt;
  5. A prudential indicator is required for the net income from commercial and service investments as a proportion of the net revenue stream;
  6. Create new Investment Management Practices to manage risks associated with non-treasury investments, (similar to the current Treasury Management Practices).
10. An authority's Capital Strategy or Annual Investment Strategy should include: -
1. The authority's approach to investments for service or commercial purposes (together referred to as non-treasury investments), including defining the authority's objectives, risk appetite and risk management in respect of these investments, and processes ensuring effective due diligence;
  2. An assessment of affordability, prudence and proportionality in respect of the authority's overall financial capacity (i.e. whether plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services);
  3. Details of financial and other risks of undertaking investments for service or commercial purposes and how these are managed;
  4. Limits on total investments for service purposes and for commercial purposes respectively (consistent with any limits required by other statutory guidance on investments);
  5. Requirements for independent and expert advice and scrutiny arrangements (while business cases may provide some of this material, the information contained in them will need to be periodically re-evaluated to inform the authority's overall strategy);
  6. State compliance with paragraph 51 of the Prudential Code in relation to investments for commercial purposes, in particular the requirement that an authority must not borrow to invest primarily for financial return;
11. As this Treasury Management Strategy Statement and Annual Investment Strategy deals solely with treasury management investments, the categories of service delivery and commercial investments should be addressed as part of the Capital Strategy report.

## Background

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

13. The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning, to ensure that 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.
14. 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.
15. CIPFA defines treasury management as:
 

*“The management of the local authority’s borrowing, investments and cash flows, including 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.”*
16. 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

17. 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 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.
18. The aim of the strategy is to ensure that all the councils's elected members fully understand the overall long-term policy objectives and resulting Capital Strategy requirements, governance procedures and risk appetite.

### Treasury Management Reporting

19. The Council is currently required to receive and approve, as a minimum, three main treasury reports each year, which incorporate a variety of policies, estimates and actuals.
  - a. **Prudential and treasury indicators and treasury strategy** (this report) - The first, and most important report is forward looking and covers: -
    - the capital plans, (including prudential indicators)
    - a minimum revenue provision (MRP) policy, (how residual capital expenditure is charged to revenue over time)
    - the Treasury Management Strategy, (how the investments and 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 the Council will report performance against all forward-looking prudential indicators quarterly as part of the quartely budget monitoring process.
  - 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.
20. The above reports are required to be adequately scrutinised before being recommended to the full Council. This role is undertaken by the Audit Committee.
  21. Quarterly reports – In addition to the three major reports detailed above, from 2023/24 quarterly reporting (end of June/end of December) is also required. However, these additional reports do not have to be reported to full Council but do require to be adequately scrutinised. This role is undertaken by the Overview & Scrutiny Committee.

### **Key Notes to the Strategy**

22. The key notes and changes from the previous year's strategy are:
  1. The Council has not taken on any additional external borrowing in the last 12 months. The level of capital expenditure has been lower than forecast as a result of slippage in the capital programme and borrowing has remained well within the operational and authorised boundaries.
 

The Capital expenditure plans of the Council are expected to involve more borrowing again in 2023/24 and the years ahead. The borrowing limits proposed in the strategy have been increased to allow for the additional capital expenditure expected. If the business plans for the Town Deal projects involve additional borrowing by the council these limits will need to be reviewed and increased further.
  2. The majority of the new borrowing in future years will be for Capital purposes, but there will inevitably continue to be a smaller requirement for loans that are revenue in nature – to cover potential short term cash deficits. Such monies cannot be borrowed from the Public Works Loan Board, and will be financed from the market or where there are revenue loans made e.g. to the housing company then from existing Council reserves.
  3. The Council is required to make a Minimum Revenue Provision in respect of its borrowing – to ensure debt is repaid over an appropriate period. Where the Council is making significant investments in property, housing or other programmes the Council's MRP policy enables the Council to match the principal repayments made on loans arranged with a near equal MRP payment (an annuity methodology).
  4. Investment returns are increasing as the bank base rate is increasing rapidly. The investing environment remains uncertain. The overall cash returns are expected to decrease as the Council's reserves decline.
  5. The Council invested some £5m of its reserves in longer period investments e.g. Property Fund, Diversified Investment fund. There are no proposals to invest more

monies for potentially longer periods given the further potential calls on reserves. The monies in these funds can still be obtained quickly should the need arise.

### **Balanced Budget**

23. It is a statutory requirement under the Local Government Finance Act 1992, for the Council to calculate its Council Tax requirement. In particular, Section 31 requires a local authority in calculating the Council Tax requirement for each financial year to include the revenue costs that flow from capital financing decisions. Thus, any increases in costs (running costs & borrowing costs) from new capital projects must be limited to a level which is affordable within the projected income of the Council for the foreseeable future.

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

24. This topic is becoming a more commonplace discussion within the wider investment community, including Local Authorities. While around two thirds of councils have declared a “climate emergency” to date, this has not translated into the incorporation of something more formal within their treasury-related Annual Investment Strategy. Changes to the CIPFA TM Code 2021 will see ESG incorporated into Treasury Management Practice 1. The following wording (page 18 of the Treasury Management Code) suggests the scope of what is included: “The organisation’s credit and counterparty policies should set out its policy and practices relating to environmental, social and governance (ESG) investment considerations. This is a developing area, and it is not implied that the organisation’s ESG policy will currently include ESG scoring or other real-time ESG criteria at individual investment level.”
25. Furthermore, page 50 of the Treasury Management Code states “ESG issues are increasingly significant for investors and investment managers. This is better developed in equity and bond markets than for short-term cash deposits, and there is a diversity of market approaches to ESG classification and analysis. This means that a consistent and developed approach to ESG for public service organisations is currently difficult. Organisations are therefore recommended to consider their credit and counterparty policies in light of ESG information and develop their own ESG investment policies and treasury management practices consistent with their organisation’s own relevant policies, such as environmental and climate change policies.”
26. The most important issue is ensuring that there is a clear understanding of what “environmental, social and governance (ESG)” investment considerations means. It is about understanding the ESG “risks” that an entity is exposed to and evaluating how well it manages these risks, (all entities will be subject to these to one extent or other). It is NOT the same as Socially Responsible Investing, (typically where you apply negative screens), and equally, it is NOT the same as Sustainable Investing, (investing in products / companies based on expected sustainable and beneficial societal impact, alongside a financial return).
27. There is such a huge potential for misunderstanding which could have material unintended consequence i.e., limiting of potential counterparty options, thus decreasing diversification. The above could then lead to authorities widening credit criteria to take on more names, or those with a stronger “ESG” performance, which could then increase credit risk...which would place the cornerstone of prudent investing at risk.
28. The other factor, i.e., what local authorities can or already do to take this into account, is credit ratings. All the main agencies are now extolling how they incorporate ESG risks alongside more traditional financial risk metrics when assessing counterparty ratings. As such, you could argue that their incorporation is already being done, to an extent, by the use of mainstream rating agencies.

29. Also, a final note to point out is that given ESG risks are all about potential impact on entity enterprise value; the “G” is by far the most important one when considering treasury investments, the majority of which will be shorter-term in nature. This is because poor governance can have a more immediate impact on the financial circumstances of an entity and the potential for a default event that would impact the amount the local authorities receive back from their investments. Those financial institutions that are viewed as having poor/weak corporate governance are generally less well rated in the first instance or have a higher propensity for being subject to negative rating action. So, this element of ESG is of high importance to an investor that is following investment guidance with the security, liquidity and yield (SLY) principle at its core. Environmental & Social factors are also important, but more for the long-term impact, unless you are specifically going down the “impact” / “sustainable” type investment route...and there are not many options for that in respect of short-term investments.

## **PRUDENTIAL AND TREASURY LIMITS FOR 2023/24 TO 2025/26**

### **The Council’s Capital Position (Prudential Indicators)**

30. 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.
31. The prudential code requires the local authority to identify prudential indicators that enable members, officers and the public to make a meaningful judgement on the Council’s total exposure from borrowing and investment decisions. The indicators are required to cover both the Council’s current position and the expected position assuming all planned investments in the forthcoming years are completed.
32. This part of the report is structured to update:
- The Council’s capital expenditure plans;
  - How these plans are being financed;
  - The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
  - Reviewing the limits in place for borrowing activity.

### **Prudential Indicator for Capital Expenditure**

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

	<b>Actual 2021/22 £'000s</b>	<b>Budget 2022/23 £'000s</b>	<b>Forecast 2022/23 £'000s</b>	<b>Budget 2023/24 £'000s</b>	<b>Budget 2024/25 £'000s</b>	<b>Budget 2025/26 £'000s</b>
<b>Capital Expenditure</b>	<b>4,614</b>	<b>21,746</b>	<b>16,879</b>	<b>31,322</b>	<b>15,324</b>	<b>2,591</b>
<b>Financed by:</b>						
Capital receipts	60	5,500	5,500	50	50	50
Capital grants	3,192	6,930	9,693	5,533	3,803	2,056
Reserves	407	0	0	0	0	0
Revenue	0	0	0	0	0	0
<b>Borrowing</b>	<b>955</b>	<b>9,316</b>	<b>1,686</b>	<b>25,739</b>	<b>11,471</b>	<b>485</b>

### Capital Expenditure – Financing

34. The table above summarises the capital expenditure plans and how these plans are being financed – either by own resources e.g. Section 106, Capital receipts or through borrowing. New Capital schemes will generally be financed by borrowing, unless Capital receipts from the sale of assets are available. If capital receipts can be generated from asset sales the amount of borrowing shown above may decrease.
35. The schemes in the capital programme which are expected to require financing (at least in part) from borrowing in 2023/24 are:
- Cornwallis Street Development (£8.4m)
  - Housing Acquisition Programme 50 units of Temporary Accommodation (£5.9m)
  - Mayfield E – Housing (£4.5m)
  - Bexhill Road South (£2.5m)
  - Energy – Unallocated (£2.3m)
  - Cliff Railways (£1m)
  - Annual programme of roof refurbishment (£700k)
  - Grounds Maintenance Equipment (£626k)
  - Energy – Solar Panels (£500k)
  - Priory Meadow Contribution to Capital Works (£288k)
  - Restoration of Pelham Crescent / Pelham Arcade (£350k)
  - Conversion of 12-13 York Buildings (£74k)
  - Groyne Refurbishment (£35k)

### Impact on the prudential indicators

36. The treasury indicators for borrowing activity are the **Authorised Limit** and the **Operational Boundary** for external debt.



The **Authorised Limit**, which is a limit beyond which external debt is prohibited, needs to be set or revised by the full Council; it is a statutory duty under Section 3 (1) of the Local Government Act 2003 and supporting regulations. It reflects the level of borrowing which, while not desired, could be afforded in the short term. It is the expected maximum borrowing need with some headroom for unexpected movements.

<b>Authorised Limit</b>	<b>2021/22</b>	<b>2022/23</b>	<b>2023/24</b>	<b>2024/25</b>	<b>2025/26</b>
	£'000	£'000	£'000	£'000	£'000
Debt	110,000	110,000	135,000	135,000	135,000
Other long term liabilities	5,000	5,000	5,000	5,000	5,000
<b>TOTAL</b>	<b>115,000</b>	<b>115,000</b>	<b>140,000</b>	<b>140,000</b>	<b>140,000</b>

The **Operational Boundary** is the limit beyond which external debt is not normally expected to exceed.

<b>Operational Boundary</b>	<b>2021/22</b>	<b>2022/23</b>	<b>2023/24</b>	<b>2024/25</b>	<b>2025/26</b>
	£'000	£'000	£'000	£'000	£'000
Debt	105,000	105,000	130,000	130,000	130,000
Other long term liabilities	5,000	5,000	5,000	5,000	5,000
<b>TOTAL</b>	<b>110,000</b>	<b>110,000</b>	<b>135,000</b>	<b>135,000</b>	<b>135,000</b>

37. Essentially the Council is required to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future Council Tax levels is 'acceptable'.
38. Whilst termed an "Affordable Borrowing Limit", the capital plans to be considered for inclusion in the Capital programme incorporate financing by both external borrowing as well as other forms of liability e.g. Credit arrangements (such as leases).
39. The Authorised Limit and Operational Boundary are to be set, on a rolling basis, for the forthcoming financial year and two successive financial years by full Council as part of this strategy.
40. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.
41. Given the current level of capital expenditure plans for the years ahead it is recommended that the limits are each increased by £25m to allow sufficient headroom for our capital aspirations.

## **PROSPECTS FOR INTEREST RATES**

42. The Council has appointed Link Group, Link Treasury Services Limited as its external treasury management advisor. Part of their service is to assist the Council to formulate a view on interest rates. Link provided the following forecasts on 19/12/2022. These are forecasts for certainty rates, gilt yields plus 80 bps. The table below provides an overview (please also see Appendix 2).

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

43. Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.
44. The central forecast reflects a view that the MPC will be keen to demonstrate its anti-inflation credentials by delivering a succession of rate increases. This has happened throughout 2022, but the new Government's policy of emphasising fiscal rectitude will probably mean Bank Rate does not now need to increase to further than 4.5%.
45. Further down the road, we anticipate the Bank of England will be keen to loosen monetary policy when the worst of the inflationary pressures have lessened – but that timing will be one of fine judgment: cut too soon, and inflationary pressures may well build up further; cut too late and any downturn or recession may be prolonged.
46. The CPI measure of inflation will peak at close to 11% in Q4 2022. Despite the cost-of-living squeeze that is still taking shape, the Bank will want to see evidence that wages are not spiralling upwards in what is evidently a very tight labour market. Wage increases, excluding bonuses, are currently running at 5.7%.
47. Regarding the plan to sell £10bn of gilts back into the market each quarter (Quantitative Tightening), this has started but will focus on the short to medium end of the curve for the present. This approach will prevent any further disruption to the longer end of the curve following on from the short-lived effects of the Truss/Kwarteng unfunded dash for growth policy.
48. In the upcoming months, our forecasts will be guided not only by economic data releases and clarifications from the MPC over its monetary policies and the Government over its fiscal policies, but the on-going conflict between Russia and Ukraine. More recently, the heightened tensions between China/Taiwan/US also have the potential to have a wider and negative economic impact.
49. On the positive side, consumers are still estimated to be sitting on over £160bn of excess savings left over from the pandemic so that will cushion some of the impact of the above challenges. However, most of those are held by more affluent people whereas lower income families already spend nearly all their income on essentials such as food, energy and rent/mortgage payments.
50. An economic review from the Council's treasury advisors is included in Appendix 3. Such forecasts are being kept under regular review.

## **Public Works Loan Board (PWLB) Rates**

51. Yield curve movements have become less volatile under the Sunak/Hunt government. PWLB 5 to 50 years Certainty Rates are, generally, in the range of 3.75% to 4.50%. The medium to longer part of the yield curve is currently inverted (yields are lower at the longer end of the yield curve compared to the short to medium end).
52. Link Group view the markets as having built in, already, nearly all the effects on gilt yields of the likely increases in Bank Rate and the poor inflation outlook but markets are volatile and further whipsawing of gilt yields across the whole spectrum of the curve is possible.

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

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

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

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

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

- The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly and for a longer period within the UK economy, which then necessitates an even more rapid series of increases in Bank Rate faster than we currently expect.
- The Government acts too slowly to increase taxes and/or cut expenditure to balance the public finances, in the light of the cost-of-living squeeze.
- The pound weakens because of a lack of confidence in the UK Government's fiscal policies, resulting in investors pricing in a risk premium for holding UK sovereign debt.
- Longer term US treasury yields rise strongly, if inflation numbers disappoint on the upside, and pull gilt yields up higher than currently forecast.

54. **Borrowing advice from Link Group:** Our long-term (beyond 10 years) forecast for Bank Rate stands at 2.5%. As all PWLB certainty rates are now above this level, borrowing strategies will need to be reviewed in that context. Better value can generally be obtained at the shorter end of the curve and short-dated fixed LA to LA monies should be considered. Temporary borrowing rates are likely, however, to remain near Bank Rate and may also prove attractive whilst the market waits for inflation, and therein gilt yields, to drop back later in 2023.
55. Link Group's suggested budgeted earnings rates for investments up to about three months' duration in each financial year are as follows: -

Average earnings in each year	
2022/23 (remainder)	3.95%
2023/24	4.40%
2024/25	3.30%
2025/26	2.60%
2026/27	2.50%
Years 6 to 10	2.80%
Years 10+	2.80%

56. As there are so many variables at this time, caution must be exercised in respect of all interest rate forecasts.
57. Link Group's interest rate forecast for Bank Rate is in steps of 25 bps, whereas PWLB forecasts have been rounded to the nearest 10 bps and are central forecasts within bands of + / - 25 bps. Naturally, Link Group continue to monitor events and will update their forecasts as and when appropriate.

## BORROWING STRATEGY

58. The capital expenditure plans set out in the budget provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities.

## Current Portfolio Position

59. The Council's forecast debt position for 31 March 2023, if no further borrowing is taken for the rest of the financial year, as at 12 January 2023, amounted to £65.4m (See Table 1 below).

**Table 1 - Borrowing**

Debt	1 April 2022 Principal	Start Date	Maturity Date	31 March 2023 Principal	Rate
PWLB	£7,500,000	25/05/2007	01/02/2033	£7,500,000	4.80%
PWLB	£909,027	04/09/2014	02/09/2044	£909,027	3.78%
PWLB (Optivo)	£1,788,235	04/09/2014	02/09/2044	£1,788,235	3.78%
PWLB (FT) (Annuity)	£125,981	21/03/2016	20/03/2026	£95,262	1.66%
PWLB	£1,000,000	11/05/2016	11/05/2056	£1,000,000	2.92%
PWLB	£1,000,000	11/05/2016	11/05/2046	£1,000,000	3.08%
PWLB	£1,000,000	11/05/2016	11/05/2036	£1,000,000	3.01%
PWLB	£1,000,000	11/05/2016	11/05/2026	£1,000,000	2.30%
PWLB	£2,000,000	24/06/2016	24/06/2054	£2,000,000	2.80%
PWLB	£1,000,000	24/06/2016	24/06/2028	£1,000,000	2.42%
PWLB	£2,000,000	21/03/2017	21/03/2057	£2,000,000	2.53%
PWLB	£2,000,000	21/03/2017	19/09/2059	£2,000,000	2.50%
PWLB	£2,000,000	23/03/2017	23/03/2060	£2,000,000	2.48%
PWLB (Annuity)	£6,772,356	01/06/2017	01/06/2057	£6,652,722	2.53%
PWLB (Annuity)	£7,860,481	22/11/2017	22/11/2057	£7,729,610	2.72%
PWLB	£2,000,000	12/12/2018	12/06/2028	£2,000,000	1.98%
PWLB (Annuity)	£3,820,026	13/12/2018	13/12/2058	£3,756,930	2.55%
PWLB (Annuity)	£2,387,758	31/01/2019	31/01/2059	£2,348,400	2.56%
PWLB (Annuity)	£4,273,795	31/01/2019	31/01/2069	£4,226,034	2.56%
PWLB (Annuity)	£8,976,150	20/03/2019	20/03/2059	£8,827,583	2.54%
PWLB (Annuity)	£4,649,533	02/09/2019	02/09/2069	£4,587,401	1.83%
PWLB	£2,000,000	13/01/2022	13/01/2062	£2,000,000	1.89%
<b>Total Debt</b>	<b>£66,063,342</b>			<b>£65,421,204</b>	<b>2.81%</b>

60. The Council has loaned money to four other organisations. Six longer-term loans are outstanding. Namely:

**Table 2 - Loans to Other Organisations**

3rd Party Organisations	Rate/Return (%)	Start Date	End Date	Principal Outstanding as at 31/03/2023 £	Type
Amicus /Optivo	3.78%	04/09/2014	02/09/2044	£1,788,235	Maturity
The Foreshore Trust	1.66%	21/03/2016	20/03/2026	£95,262	Annuity
The Source	2.43%	17/12/2015	17/12/2025	£8,144	Annuity
			<b>Sub-Total</b>	<b>£1,891,641</b>	
<b>Hastings Housing Company</b>					
Hastings Housing Company - Loan 1	4.48%	28/02/2018	28/02/2058	£784,676	Maturity
Hastings Housing Company - Loan 2	4.84%	12/02/2019	12/02/2059	£344,810	Maturity
Hastings Housing Company - Loan 3	4.84%	13/06/2019	13/06/2059	£4,359,912	Maturity
			<b>Sub-Total</b>	<b>£5,489,398</b>	
			<b>Total</b>	<b>£7,381,039</b>	

61. Borrowing from the PWLB was taken to fund the Amicus Horizon (now Optivo) loan (£1,788,235 - maturity loan) and the loan to the Foreshore Trust (£300,000 originally

borrowed – annuity loan); these correspond to PWLB loans in Table 1 above. The £25,000 loan to the Source is repayable over a 10 year period and is financed from HBC reserves.

62. Borrowing from the PWLB was taken to fund the loans to Hastings Housing Company Ltd (HHC). The three loans, totalling £5,489,398, are maturity loans and will be due for repayment by HHC at the end of their term.

### **Borrowing Limit – Capital Financing Requirement (CFR)**

63. 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 Council's underlying borrowing need. Any capital expenditure which has not been funded from grants, revenue, reserves or capital receipts will increase the CFR.
64. The Council has at the time of writing some £65.4m of PWLB debt. To borrow for the remainder of the 2022/23 capital programme i.e. up to the projected level of the CFR (£78.2m) it would need to borrow a further £12.8m by the end of March 2023. The Capital Financing Requirement has increased significantly over the last few years. It is expected to reach some £110.3m by 2024/25 (based on the capital programme).
65. As a key indicator the Council needs to ensure that its 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 2022/23 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.
66. The Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision (MRP), to reduce the CFR. This is effectively a repayment of the borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.
67. The total CFR can also be reduced by:
- (i) the application of additional capital financing resources (such as unapplied capital receipts); or
  - (ii) charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).
68. The Council had achieved a near fully funded position at the start of 2020/21 which put the Council in a good position when the pandemic hit. This means that the capital borrowing need (the Capital Financing Requirement), has been fully funded with loan debt. This strategy had been considered prudent as borrowing costs had been increasing. However, there is a cost of doing this as investment returns are

low compared to borrowing costs and counterparty risk is still an issue that needs to be considered.

69. However during 2020/21 and much of 2021/22, interest rates looked set to remain low for a period of time and thus there was a stronger case to not borrow externally until we really had to i.e. temporarily use existing resources. This was the strategy that was proposed for 2021/22 (as far as practical) and has saved on borrowing costs and assisted the Council's revenue account. There is however only a limited ability to do this given the depletion of Council reserves, and funds already invested for longer periods.
70. For 2021/22 the Council started the year with internal borrowing of £7.994m - cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure to fund the Capital expenditure. With interest rates now increasing and forecast to increase further over the coming years, the Council will need to externalise some of this internal borrowing. This process has already begun with the Council taking a new £2m, 40 year maturity loan from the PWLB on 13<sup>th</sup> January 2022. The rapid rate of the rise of interest rates during 2022 has caught the Council somewhat off guard with the potential cost of borrowing now jeopardising some capital schemes.
71. To finance the future Capital programme will require substantial new borrowing by the Council. The key considerations are when to borrow and the level of internal borrowing. The Chief Finance Officer will make these decisions in conjunction with advice and guidance from our treasury advisors. Current guidance suggest that interest rates will peak in December 2023 so the strategy will be looking at utilising internal borrowing as much as possible to see us through until the expected lower rate environment. Where borrowing is required the option of borrowing short-term will be considered rather than locking into higher rates for a prolonged period. Some longer term borrowing will be required and will be encouraged where affordable as it reduced the risk of future adverse movements in interest rates.

The table below provides an estimate of the Council's Capital Financing Requirement (CFR) for the current and next 3 years.

**Table 3 - Capital Financing Requirement (CFR)**

CFR	2021/22 (unaudited) £'000s	2022/23 (Estimate) £'000s	2023/24 (Estimate) £'000s	2024/25 (Estimate) £'000s	2025/26 (Estimate) £'000s
CFR-Opening	72,683	71,970	72,737	97,512	107,816
Less MRP	(1,668)	(919)	(964)	(1,168)	(1,287)
Plus New Borrowing	955	1,686	25,739	11,471	485
<b>CFR Closing</b>	<b>71,970</b>	<b>72,737</b>	<b>97,512</b>	<b>107,816</b>	<b>107,014</b>

72. The table below highlights the Council's projected gross borrowing position against the CFR (showing the level that is financed from internal borrowing).

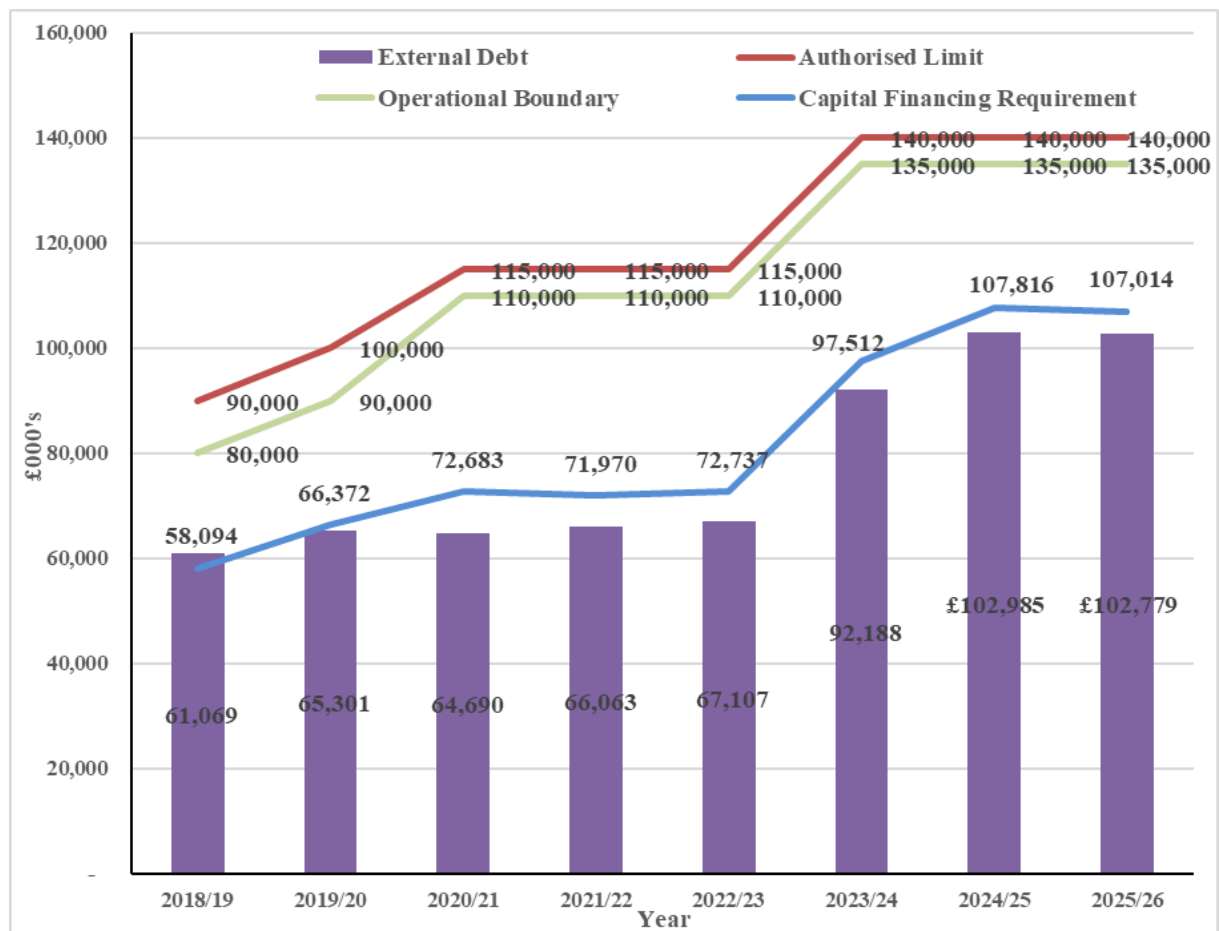
**Table 4 - Council's Projected Gross Borrowing Position Against the CFR**

Internal Borrowing	2020/21 Actual £000's	2021/22 Actual £000's	2022/23 Estimate £000's	2023/24 Estimate £000's	2024/25 Estimate £000's	2025/26 Estimate £000's
Capital Financing Requirement (CFR)	72,683	71,970	72,737	97,512	107,816	107,014
External Borrowing	64,690	66,063	67,107	92,188	102,985	107,014
<b>Net Internal Borrowing</b>	<b>7,994</b>	<b>5,907</b>	<b>5,630</b>	<b>5,324</b>	<b>4,831</b>	<b>0</b>

73. The Council is now (20 January 2023) maintaining an under-borrowed position.

Borrowing activity is constrained by prudential indicators particularly the CFR, and by the authorised limit. The Council's long term borrowing must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure.

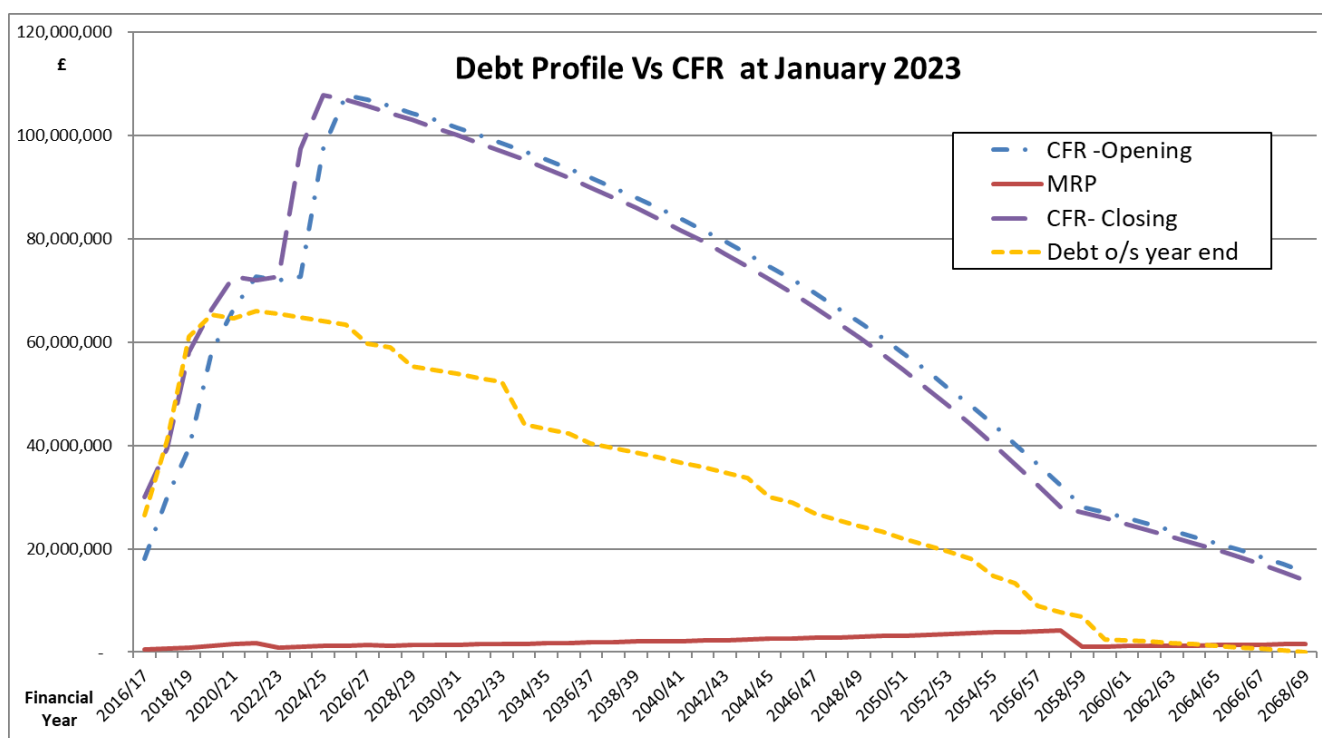
**Table 5 - External Debt, Authorised Limits and CFR Projections**



**Debt Profile and CFR**

74. The graph below shows how the CFR (blue and purple lines) reduce over time as MRP payments are made. The yellow line shows the level of external debts reducing as principal repayments are made (see debt maturity graph below).





75. The graph above is based on the current known capital programme up to 2025/26. If further capital expenditure is finance by borrowing, which is highly likely, then this will push the trajectory of the graph out into further years and increase future MRP payment.

### Liability Benchmark

76. A third and new prudential indicator for 2023/24 is the Liability Benchmark (LB). The Authority is required to estimate and measure the LB for the forthcoming financial year and the following two financial years, as a minimum, however CIPFA strongly recommends that the LB is produced for at least 10 years and should ideally cover the full debt maturity profile of the local authority.

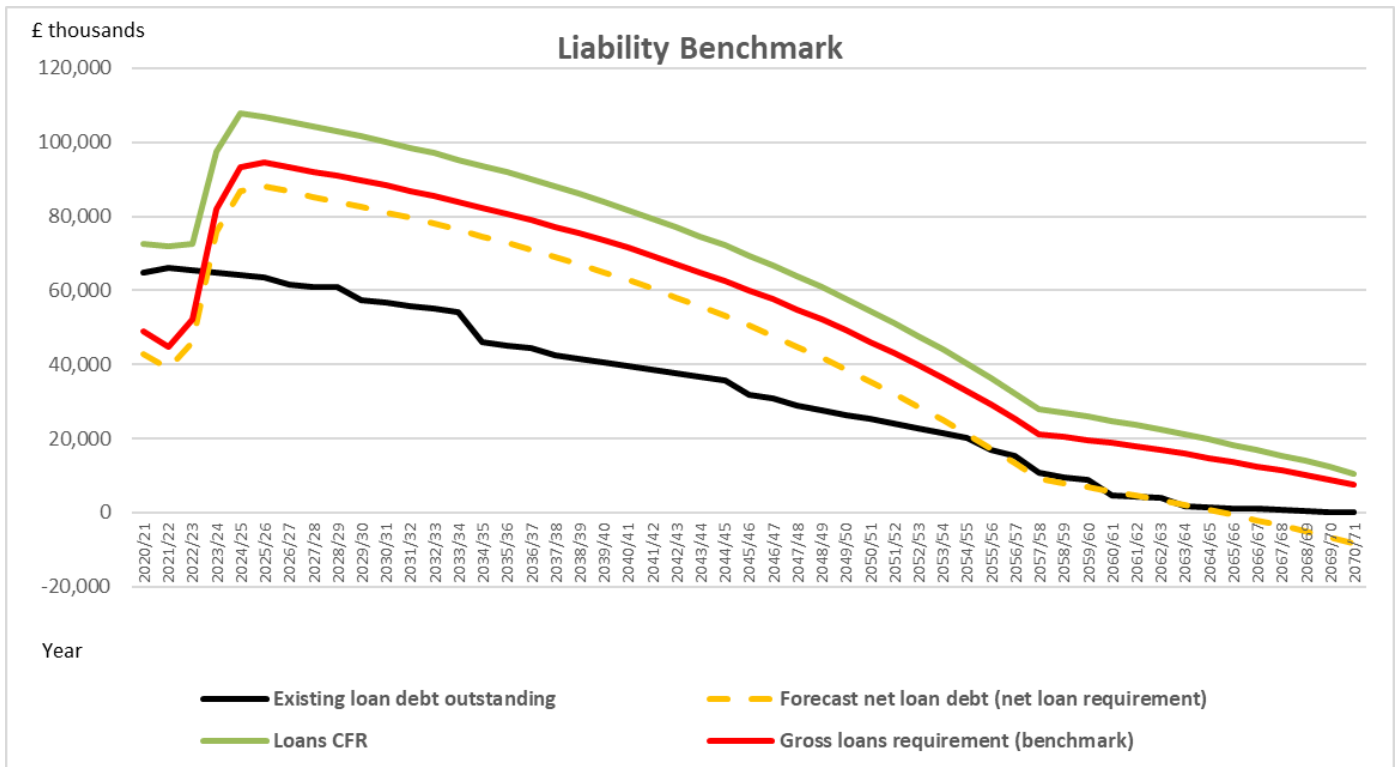
77. There are four components to the LB:

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

78. CIPFA notes on page 13 of the 2021 TM Code: “The liability benchmark should be analysed as part of the annual treasury management strategy, and any substantial

mismatches between actual loan debt outstanding and the liability benchmark should be explained. Any years where actual loans are less than the benchmark indicate a future borrowing requirement; any years where actual loans outstanding exceed the benchmark represent an overborrowed position, which will result in excess cash requiring investment (unless any currently unknown future borrowing plans increase the benchmark loan debt requirement). The treasury strategy should explain how the treasury risks inherent in these mismatched positions will be managed.”

79. The Liability Benchmark for the Council is shown in the chart below.



80. Some analysis on the lines on the chart above is provided below:

- Existing Loan Debt Outstanding (black line) – The line shows the external loans that the Council has with the PWLB and how the value decreases over time as the principal is repaid.
- Loans CFR (green line) – This line shows the Capital Financing Requirement for the Council. The line decreases as annual MRP payments are made.
- Net Loan Debt (yellow dotted line) – This line shows the Council’s debt (CFR) less the value of any external investments it has made i.e. the net debt. You can see that in 2065/66 the line goes below zero and becomes negative. This is because the value of external investments the council is forecasting to be holding is greater than the level of debt that the council has.
- Gross loans requirement (red line) – this line very closely mirrors the Net Loan Debt (yellow dotted) line. It essentially shows the same thing but with an added liquidity allowance – essentially a working balance for the council’s treasury activities. This level has been set at £6m to match the council’s

minimum recommended level of reserves (but in the chart has been inflated by 2% annually so that it maintains its value in real terms).

81. It should be noted that the Libality Benchmark is only a snapshot in time and as capital expenditure plans evolve further borrowing is likely to be incurred which will increase the CFR and push the point at which the lines move towards zero further out into future years.

### **Borrowing – Overall Limits**

82. In determining what is a prudent level of borrowing, the Council needs to ensure that it would still be able to provide core services if its investments or income generating initiatives failed – at least in part. As a guide each £1m of new borrowing, financing an asset with a life of 50 years would currently cost the Council some 5.5% p.a. (based on an annuity loan with a 5% interest rate) i.e. £55,000 p.a.
83. In taking on significant levels of additional debt the Council has to ensure that it can afford to do so. It also needs to ensure that it has an affordable exit strategy in the event that expected returns are not realised. Where property is concerned there is normally an asset to dispose of and such schemes are not therefore at the higher end of the risk spectrum. It is considered that the Council currently has sufficient reserves to ensure that it could dispose of assets in a reasonable period and not be forced into an immediate fire sale. In the event that property values fell by say 20% the Council would not be forced to sell assets providing the rental streams were secure.

### **Borrowing – Certainty Rate**

84. The Council again registered for the PWLB certainty rate earlier in the year which has given a 20 basis point reduction in the average rate of borrowing. The Council will look to do so again annually – for as long as it remains available.

### **Borrowing – Change of Sentiment**

85. In normal circumstances the main sensitivities of the forecast are likely to be the two scenarios noted below. The Chief Finance Officer, in conjunction with the treasury advisors, will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a change of sentiment:
- a. if it were felt that there was a significant risk of a sharp FALL in long and short term rates, e.g. due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.
  - b. if it were felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still relatively cheap.

### **Borrowing – Timing**

86. The general aim of this treasury management strategy is to minimise the costs of borrowing in both the short and longer term. In the short term it can consider avoiding new borrowing and using cash balances to finance new borrowing (internal borrowing). However, to minimise longer term costs it needs to borrow when rates are at lower levels. The timing of new borrowing is therefore important to minimise the overall costs to the Council.
87. The Council has previously sought to achieve near full financing of the Capital programme via external debt over recent years in order to take advantage of the historically low borrowing rates and avoid the risk of having to lock into high interest rates when it has no option but to borrow. For the last year a higher level of internal borrowing was adopted to temporarily finance long life assets. Currently, with interest rates looking likely to increase further the Council is considering externalising some of the internal debt to lock in rates at lower levels.
88. Given that the Council is increasingly using its reserves these need to be readily available and not subjected to unnecessary risk or exposure.

### **Summary**

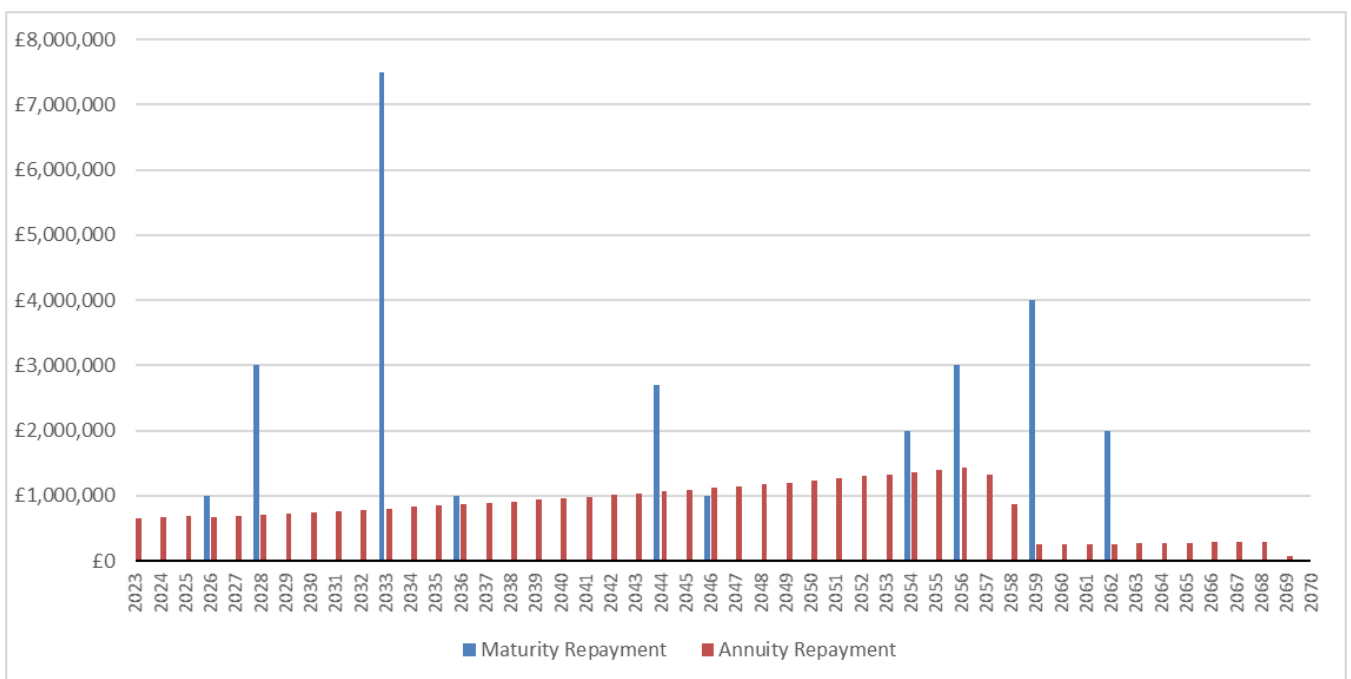
89. No new external borrowing has been taken over the last 12 months but instead the council has been utilising internal borrowing to minimise interest costs.
90. The capital expenditure plans require further substantial new borrowing by the Council. The plans play a large part in the consideration as to when to borrow and the level of internal borrowing. The Council has taken advantage of other investment opportunities which have been providing higher returns than the cost of borrowing e.g. property funds. To date the Council has increased the level of internal funding in order to save on interest payments as the cost of these exceeds returns that can be achieved by investing surplus funds in the short term.
91. For the last few years the cheapest borrowing has been internal borrowing by running down cash balances and foregoing interest earned at historically low rates. However, the Council may not have sufficient balances to temporarily finance all the capital expenditure in 2022/23 and may need to borrow before March 2023. In view of the overall forecast for long term borrowing rates to increase in the medium term, consideration has been given to weighing the short term advantage of internal borrowing against the potential increase in long term costs as rates rise. As such additional new borrowing will continue to be taken when good opportunities arise in the interest of minimising the costs of debt over the long term.
92. The use of PWLB variable rate loans for up to 10 years will still be considered as they can be repaid early without early redemption premiums. They can also be converted into longer dated fixed rate debt should it be considered prudent to do so.
93. The use of fixed rate market loans will also be considered should rates be below PWLB rates for the equivalent maturity period. The use of either PWLB maturity or annuity loans will be considered in order to minimise annual borrowing costs.

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

94. 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 considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds.
95. In determining whether borrowing will be undertaken in advance the Council will:
- ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance.
  - ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered.
  - evaluate the economic and market factors that might influence the manner and timing of any decision to borrow.
  - consider the merits and demerits of alternative forms of funding.
  - consider the appropriate funding period.
  - consider the impact of borrowing in advance on temporarily (until required to finance capital expenditure) increasing investment cash balances and the consequent increase in exposure to counterparty risk, and the level of such risks given the controls in place to minimise them.
96. 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 Maturity

97. The Graph below shows the profile of when debt (loans from the PWLB) become repayable. Blue lines indicate maturity loans and red lines indicate annuity loans.



98. The Council will need to carefully consider the structure and timing of any new borrowing to ensure debt does not exceed the CFR in the years ahead.

### **Debt Rescheduling**

99. The Council also keeps under review the potential for making premature debt repayments in order to reduce borrowing costs as well as reducing counterparty risk by reducing investment balances. However, the cost of the early repayment premiums that would be incurred and the increase in risk exposure to significantly higher interest rates for new borrowing, continue to make this option unattractive. No debt rescheduling is being contemplated at present.
100. The reasons for any rescheduling to take place will include:
- a. the generation of cash savings and / or discounted cash flow savings,
  - b. helping to fulfil the strategy outlined above
  - c. enhancing the balance of the portfolio (amend the maturity profile and/or the balance of volatility).
101. If rescheduling is to be undertaken, it will be reported to the Audit Committee and Cabinet, at the earliest meeting following its action.

### **Other Source of Borrowing**

102. Currently the PWLB Certainty Rate is set at gilts + 80 basis points. However, consideration may still need to be given to sourcing funding from the following sources for the following reasons:
- Local authorities (primarily shorter dated maturities out to 3 years or so – generally still cheaper than the Certainty Rate).
  - Financial institutions (primarily insurance companies and pension funds but also some banks, out of forward dates where the objective is to avoid a “cost of carry” or to achieve refinancing certainty over the next few years).
  - UK Municipal Bonds Agency and UK Infrastructure Bank
103. Our advisors will keep us informed as to the relative merits of each of these alternative funding sources.

### **Minimum Revenue Provision (MRP)**

104. Appendix 1 of this report provides the detail on what the MRP is and the basis of the calculation. Basically, authorities are required each year to set aside some of their revenues as provision for debt repayment. Unlike depreciation which is reversed out of the accounts, this provision has a direct impact on the Council Tax requirement. The provision is in respect of capital expenditure that is financed by borrowing or credit arrangements e.g. leases.
105. The Council is required to make a “Prudent Provision” which basically ensures that revenue monies are set aside to repay the debt over the useful life of the asset

acquired i.e. the Minimum Revenue Provision (MRP). This can be achieved by equal annual instalments (current practice) or an annuity method – annual payments gradually increasing over the life of the asset. Where an annuity loan is taken, the Council's policy (Appendix 1) was amended to reflect the matching, as far as possible, of the MRP with the actual principal repaid (within each debt repayment).

106. The MRP for 2023/24 is estimated at £995,000 (the statutory charge to revenue that remains within the accounts).
107. The Government are consulting on amending MRP regulations/guidance for England. One of the revisions likely is to make it clear to all authorities that where loans have been made for capital purposes to other organisations e.g local authority companies, housing providers, then provision for debt repayments must be made. Hastings BC has always done so and is not caught out by this sensible requirement. The latest information we have is that any changes to the guidance will take effect from 2024/25 at the earliest.

## ANNUAL INVESTMENT STRATEGY

### Investment Policy

108. The Department of Levelling Up, Housing and Communities (DLUHC - this was formerly the Ministry of Housing, Communities and Local Government (MHCLG)) and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with treasury (financial) investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy.
109. The Council's investment policy has regard to the DLUHC's Guidance on Local Government Investments ("the Guidance"), the CIPFA Treasury Management in the Public Services Code of Practice and Cross Sectoral Guidance Notes 2021 ("the Code") and the CIPFA Treasury Management Guidance Notes 2021.
110. The Council's investment priorities will be security first, portfolio liquidity second, and then yield (return). The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the Council's risk appetite.
111. 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.
112. The above guidance from the DLUHC and CIPFA places a high priority on the management of risk. This Council 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 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.
- 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 Council has defined the list of **types of investment instruments** that the treasury management team are authorised to use. There are two lists in Appendix 5 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.

- e. **Lending limits**, (amounts and maturity), for each counterparty as set out in the creditworthiness policy below.
- f. **Transaction limits** are set for each type of investment.
- g. Investments will only be placed with counterparties from countries with a specified **minimum sovereign rating**.
- h. This Council has engaged **external consultants** (Link Group), to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of the council in the context of the expected level of cash balances and need for liquidity throughout the year.
- i. All investments will be denominated in **sterling**.
- j. Consideration will be given to organisations Environmental, Social & Governance (ESG) credentials, although no scoring will be applied.
- k. As a result of the change in accounting standards for 2022/23 under IFRS 9, the Council 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 31/03/2023. In December 2022 a further extension to the over-ride was agreed by Government until 31/03/2025.

113. However, the Council 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.
114. There are no changes in our risk management policy and the above criteria remain unchanged from last year.
115. The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.
116. In accordance with guidance from the DLUHC and CIPFA, and in order to minimise the risk to investments, the Council has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies with a full understanding of what these reflect in the eyes of each agency.

### **Creditworthiness Policy**

117. The Council uses the creditworthiness service provided by Link Group. The potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications. This service uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moody's and Standard and Poor's, forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following as overlays: -
  - Credit watches and credit outlooks from credit rating agencies;
  - Credit Default Swap (CDS) spreads to give early warning of likely changes in credit ratings;
  - Sovereign ratings to select counterparties from only the most creditworthy countries.
118. 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 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 and are therefore referred to as durational bands. This is a service which the Council would not be able to replicate using in-house resources.
119. The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions down to a minimum durational band within Link Group's weekly credit list of worldwide potential counterparties. The Council will therefore use counterparties within the following durational bands: -

- Purple            2 years (but HBC will only invest for up to 1 year – except Property Fund and Diversified Income Fund)
- Blue             1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange          1 year
- Red              6 months
- Green           100 days
- No Colour      not to be used

120. The Link Groups' creditworthiness service uses a wider array of information other than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings.

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

122. This Council will not use the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties as Moody's tend to be more aggressive in giving low ratings than the other two agencies. This would therefore be unworkable and leave the Council with few banks on its approved lending list. The Link creditworthiness service does though, use ratings from all three agencies, but by using a risk based scoring system, does not give undue weighting to just one agency's ratings.

123. The Council is alerted to the changes to credit ratings of all three agencies through its use of the Link creditworthiness service. These are monitored on a daily basis with lists updated weekly by Link Group. If a downgrade results in the counterparty / investment scheme no longer meeting the Authority's minimum criteria, its further use as a new investment will be withdrawn immediately.

124. Sole reliance will not be placed on the use of this external service. In addition, this Council will also use market data and market information, information on government support for banks and the credit ratings of that government support.

125. The Council only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent from other agencies if Fitch does not provide). The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 6. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy. The maximum investment in any non UK country is not to exceed £10m.

## Investment Strategy

126. The level of investments can fluctuate significantly on a day to day basis, given the level of funding received, precept payments, grants payable and receivable, salaries and wages, etc.

127. As at 1 December 2022 the Council had balances amounting to £35.7m. The monies held are higher than would normally be expected and include monies that the Council is holding in respect of a number of grant schemes.
128. Priority is given to security and liquidity of investments in order to reduce counterparty risk to the maximum possible extent. To this end at the start of the Covid-19 crisis special arrangements were made with the Council's bankers to be able to accommodate larger than normal balances and daily transaction amounts associated with the government's business grant schemes. The Council is now again in the position to ensure that its cash balances are spread across numerous counterparties.
129. The Council has had various investment limits depending upon the credit rating e.g. £5m with any one institution with a minimum short term rating of F+, and a long term rating of A+ or above, supported by a red (6 month) rating by Link Group. The £5m limit generally represents a level of up to 25% of the investment portfolio with any one institution or group at any one time. It is also necessary, at times, to invest sums of this size in order to attract the larger institutions which have the higher credit ratings.
130. The Eurozone and Brexit led to a number of downgrades to banks' credit ratings, making it increasingly difficult at times to spread investments across a number of institutions. The Chief Finance Officer has the authority to amend the limits on a daily basis if necessary, to ensure that monies can be placed with appropriate institutions. The use of Money Market funds is anticipated and the Council is in the process of getting setup on a portal to allow access to a diversified range of money market funds from different providers.
131. The pandemic has impacted on countries around the world and in turn on credit ratings. The Council follows the Credit ratings of Link Group and the ratings now enable the Council to invest £5m with any one institution with a minimum short term rating of F (rather than F+), and a long term rating of A+ and above (Unchanged), supported by a red (6 month) rating.

### Investment Strategy – Property Fund

132. It was agreed in February 2017 that the option for diversification of some of the investments into a property fund be undertaken with CCLA in the sum of £2m. The investment being in respect of the Council's reserves that are not required for a period of at least 5 years in order that any fall in values and entry costs into such funds can be covered. The £2m was invested in April 2017 and the performance is detailed below:

**Table 6: CCLA – LA's Property Prices and Dividend yields**

End of	Sep-22	Jun-22	Mar-22	Mar-21	Mar-20	Mar-19	Mar-18	Apr-17
Offer Price p	371.27	387.73	368.46	313.45	315.7	327.4	322.40	307.19
Net Asset Value p	347.79	363.21	345.17	293.63	295.74	306.7	302.01	287.77
Bid Price p	342.40	357.58	339.82	289.08	291.15	301.95	297.33	283.31
Dividend* on XD Date p	3.26	2.8523	2.7875	2.9797	3.25	3.31	3.21	-
Dividend* - Last 12 Months p	11.78	11.21	11.22	12.63	13.06	13.08	13.70	13.19
Dividend Yield on NAV %	3.39	3.09	3.13	4.3	4.41	4.26	4.54	4.58

133. The dividend yield is currently around 3.4% p.a. on the net asset value. Dividends for the first 2 quarters of 2022/23 amount to £39,811 (£36,178 at the same point last year). Full year dividends for 2022/23 are estimated at around £80,300 and a similar return is anticipated for 2023/24.

**Table 7: CCLA - Property Fund Capital Value**

Units (651,063)	Sep-22	Jun-22	Mar-22	Mar-21	Mar-20	Mar-19	Mar-18	Apr-17
Mid Market Price(£)	2,264,332	2,364,726	2,247,274	1,911,716	1,925,454	1,996,810	1,966,275	1,873,564
Bid Price (£)	2,229,240	2,328,071	2,212,442	1,882,093	1,895,570	1,965,885	1,935,806	1,844,527

134. The Capital value has increased by 20.86% between April 2017 and September 2022 and is now above that of the original investment made and continues to recover from the low point experienced in August 2020 following the impact of Covid-19. It is important that this is continued to be viewed as a longer term investment (5 years plus).

### **Diversified Income Fund**

135. It was agreed in February 2019 that a sum of £3m would be made available for further diversification of the Council's investments. £1m was invested on 26 July 2019 and a further £2m investment was made on 24 September 2019 into the CCLA Diversified Income Fund. Anticipated returns were around 3% with the added advantage of much higher liquidity than the property fund.
136. The capital value had recovered from the initial investment where charges are effectively deducted and was valued at £3,012,479 at the end of December 2019. In March 2020 the market value had fallen to £2.62m but continues to recover and was valued at £2,717,180 on 30 September 2022 (9.4% below the initial investment amount). Dividend yield on price was at 2.79% for September 2022 (2.6% September 2021). Dividends payable for the first 2 quarters of 2022/23 amount to £44,402 (£39,614 at the same point last year). It should be remembered that this is a long term investment and prices can go up and down.

### **Investment Strategy – View on Interest Rates**

137. As the Bank of England (BOE) has increased interest rates investment returns have increased in line with the increase in base rate. Investment returns are likely to increase further as additional increases in the base rate are anticipated. The Council at this time needs access to its cash reserves and as such cannot afford to invest further longer term – until it achieves a balanced budget or has capital receipts.

### **Investment Return Expectations**

138. Bank Rate is forecast to peak at 4.5% in the second quarter of 2023 then gradually reduce over the following years. However, as has been seen during 2022 the financial position can often change quickly, and the Council needs to be prepared for increases in rates. The historic low interest rates that we have been accustomed to have now gone and we may never see rates at those levels again.

139. The Council will look to report on the actual return achieved on its cash investments, both in terms of percentage and actual cash. It will look to report separately on different categories of cash investments e.g. Property Fund.

### **Regeneration and Economic Development – Income Generation**

140. The Council has remained keen to pursue capital schemes that also generate income. Substantial investments in housing and energy projects will necessitate new borrowing. The levels of new borrowing that the Council can afford to take on board will be dependent upon the individual proposals and credit worthiness of the counterparties involved.

141. The additional risks that the Council is taking on need to be considered in the context of the totality of risk that the Council faces e.g. external claims, rates revaluation, robustness of income streams, economic downturns, etc. Where there is more risk and volatility in income streams the Council will need to ensure that it maintains sufficient reserves to ensure the Council's ability to deliver key services is not jeopardised.

### **Treasury Management Reporting**

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

- a) Prudential and treasury indicators and treasury strategy (this report) - The first, and most important report is forward looking and covers:
  - the capital plans, (including prudential indicators);
  - a minimum revenue provision (MRP) policy, (how residual capital expenditure is charged to revenue over time);
  - the treasury management strategy, (how the investments and borrowings are to be organised), including treasury indicators; and
  - an investment strategy, (the parameters on how investments are to be managed).
- b) A mid-year treasury management report – This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision.
- c) An annual treasury report – This is a backward-looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy. At the end of the financial year, officers will report to Council on its investment activity as part of its Annual Treasury Report (to be presented by no later than 30 September).

### **Policy on Use of External Service Providers**

143. The Council uses Link Group, Treasury solutions as its external treasury management advisors. There is currently value in employing external providers of

treasury management services in order to acquire access to credit worthiness information and specialist advice.

## **Training**

144. The CIPFA Code requires the responsible officer (Chief Financial Officer) to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. In terms of treasury management in general, training has been undertaken by members on an annual basis to date.
145. Furthermore, 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.
146. 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 key members.
  - Require treasury management officers and key members to undertake self-assessment against the required competencies.
  - Have regular communication with officers and key members, encouraging them to highlight training needs on an ongoing basis.
147. Treasury Management Training was offered to all members on 10th January 2022 and the following year on 11th January 2023. Further training will be arranged as required.
148. The training needs of treasury management officers are periodically reviewed.
149. A formal record of the training received by officers and members central to the Treasury function is maintained by the Deputy Chief Finance Officer.

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

150. In brief, this directive requires the Council to distinguish itself as either a retail or professional client. In order to qualify for professional status, the Council is required to show that it has more than £10m in investments, invests regularly (more than 10 times a quarter), as well as having appropriately trained and experienced staff.
151. To date only two counterparties have required us to complete the forms in order to maintain the existing professional status. The directive became law on 1 January 2018.
152. The two parties to date are Link Group and CCLA. A schedule of such counterparties will be maintained, as per the requirements of the Code, should the list expand further.

## **Scheme of Delegation**

153. Please see Appendix 9.

## **Role of the Section 151 Officer**

154. Please see Appendix 10.

## APPENDIX 1

# Minimum Revenue Provision – An Introduction

### 1. What is a Minimum Revenue Provision?

Capital expenditure is generally expenditure on assets which have a life expectancy of more than one year e.g. buildings, vehicles, machinery etc. It would be impractical to charge the entirety of such expenditure to revenue in the year in which it was incurred therefore such expenditure is spread over several years in order to try to match the years over which such assets benefit the local community through their useful life. The manner of spreading these costs is through an annual Minimum Revenue Provision, which was previously determined under Regulation, and will in future be determined under Guidance.

### 2. Statutory duty

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

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

The MRP policy statement requires full Council approval in advance of each financial year.

There is no requirement to charge MRP where the Capital Financing Requirement is nil or negative at the end of the preceding financial year.

### 3. Government Guidance

Along with the above duty, the Government issued guidance which came into force on 31st March 2008 which requires that a Statement on the Council's policy for its annual MRP should be submitted to the full Council for approval before the start of the financial year to which the provision will relate.

The Council is legally obliged to "have regard" to the guidance, which is intended to enable a more flexible approach to assessing the amount of annual provision than was required under the previous statutory requirements. The guidance offers four main options under which MRP could be made, with an overriding recommendation that the Council should make prudent provision to redeem its debt liability over a period which is reasonably commensurate with that over which the capital expenditure is estimated to provide benefits. The requirement to 'have regard' to the guidance therefore means that: -

Although four main options are recommended in the guidance, there is no intention to be prescriptive by making these the only methods of charge under which a local authority may consider its MRP to be prudent.

It is the responsibility of each authority to decide upon the most appropriate method of making a prudent provision, after having had regard to the guidance.



### **Option 1: Regulatory Method**

Under the previous MRP regulations, MRP was set at a uniform rate of 4% of the adjusted CFR (i.e. adjusted for “Adjustment A”) on a reducing balance method (which in effect meant that MRP charges would stretch into infinity). This historic approach must continue for all capital expenditure incurred in years before the start of this new approach. It may also be used for new capital expenditure up to the amount which is deemed to be supported through the Supported Capital Expenditure (SCE) annual allocation.

### **Option 2: Capital Financing Requirement Method**

This is a variation on option 1 which is based upon a charge of 4% of the aggregate CFR without any adjustment for Adjustment A, or certain other factors which were brought into account under the previous statutory MRP calculation. The CFR is the measure of an authority’s outstanding debt liability as depicted by their balance sheet.

### **Option 3: Asset Life Method.**

This method may be applied to most new capital expenditure, including where desired that which may alternatively continue to be treated under options 1 or 2.

Under this option, it is intended that MRP should be spread over the estimated useful life of either an asset created, or other purpose of the expenditure. There are two useful advantages of this option: -

- Longer life assets e.g. freehold land can be charged over a longer period than would arise under options 1 and 2.
- No MRP charges need to be made until the financial year after that in which an item of capital expenditure is fully incurred and, in the case of a new asset, comes into service use (this is often referred to as being an ‘MRP holiday’). This is not available under options 1 and 2.

There are two methods of calculating charges under option 3:

- equal instalment method – equal annual instalments,
- annuity method – annual payments gradually increase during the life of the asset.

### **Option 4: Depreciation Method**

Under this option, MRP charges are to be linked to the useful life of each type of asset using the standard accounting rules for depreciation (but with some exceptions) i.e. this is a more complex approach than option 3.

The same conditions apply regarding the date of completion of the new expenditure as apply under option 3.

## Minimum Revenue Provision Policy Statement 2023/24

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).

Regulation 28 of the Local Authorities (Capital Finance and Accounting) (England) (Amendment) regulations 2008 require the Authority to calculate a prudent provision of MRP whilst having regard to the current MRP Guidance (2018). The broad aim of prudent provision is to ensure that the outstanding debt liability is repaid over a period that is reasonably commensurate with that over which the capital expenditure provides benefits. The Guidance gives four ready-made options for calculating MRP but the Authority can use any other reasonable basis that it can justify as prudent.

The MRP policy statement requires full Council approval in advance of each financial year.

It is recommended that Council approves the following MRP Policy Statement.

- Supported borrowing incurred before 1st April 2008 will apply the Asset Life Method using an annuity calculation over 50 years.
- Unsupported borrowing will be subject to MRP using the Asset Life Method, which will be charged over a period which is reasonably commensurate with the estimated useful life of the assets. An annuity method will be applied for the MRP calculation.
- The interest rate applied to the annuity calculations will reflect the market conditions at the time. For the 2023/24 financial year the interest rate used will be average PWLB rate for the year.
- MRP will commence in the financial year following the one in which the expenditure was incurred, or in the year after the asset becomes operational.
- MRP in respect of unsupported borrowing taken to meet expenditure, which is treated as capital expenditure by virtue of either a capitalisation direction or regulations, will be determined in accordance with the asset life method as recommended by the MRP guidance.
- MRP in respect of assets acquired under PFI or Finance Leases will be charged at a rate equal to the principal element of the annual lease rental for the year in question.
- MRP Overpayments - The MRP Guidance allows that any charges made in excess of the statutory MRP, i.e. voluntary revenue provision (VRP) or overpayments, can 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. The VRP overpayments up to 31st March 2022 are £0.
- On an annual basis the Section 151 Officer shall review the level of MRP to be charged, to determine if this is at a level which is considered prudent based on the Authority's circumstances at that time, taking into account medium / long term financial plans, current budgetary pressures, current and future capital expenditure plans. Dependant on this review the Section 151 officer will adjust the annual MRP charge by making VRP or reclaiming previous VRP. The amount of MRP charged shall not be less than zero in any financial year.

## APPENDIX 2 - Interest Rate Forecasts

Link Group Interest rate forecast – Dec 2022 – March 2025

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

Note: PWLB rates and forecast shown above have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012.

## APPENDIX 3 - Economic Review (by Link Group)

### ECONOMIC BACKGROUND

Against a backdrop of stubborn inflationary pressures, the easing of Covid restrictions in most developed economies, the Russian invasion of Ukraine, and a range of different UK Government policies, it is no surprise that UK interest rates have been volatile right across the curve, from Bank Rate through to 50-year gilt yields, for all of 2022.

Market commentators' misplaced optimism around inflation has been the root cause of the rout in the bond markets with, for example, UK, EZ and US 10-year yields all rising by over 200bps since the turn of the year. The table below provides a snapshot of the conundrum facing central banks: inflation is elevated but labour markets are extra-ordinarily tight, making it an issue of fine judgment as to how far monetary policy needs to tighten.

	UK	Eurozone	US
<b>Bank Rate</b>	3.5%	2.0%	4.25%-4.50%
<b>GDP</b>	-0.2%q/q Q3 (2.4%/y/y)	+0.2%q/q Q3 (2.1%/y/y)	2.6% Q3 Annualised
<b>Inflation</b>	10.7%/y/y (Nov)	10.1%/y/y (Nov)	7.1%/y/y (Nov)
<b>Unemployment Rate</b>	3.7% (Oct)	6.5% (Oct)	3.7% (Nov)

Q2 of 2022 saw UK GDP revised upwards to +0.2% q/q, but this was quickly reversed in the third quarter, albeit some of the fall in GDP can be placed at the foot of the extra Bank Holiday in the wake of the Queen's passing. Nevertheless, CPI inflation has picked up to what should be a peak reading of 11.1% in October, although with further increases in the gas and electricity price caps pencilled in for April 2023, and the cap potentially rising from an average of £2,500 to £3,000 per household, there is still a possibility that inflation will spike higher again before dropping back slowly through 2023.

The UK unemployment rate fell to a 48-year low of 3.6%, and this despite a net migration increase of c500k. The fact is that with many economic participants registered as long-term sick, the UK labour force actually shrunk by c£500k in the year to June. Without an increase in the labour force participation rate, it is hard to see how the UK economy will be able to grow its way to prosperity, and with average wage increases running at over 6% the MPC will be concerned that wage inflation will prove just as sticky as major supply-side shocks to food and energy that have endured since Russia's invasion of Ukraine on 22nd February 2022.

Throughout Q3 Bank Rate increased, finishing the quarter at 2.25% (an increase of 1%). Q4 has seen rates rise to 3% in November and the market expects Bank Rate to hit 4.5% by May 2023.

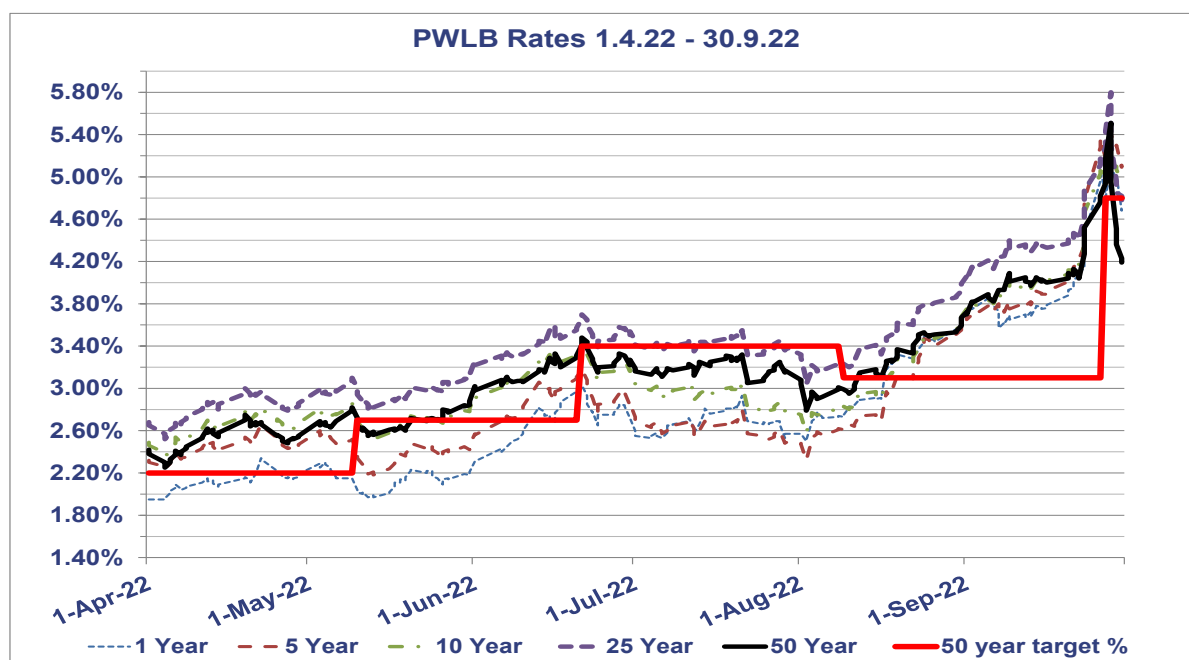
Following a Conservative Party leadership contest, Liz Truss became Prime Minister for a tumultuous seven weeks that ran through September and December. Put simply, the markets did not like the unfunded tax-cutting and heavy spending policies put forward by her Chancellor, Kwasi Kwarteng, and their reign lasted barely seven weeks before being replaced by Prime Minister Rishi Sunak and Chancellor Jeremy Hunt. Their Autumn Statement of 17<sup>th</sup> November gave rise to a net £55bn fiscal tightening, although much of the "heavy lifting" has been left for the next Parliament to deliver. However, the markets liked what they heard, and UK gilt yields have completely reversed the increases seen under the previous tenants of No10/11 Downing Street.

Globally, though, all the major economies are expected to struggle in the near term. The fall below 50 in the composite Purchasing Manager Indices for the UK, US, EZ and China all point

to at least one if not more quarters of GDP contraction. In November, the MPC projected eight quarters of negative growth for the UK lasting throughout 2023 and 2024, but with Bank Rate set to peak at lower levels than previously priced in by the markets and the fiscal tightening deferred to some extent, it is not clear that things will be as bad as first anticipated by the Bank.

The £ has strengthened of late, recovering from a record low of \$1.035, on the Monday following the Truss government's "fiscal event", to \$1.20. Notwithstanding the £'s better run of late, 2023 is likely to see a housing correction of some magnitude as fixed-rate mortgages have moved above 5% and affordability has been squeezed despite proposed Stamp Duty cuts remaining in place.

In the table below, the rise in gilt yields, and therein PWLB rates, through the first half of 2022/23 is clear to see.



However, the peak in rates on 28<sup>th</sup> September as illustrated in the table covering April to September 2022 below, has been followed by the whole curve shifting ever lower. PWLB rates at the front end of the curve are generally over 1% lower now whilst the 50 years is over 1.75% lower.

	1 Year	5 Year	10 Year	25 Year	50 Year
<b>Low</b>	1.95%	2.18%	2.36%	2.52%	2.25%
<b>Date</b>	01/04/2022	13/05/2022	04/04/2022	04/04/2022	04/04/2022
<b>High</b>	5.11%	5.44%	5.35%	5.80%	5.51%
<b>Date</b>	28/09/2022	28/09/2022	28/09/2022	28/09/2022	28/09/2022
<b>Average</b>	2.81%	2.92%	3.13%	3.44%	3.17%
<b>Spread</b>	3.16%	3.26%	2.99%	3.28%	3.26%

After a shaky start to the year, the S&P 500 and FTSE 100 have climbed in recent weeks, albeit the former is still 17% down and the FTSE 2% up. The German DAX is 9% down for the year.

### CENTRAL BANK CONCERNS – NOVEMBER 2022

At the start of November, the Fed decided to push up US rates by 0.75% to a range of 3.75% - 4%, whilst the MPC followed a day later by raising Bank Rate from 2.25% to 3%, in line with market expectations. EZ rates have also increased to 1.5% with further tightening in the pipeline.

Having said that, the press conferences in the US and the UK were very different. In the US, Fed Chair, Jerome Powell, stated that rates will be elevated and stay higher for longer than

markets had expected. Governor Bailey, here in the UK, said the opposite and explained that the two economies are positioned very differently so you should not, therefore, expect the same policy or messaging.

Regarding UK market expectations, although they now expect Bank Rate to peak within a lower range of 4.5% - 4.75%, caution is advised as the Bank of England Quarterly Monetary Policy Reports have carried a dovish message over the course of the last year, only for the Bank to have to play catch-up as the inflationary data has proven stronger than expected.

In addition, the Bank's central message that GDP will fall for eight quarters starting with Q3 2022 may prove to be a little pessimistic. Will the £160bn excess savings accumulated by households through the Covid lockdowns provide a spending buffer for the economy – at least to a degree? Ultimately, however, it will not only be inflation data but also employment data that will mostly impact the decision-making process, although any softening in the interest rate outlook in the US may also have an effect (just as, conversely, greater tightening may also).

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## APPENDIX 4 - Prudential Indicators

The Council's Capital expenditure plans are the key driver of treasury management activity. The output of the Capital expenditure plans (detailed in the budget) is reflected in the prudential indicators below.

TREASURY MANAGEMENT PRUDENTIAL INDICATORS	2021/22	2022/23	2023/24	2024/25	2025/26
	£'000	£'000	£'000	£'000	£'000
<b>Authorised Limit for external debt</b>					
borrowing	110,000	110,000	135,000	135,000	135,000
other long term liabilities	5,000	5,000	5,000	5,000	5,000
<b>TOTAL</b>	115,000	115,000	140,000	140,000	140,000
<b>Operational Boundary for external debt</b>					
borrowing	105,000	105,000	130,000	130,000	130,000
other long term liabilities	5,000	5,000	5,000	5,000	5,000
<b>TOTAL</b>	110,000	110,000	135,000	135,000	135,000

Interest Rate Exposures	2022/23 Upper	2023/24 Upper	2024/25 Upper
Limits on fixed interest rates based on <b>net</b> debt	100%	100%	100%
Limits on variable interest rates based on <b>net</b> debt	100%	100%	100%
Limits on fixed interest rates:			
· Debt only	100%	100%	100%
· Investments only	100%	100%	100%
Limits on variable interest rates			
· Debt only	30%	30%	30%
· Investments only	100%	100%	100%
<b>Maturity Structure of fixed interest rate borrowing 2023/24</b>			
	<b>Lower</b>	<b>Upper</b>	
Under 12 Months	0%	100%	
12 months to 2 years	0%	100%	
2 years to 5 years	0%	100%	
5 years to 10 years	0%	100%	
10 years to 20 years	0%	100%	
20 years to 30 years	0%	100%	
30 years to 40 years	0%	100%	
40 years to 50 years	0%	100%	
<b>Maturity Structure of variable interest rate borrowing 2023/24</b>			
	<b>Lower</b>	<b>Upper</b>	
Under 12 Months	0%	30%	
12 months to 2 years	0%	30%	
2 years to 5 years	0%	30%	
5 years to 10 years	0%	30%	
10 years to 20 years	0%	10%	
20 years to 30 years	0%	10%	
30 years to 40 years	0%	10%	
40 years to 50 years	0%	10%	

## Affordability Prudential Indicator - Ratio of financing costs to net revenue stream

This indicator assesses the affordability of the capital investment plans. It provides an indication of the impact of the capital investment plans on the Council's overall finances. This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

<b>Prudential Indicator: Financing Cost to Net Revenue Stream</b>	<b>2021/22 Actual</b>	<b>2022/23 Estimate</b>	<b>2023/24 Estimate</b>	<b>2024/25 Estimate</b>	<b>2025/26 Estimate</b>
<b>Financing Costs</b>	£'000	£'000	£'000	£'000	£'000
1. Interest Charged to General Fund	1,825	1,847	2,811	3,681	3,665
2. Interest Payable under Finance Leases and any other long term liabilities	-	-	-	-	-
3. Gains and losses on the repurchase or early settlement of borrowing credited or charged to the amount met from government grants and local taxpayers	-	-	-	-	-
4. Interest and Investment Income	(540)	(808)	(824)	(618)	(618)
5. Amounts payable or receivable in respect of financial derivatives	-	-	-	-	-
6. Minimum Revenue Provision (MRP) / Voluntary Revenue Provision (VRP)	1,668	920	995	1,168	1,287
7. Depreciation/Impairment that are charged to the amount to be met from government grants and local taxpayers	-	-	-	-	-
<b>Total</b>	<b>2,953</b>	<b>1,959</b>	<b>2,982</b>	<b>4,231</b>	<b>4,334</b>
<b>Net Revenue Stream</b>					
Amount to be met from government grants and local taxpayers	14,253	14,530	14,821	15,117	15,420
<b>Ratio</b>					
<b>Financing Cost to Net Revenue Stream</b>	<b>21%</b>	<b>13%</b>	<b>20%</b>	<b>28%</b>	<b>28%</b>

This prudential indicator shows that the ratio of financing costs to the net revenue stream is increasing. This is not unexpected given that the Council has had an income generation strategy that has resulted in increased Capital expenditure over the period 2017/18 to 2021/22 and that the Council agreed a programme for over £54m of Capital expenditure over the period 2020/21 to 2023/24 - thus increasing borrowing costs. The above ratio does not take into account the income is being generated from some of the initiatives and commercial property acquisitions as these are not treated as investment income.

### Other Prudential Indicators

Internal Borrowing and Gearing ratios for the authority are included in the Capital Strategy.



## APPENDIX 5 - Specified and Non-Specified Investments

### Specified Investments:

The idea of specified investments is to identify investments offering high security and high liquidity. All these investments should be in sterling and with a maturity of up to a maximum of one year.

### Schedule A

	Security / Minimum Credit Rating	Maximum Maturity Period
Local authorities	N/A	1 year
DMADF – UK Government	N/A	1 year
Money Market Funds (CNAV, LVAV, VNAV)	AAA	Liquid
Term deposits with banks and building societies	Blue Orange Red Green No Colour	Up to 1 year Up to 1 year Up to 6 months Up to 3 months Not for use
Certificates of deposits (CDs) issued by credit rated deposit takers (banks and building societies)	Blue Orange Red Green No Colour	Up to 1 year Up to 1 year Up to 6 months Up to 3 months Not for use
UK Government Gilts	UK sovereign rating	12 months
UK Government Treasury Bills	UK sovereign rating	12 months

### Non-Specified Investments

These are any investments which do not meet the specified investment criteria. The aim is to ensure that proper procedures are in place for undertaking risk assessments of investments made for longer periods or with bodies which do not have a “high” credit rating. As far as this Council is concerned the risks are in relation to the value of the investments, which may rise, or fall, rather than deficient credit rating.

There is no intention to invest in Non-Specified Investments, other than those Property Funds where there are no Capital accounting implications, without taking specialist advice first. The limits on Investments in Property Funds will be agreed as part of this Treasury Management Strategy and Investment Policy. For clarity any increase in the level of the investment would need Council approval.

## Schedule B

Investment	Security / Minimum credit rating	(A) Why use it? (B) Associated risks
Property Funds	<p><i>The use of these instruments can be deemed capital expenditure, and as such will be an application (spending) of capital resources. This Authority will check on the status of any fund it may consider using. Appropriate due diligence will also be undertaken before investment of this type is undertaken. These are longer term investments and will extend beyond 365 days (expected to be invested for 5 years or more)</i></p>	
UK Government Gilts with maturities in excess of 1 year Custodial arrangement required prior to purchase	Government backed	<p>(A) Why use it?</p> <ul style="list-style-type: none"> <li>(i) Excellent credit quality.</li> <li>(ii) Very liquid.</li> <li>(iii) if held to maturity, known yield (rate of return) per annum – aids forward planning.</li> <li>(iv) If traded, potential for capital gain through appreciation in value (i.e. sold before maturity)</li> <li>(v) No currency risk.</li> </ul> <p>(B) Associated risks</p> <ul style="list-style-type: none"> <li>(i) 'Market or interest rate risk': Yield subject to movement during life of sovereign bond which could negatively impact on price of the bond i.e. potential for capital loss.</li> </ul>

## **APPENDIX 6 - Approved Countries for Investments**

The list is based on those countries which have sovereign ratings of AA- or higher (the lowest rating shown from Fitch, Moody's and S&P) and also have banks operating in sterling markets which have credit ratings of green or above in the Link credit worthiness service.

Countries that meet our criteria 1 (at 02.12.2022)

### ***Based on lowest available rating***

#### **AAA**

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

#### **AA+**

- Canada
- Finland
- U.S.A.

#### **AA**

- Abu Dhabi (UAE)
- France

#### **AA-**

- Belgium
  - Qatar
  - **U.K.**
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## **APPENDIX 7 - Treasury Management Policy Statement**

The Council defines the policies and objectives of its treasury management activities as:

“The management of the organisation’s borrowing, investments and cash flows, including its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks”.

This Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

The Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.”

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## **APPENDIX 8 - Key Principles and Clauses formally adopted**

The Code identifies three key principles:

### **Key Principle 1**

Public service organisations should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities.

### **Key Principle 2**

Their policies and practices should make clear that the effective management and control of risk are the prime objectives of their treasury management activities and that responsibility for these lies clearly within their organisations. Their appetite for risk should form part of their annual strategy, including any use of financial instruments for the prudent management of those risks, and should ensure that priority is given to security and portfolio liquidity when investing treasury management funds.

### **Key Principle 3**

They should acknowledge that the pursuit of value for money in treasury management and the use of suitable performance measures, are valid and important tools for responsible organisations to employ in support of their business and service objectives; and that within the context of effective risk management, their treasury management policies and practices should reflect this.

### **Clauses formally adopted**

1. This organisation will create and maintain, as the cornerstones for effective treasury management:
  - A Treasury Management Policy Statement, stating the policies, objectives and approach to risk management of its treasury management activities.
  - Suitable Treasury Management Practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.
  - Investment Management Practices (IMPs) for investments which are not for treasury management purposes

The content of the policy statement TMPs and IMPs will follow the recommendations contained in Sections 6, 7 and 8 of the Code, subject only to amendment where necessary to reflect the particular circumstances of this organisation. Such amendments will not result in the organisation materially deviating from the Codes key principles.

2. This organisation (i.e. full Council) will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid- year review and an annual report after its close, in the form prescribed in its TMPs and IMPs.
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3. This council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to Cabinet, and for the execution and administration of treasury decisions to the Chief Financial Officer, who will act in accordance with the organisations policy statement, TMPs and IMPs and, if he/she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.
  4. This Council nominates the Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.
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## **APPENDIX 9 - Treasury Management Scheme of Delegation**

### **(i) Full Council**

1. Approval of the Treasury Management Strategy - prior to the new financial year
2. Approval of the Investment Strategy - prior to the new financial year
3. Approval of the MRP Policy - prior to the start of the new financial year
4. Approval of any amendments required to the Strategy during the year
5. Receipt of a mid-year report on the Treasury Management Strategy, to include consideration of any recommendations of the Cabinet or Audit Committee arising from any concerns since the original approval.

### **(ii) Cabinet**

1. Developing and determining the Treasury Management Strategy, Investment Strategy and MRP policy and recommending them to full Council - prior to the start of the new financial year.
2. Receipt of a mid-year report on the Treasury Management Strategy and any concerns since the original approval and making recommendations to Council as appropriate.
3. Receiving, and reviewing reports on treasury management policies, practices, activities, and performance reports (based on quarterly reporting).
4. Approval of/amendments to the organisation's adopted clauses, treasury management policy statement;
5. Budget consideration and approval;
6. Approval of the division of responsibilities;

### **(iii) Audit Committee**

1. Scrutinising the Council's Treasury Management Strategy, Investment Strategy and MRP policy, Treasury Management Policy Statement and Treasury Management Practices and making recommendations to Cabinet and Council as appropriate.
  2. Receiving and reviewing monitoring reports (based on quarterly reporting) and making recommendations as appropriate.
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## **APPENDIX 10 - The Treasury Management Role of the Section 151 Officer**

Chief Finance Officer (S151 Officer) responsibilities:

- recommending clauses, treasury management policy for approval, determining Treasury Management Practices, reviewing the same regularly, and monitoring compliance
- submitting regular treasury management policy reports
- submitting budgets and budget variations
- receiving and reviewing management information reports
- reviewing the performance of the treasury management function
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- ensuring the adequacy of internal audit, and liaising with external audit
- recommending the appointment of external service providers.

### **Additional Responsibilities following new Codes of Practice/ Investment Guidance**

The above list of specific responsibilities of the S151 officer in the 2021 Treasury Management Code has not changed. However, implicit in the changes in both the Prudential and the Treasury Management Codes, is a major extension of the functions of this role, especially in respect of non-financial investments, (which CIPFA has defined as being part of treasury management). Namely:-

1. preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe (say 20+ years – to be determined in accordance with local priorities).
  2. ensuring that the capital strategy is sustainable, affordable and prudent in the long term and provides value for money.
  3. ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority.
  4. ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing.
  5. ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources.
  6. ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities.
  7. provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees
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8. ensuring that members are adequately informed and understand the risk exposures taken on by an authority.
  9. ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above.
  10. creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed, to include the following): -
    - Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;
    - Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;
    - Decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;
    - Reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken;
    - Training and qualifications (TMP10 and schedules), including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.
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