

<b>REPORT REFERENCE NO.</b>	<b>RC/23/7</b>
<b>MEETING</b>	<b>RESOURCES COMMITTEE (Budget Meeting)</b>
<b>DATE OF MEETING</b>	<b>6 FEBRUARY 2023</b>
<b>SUBJECT OF REPORT</b>	<b>TREASURY MANAGEMENT STRATEGY (INCLUDING PRUDENTIAL AND TREASURY INDICATORS 2023-24 TO 2025-26)</b>
<b>LEAD OFFICER</b>	<b>Director of Finance, People &amp; Estates (Treasurer)</b>
<b>RECOMMENDATIONS</b>	<i>That the Authority be recommended to approve:</i> <i>(a). the Treasury Management Strategy and the Annual Investment Strategy; and</i> <i>(b). the Minimum Revenue Provision statement for 2023-24, as contained as Appendix B.</i>
<b>EXECUTIVE SUMMARY</b>	As agreed at the Authority meeting of 18 December 2017, there is a requirement for Resources Committee to review the Treasury Management Strategy for recommendation to the Authority. This report sets out a treasury management strategy and investment strategy for 2023-24, including the Prudential Indicators associated with the capital programme for 2023-24 to 2025-26 considered elsewhere on the agenda of this meeting. A Minimum Revenue Provision Statement for 2023-24 is also included for approval. The 2021-22 revised Prudential Code also requires the Treasurer to certify that none of the Authority's spending plans include the acquisition of assets primarily held for yield.
<b>RESOURCE IMPLICATIONS</b>	As indicated in this report
<b>EQUALITY RISKS AND BENEFITS ANALYSIS (ERBA)</b>	The contents of this report are considered compatible with existing human rights and equality legislation.
<b>APPENDICES</b>	A. Prudential and Treasury Management Indicators 2023-24 to 2025-26 B. Minimum Revenue Provision Statement 2023-24. C. Link Treasury Solutions economic report
<b>BACKGROUND PAPERS</b>	Local Government Act 2003. Chartered Institute of Public Finance Accountancy's (CIPFA) Prudential Code and CIPFA Treasury Management Code of Practice

## 1. **INTRODUCTION**

### **Background**

- 1.1. The Authority 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 Authority's low risk appetite, providing adequate liquidity initially before considering investment return.
- 1.2. The second main function of the treasury management service is the funding of the Authority's capital plans. These capital plans provide a guide to the borrowing need of the Authority, essentially the longer-term cash flow planning, to ensure that the Authority 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 Authority risk or cost objectives.
- 1.3. The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.
- 1.4. CIPFA defines treasury management as:  
*"The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."*
- 1.5. The Authority has not engaged in any commercial investments and has no non-treasury investments.

### **Statutory requirements**

- 1.6. The Local Government Act 2003 (the Act) and supporting regulations requires the Authority 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 Authority's capital investment plans are affordable, prudent and sustainable.
- 1.7. The Act therefore requires the Authority to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance subsequent to the Act and included as paragraph 8 of this report); this sets out the Authority's policies for managing its investments and for giving priority to the security and liquidity of those investments.

- 1.8. MHCLG (now Department for Levelling Up, Housing and Communities - DLUHC) issued revised investment guidance which came into force from 1 April 2018. This guidance was captured within the revised Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management Code 2017.

### **CIPFA requirements**

- 1.9. The CIPFA 2021/22 Prudential and Treasury Management Codes require all local authorities to prepare a capital strategy report which will provide the following:
- a high-level long-term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
  - an overview of how the associated risk is managed
  - the implications for future financial sustainability
  - declare that the capital spends do not include the acquisition of assets primarily for yield.
- 1.10. The aim of this capital strategy is to ensure that all elected members on the full Authority fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

### **Treasury Management reporting**

- 1.11. The Authority is currently required to receive and approve, as a minimum, three main treasury reports each year, which incorporate a variety of policies, estimates and actuals.
- a. Prudential and Treasury Indicators and Treasury Strategy** (this report): The first, and most important report is forward looking and covers:
    - the capital plans, (including prudential indicators);
    - a minimum revenue provision (MRP) policy, (how residual capital expenditure is charged to revenue over time);
    - the treasury management strategy, (how the investments and borrowings are to be organised), including treasury indicators; and
    - an investment strategy, (the parameters on how investments are to be managed).
  - b. A Mid-year Treasury Management Report:** This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision. In addition, this Authority will receive quarterly update reports.
  - c. An Annual Treasury Report:** This is a backward-looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

- 1.12. The above reports are required to be adequately scrutinised before being recommended to the Authority. This role is undertaken by the Resources Committee.
- 1.13. The Authority has adopted the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management. The primary requirements of the Code are as follows:
- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Authority's treasury management activities.
  - Creation and maintenance of Treasury Management Practices which set out the manner in which the Authority will seek to achieve those policies and objectives.
  - Receipt by the Authority of an annual Treasury Management Strategy Statement – including the Annual Investment Strategy and Minimum Revenue Provision Policy for the year ahead, a mid-year review report and an annual report (stewardship report) covering activities during the previous year.
  - Delegation by the Authority of responsibilities for implementing and monitoring treasury management policies and practices - for the Authority the delegated body is Resources Committee - and for the execution and administration of treasury management decisions - for the Authority the responsible officer is the Treasurer.
  - Delegation by the Authority of the role of scrutiny of treasury management strategy and policies to a named body - for the Authority the delegated body is Resources Committee.

#### **Treasury Management Strategy for 2023-24**

- 1.14. The suggested strategy for 2023-24 in respect of the following aspects of the treasury management function is based upon the treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Authority's treasury advisor, Link Group (Link).
- 1.15. The strategy for 2023-24 covers two main areas:
- Capital Issues**
- capital plans and prudential indicators
  - the Minimum Revenue Provision statement
- Treasury Management Issues**
- treasury limits in force which will limit the treasury risk and activities of the Authority
  - treasury Indicators
  - the current treasury position
  - the borrowing requirement

- prospects for interest rates
- the borrowing strategy
- policy on borrowing in advance of need
- debt rescheduling
- the investment strategy
- creditworthiness policy
- policy on use of external service providers

### **Training**

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

### **Treasury Management Advisors**

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

## **2. CAPITAL PRUDENTIAL INDICATORS FOR 2023-24 TO 2025-26**

- 2.1. The Authority'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.
- 2.2. This prudential indicator is a summary of the Authority's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts as proposed in the Capital Programme report considered elsewhere on the agenda. Other long-term liabilities such as PFI (Private Finance Initiative) and leasing arrangements which already include borrowing instruments are excluded.

Proposed Capital Expenditure	2022-23 (forecast spending)	2023-24	2024-25 (provisional)	2025-26 (provisional)
	£m	£m	£m	£m
Estates	2.483	4.789	4.200	0.900
Fleet & Equipment	3.981	7.962	2.700	4.500
Total	6.464	12.751	6.900	5.400

- 2.3. The following table summarises the financing of the capital programmes shown above. Additional capital finance sources may become available during the year, for example, additional grants or external contributions. The Authority will be requested to approve increases to the capital programme to be financed from other capital resources as and when the need arises.

Capital Financing	2022-23 (forecast spending)	2023-24	2024-25 (provisional)	2025-26 (provisional)
	£m	£m	£m	£m
Capital receipts/ contributions	0.663	0.000	0.000	0.000
Capital grants	0.000	0.000	0.000	0.000
Capital reserves	4.296	11.418	1.405	0.846
Revenue	0.140	0.050	2.050	2.050
Existing borrowing	1.365	1.283	1.370	1.962
New borrowing	0.000	0.000	2.075	0.542
Total	6.464	12.751	6.900	5.400

#### ***The Authority's Borrowing Need (Capital Financing Requirement)***

- 2.4. The second prudential indicator is the Authority's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Authority's indebtedness and so its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.
- 2.5. The CFR does not increase indefinitely, as the Minimum Revenue Provision is a statutory annual revenue charge which broadly reduces the indebtedness in line with each assets life, and so charges the economic consumption of capital assets as they are used.
- 2.6. The CFR includes any other long-term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Authority's borrowing requirement, these types of scheme include a borrowing facility by the PFI via a public-private partnership lease provider and so the Authority is not required to separately borrow for these schemes. The Authority currently has £1.010m of such schemes within the CFR.
- 2.7. The Authority is asked to approve the CFR projections below as included in Appendix A:

Capital Financing Requirement (CFR)	2023-24 (forecast spending)	2024-25	2025-26 (provisional)	2026-27 (provisional)
	£m	£m	£m	£m
Non-HRA expenditure	23.771	25.388	25.836	24.291
Other Long Term Liabilities	0.656	0.509	0.349	0.182
Total CFR	24.426	25.897	26.186	24.473
Movement in CFR	1.283	3.445	2.504	0.150
Less MRP	(1.911)	(1.975)	(2.215)	(1.863)
Net movement in CFR	(0.628)	1.471	0.289	(1.713)

### **Core funds and expected investment balances**

- 2.8. The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed overleaf are estimates of the year-end balances for each resource and anticipated day-to-day cash flow balances.

Estimated Year end Resources	2023-24	2024-25	2025-26	2026-27
	£m	£m	£m	£m
Reserve Balances	19.032	13.500	2.082	1.236
Capital receipts/ contributions	0.000	0.000	0.000	0.000
Other	15.821	17.104	20.549	23.053
Total core funds	34.853	30.604	22.631	24.289
Working capital*	1.000	1.000	1.000	1.000
Under/over borrowing	0.000	0.000	0.000	0.000
Expected investments	35.853	31.604	23.631	25.289

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

### **Minimum Revenue Provision Strategy**

- 2.9. The Authority is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the Minimum Revenue Provision), although it is also allowed to undertake additional voluntary payments if required (Voluntary Revenue Provision).
- 2.10. The Department for Levelling-Up, Communities and Housing (DLUCH) regulations have been issued which require the Authority to approve a **Minimum Revenue Provision Statement** in advance of each year. A variety of options are provided under which Minimum Revenue Provision could be made, with an overriding recommendation that the Authority 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.
- 2.11. The Authority does not plan to make any Voluntary Revenue Provisions within the next three years.
- 2.12. Although four main options are provided under the guidance, the Authority has adopted:

### ***The Asset Life Method***

- 2.13. Where capital expenditure on an asset is financed wholly or partly by borrowing or credit arrangements, Minimum Revenue Provision is to be made in equal annual instalments over the life of the asset. In this circumstance the asset life is to be determined when Minimum Revenue Provision commences and not changed after that.
- 2.14. Minimum Revenue Provision should normally commence in the financial year following the one in which the expenditure is incurred. However, when borrowing to construct an asset, the Authority may treat the asset life as commencing in the year in which the asset first becomes operational. It may accordingly postpone beginning to make Minimum Revenue Provision until that year. Investment properties should be regarded as becoming operational when they begin to generate revenues.
- 2.15. As some types of capital expenditure incurred by the Authority are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.
- 2.16. A draft Minimum Revenue Provision statement for 2023-24 is attached as Appendix B for Authority approval.
- 2.17. The financing of the approved 2023-24 capital programme, and the resultant prudential indicators have been set on the basis of the content of this statement.

### ***Prudential Indicators for Affordability***

- 2.18. The previous sections of the report cover the overall limits for capital expenditure and borrowing, but within the overall framework indicators are also included to demonstrate the affordability of capital investment plans.
- 2.19. A key indicator of the affordability of capital investment plans is the ratio of financing costs to the net revenue stream; this indicator identifies the trend in the cost of capital financing (borrowing costs net of investment income) against the Authority's net budget requirement. Annual capital financing costs are a product of total debt outstanding, the annual repayment regime and interest rates. The forecast ratios for 2023-24 to 2025-26 based on current commitments and the proposed Capital Programme are shown below.

Financing costs as a % of net revenue	2023-24 (forecast spending)	2024-25	2025-26 (provisional)	2026-27 (provisional)
Annual cost	2.91%	2.97%	3.15%	2.67%



### 3. **BORROWING**

3.1. The capital expenditure plans set out in Section 2 provide details of the service activity of the Authority. The treasury management function ensures that the Authority's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity and the Authority's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

#### ***Current borrowing position***

3.2. The Authority's treasury portfolio position at 31 March 2022 and the current position are summarised below.

<b>TREASURY PORTFOLIO</b>				
	actual 31.3.22	actual 31.3.22	current 31.12.22	current 31.12.22
	£000	%	£000	%
<b>Treasury investments</b>				
banks	31,000	91%	30,000	97%
building societies - unrated		0%		0%
building societies - rated		0%		0%
local authorities	1,500	4%		0%
DMADF (H.M.Treasury)		0%		0%
money market funds	1,751	5%	785	3%
certificates of deposit		0%		0%
<b>Total managed in house</b>	<b>34,251</b>	<b>100%</b>	<b>30,785</b>	<b>100%</b>
bond funds		0%		0%
property funds		0%		0%
<b>Total managed externally</b>	<b>0</b>	<b>0%</b>	<b>0</b>	<b>0%</b>
<b>Total treasury investments</b>	<b>34,251</b>	<b>100%</b>	<b>30,785</b>	<b>100%</b>
<b>Treasury external borrowing</b>				
local authorities		0%		0%
PWLB	24,757	100%	24,710	100%
LOBOs		0%		0%
<b>Total external borrowing</b>	<b>24,757</b>	<b>100%</b>	<b>24,710</b>	<b>100%</b>

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

External Debt	2023-24 (forecast spending)	2024-25	2025-26	2026-27
	£m	£m	£m	£m
Debt at 1 April	24.264	23.771	25.388	25.836
Expected change in Debt	(0.493)	1.617	0.449	(0.593)
Other long-term liabilities (OLTL)	0.791	0.656	0.509	0.349
Expected change in OLTL	(0.135)	(0.147)	(0.160)	(0.167)
Actual gross debt at 31 March	24.427	25.897	26.186	25.425
CFR	24.426	25.897	26.186	24.473
Under/ Over borrowing	0.000	(0.000)	0.000	0.953

- 3.4. Within the prudential indicators there are a number of key indicators to ensure that the Authority operates its activities within well-defined limits. One of these is that the Authority needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2023-24 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes.
- 3.5. The Authority complied with this prudential indicator in the current year and is not envisaging difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

#### ***Limits to Borrowing Activity***

- 3.6. Two Treasury Management Indicators control the level of borrowing. They are:
- **The operational boundary.** This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

Estimated Operational Boundary	2023-24	2024-25	2025-26	2026-27
	£m	£m	£m	£m
Non-HRA expenditure	24,364	25,946	26,030	25,936
Other Long Term Liabilities	791	656	509	349
Total	25,155	26,602	26,539	26,286

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

This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all Authority's plans, or those of a specific Authority, although this power has not yet been exercised.

The Authority is asked to approve the following authorised limit:

Estimated Authorised Limit	2023-24	2024-25	2025-26	2026-27
	£m	£m	£m	£m
Non-HRA expenditure	25,553	27,215	27,321	27,151
Other Long Term Liabilities	823	681	527	359
Total	26,376	27,897	27,848	27,509

### ***Prospects for interest rates***

- 3.7. The Authority has appointed Link Group as its treasury advisor and part of their service is to assist the Authority to formulate a view on interest rates. The following table and narrative within Appendix C - paragraphs C28 and C33 gives their view.

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 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

### ***Borrowing strategy***

- 3.8. As reported in the separate report on this agenda “Capital Programme 2023-24 to 2024-25”, it is the strategic intent of the Authority not to increase its exposure to external borrowing during the next three years. However, due to pressures within the revenue budget, a revenue contribution to capital investment has been suspended for 2023-24.
- 3.9. This being the case there is no intention to take out any new borrowing during 2023-24 as the Authority can rely on its prudent Capital Reserve. Should this position change then the Treasury Management Strategy will need to be reviewed to reflect any change to the borrowing strategy and would be subject to a further report to the Authority.

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

- 3.10. Per statutory requirements, the Authority will not borrow more than, or in advance of, its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the Authority can ensure the security of such funds.

### ***Debt rescheduling***

- 3.11. Officers regularly engage with Link to review the PWLB loan portfolio and consider opportunities for early repayment, this is not currently economically viable due to the penalties applied.
- 3.12. Rescheduling of current borrowing in our debt portfolio is unlikely to occur in the short-term but a watchful eye is kept on the viability of early repayment without incurring a penalty in doing so.

3.13. If rescheduling was done, it will be reported to this Committee, at the earliest meeting following its action.

**Liability Benchmark**

3.14. CIPFA has issued revised codes of practice on Treasury Management and the Prudential Code for Capital Finance in Local Authorities. One of the changes to the Treasury Management code is the introduction of a liability benchmark that can be compared to the local authority’s borrowing strategy and can be calculated to show the lowest risk level of borrowing.

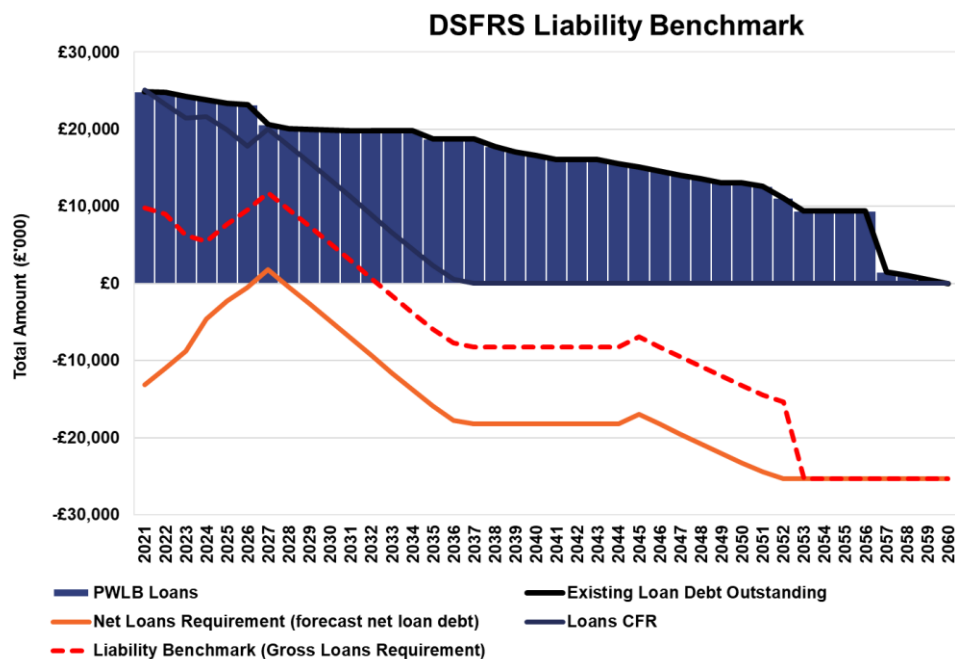
3.15. The chart below shows the liability benchmark that has been calculated from 2021 and future years: The following explanations are provided to assist with understanding the chart:

i. Blue shaded area – represents the Authority’s current fixed term loans for 2021 and future years. The amounts shown include any new borrowing for schemes included in the capital programme but does not include the replacement borrowing for maturing loans, hence the line reduces over time as existing loans are paid off.

ii. Solid blue line – an estimate of Loans Capital Financing Requirement (the CFR less any other long-term debt liabilities), this being the required level to fund the capital programme.

Solid red line – a forecast of the year end liability benchmark representing the lowest amount of borrowing that should be undertaken to maintain the Authority’s liquidity and minimise credit risk.

3.16. It is anticipated that the above borrowing requirement is manageable within the current borrowing strategy.



## 4. **ANNUAL INVESTMENT STRATEGY**

### ***Investment Policy***

- 4.1. The Authority's investment policy has regard to the MHCLG's Guidance on Local Government Investments ("the Guidance"), CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the Code") and the CIPFA Treasury Management Guidance Notes 2018. The Authority's investment priorities will be security first, portfolio liquidity second, then yield.
- 4.2. In accordance with the above guidance from the MHCLG and CIPFA, and in order to minimise the risk to investments, the Authority applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short-term and long-term ratings.
- 4.3. Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Authority will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.
- 4.4. Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

### ***Creditworthiness Policy***

- 4.5. The Authority applies the creditworthiness service provided by Link Group. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard & Poor's.
- 4.6. The credit ratings of counterparties are supplemented with the following overlays:
- credit watches and credit outlooks from credit rating agencies;
  - credit defaults swap spreads to give early warning of likely changes in credit ratings;
  - Sovereign ratings to select counterparties from only the most creditworthy countries.

- 4.7. This modelling approach combines credit ratings, credit watches, credit outlooks and Credit Default Swap spreads in a weighted scoring system which is then combined with an overlay of Credit Default Swap spreads for which the end product is a series of colour code bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Authority to determine the duration for investments and are therefore referred to as durational bands. The Authority is satisfied that this service now gives a much improved level of security for its investments. It is also a service which the Authority would not be able to replicate using in house resources.
- 4.8. The Link Group creditworthiness service uses a wider array of information than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings.
- 4.9. Typically the minimum credit ratings criteria the Authority 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.
- 4.10. All credit ratings will be monitored weekly. The Authority is alerted to changes to ratings of all three agencies through its use of the Link creditworthiness service. If a downgrade results in the counterparty/investment scheme no longer meeting the Authority's minimum criteria, its further use as a new investment will be withdrawn immediately. In addition to the use of Credit Ratings the Authority will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Authority's lending list.
- 4.11. Sole reliance will not be placed on the use of this external service. In addition the Authority will also use market data and market information, information on government support for banks and the credit ratings of that government support.

#### ***Approved Instruments for Investments***

- 4.12. Investments will only be made with those bodies identified by the authority for its use through the Annual Investment Strategy.
- 4.13. **Country Limits** The Authority will apply a sovereign rating at least equal to that of the United Kingdom for any UK based counterparty. At the time of writing this was AA long term and F1+ short term. It is possible that the credit rating agencies could downgrade the sovereign rating for the UK but as we have no minimum sovereign rating applying to the UK this approach will not limit the number of UK counterparties available to the Authority. Therefore, to ensure our credit risk is not increased outside the UK, the sovereign rating requirement for investments was amended to "Non UK countries with a minimum sovereign rating of AA-".

4.14. **IFRS9 Lease Accounting** As a result of the change in accounting standards for 2019/20 under IFRS 9, the Authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, 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 commencing from 1.4.18.). The Authority does not currently hold any finance leases to which this accounting standard would apply.

***Non-specified Investments***

4.15. Non specified investments are those which do not meet the Specified Investment Criteria and covers those counterparties where there is either no recognised credit rating and/or an anticipation that an investment will be for greater than one year in duration.

4.16. The Authority had not previously placed non-specified investments as a result of its prudent approach to place security and liquidity over yield. However, from April 2015 it was agreed that the strategy be amended to include investments with maturity of longer than 364 days. The maximum duration limit on any non-specified deposit will be determined by the colour assigned to the Counterparty on the Link Group credit list on the date the investment is placed, but typically will be for no longer than 24 months. Where such investments are placed via the Secondary Market i.e. buying the remaining term of an existing instrument, then the term will be for 24 months.

4.17. A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the categories outlined in Table 13 overleaf.

4.18. The maturity limits recommended will not be exceeded. Under the delegated powers the Section 112 Officer (Treasurer) can set limits that are based on the latest economic conditions and credit ratings.

4.19. The following table shows those bodies with which the Authority will invest.

Specified Investments	Non Specified Investments
	Subsidiary entities
Deposits with the Debt Management Agency Deposit Facility	
Term Deposits with UK government, UK local authorities, highly credit rated banks and building societies (including callable deposits and forward deals)	Term Deposits with UK government, UK local authorities, highly credit rated banks and building societies (including callable deposits and forward deals) Non-credit rated building societies.

	<b><i>The total amount of non-specified investments will not be greater than £5m in value.</i></b>
Banks nationalised/part nationalised or supported by the UK government	Banks nationalised/part nationalised or supported by the UK government
Money Market Funds	
Non UK highly credited rated banks	
UK Government Treasury Bills	
Certificates of Deposit	
Corporate Bonds	
Gilts	

4.20. The Authority's detailed risk management policy is outlined in the Treasury Management Policy which is reviewed and considered on an annual basis.

4.21. The above criteria has been amended since last year to reflect the potential for a loan to be made to the Authority's subsidiary company, although this would be subject to terms and conditions as approved by the Authority.

***Investment Strategy***

4.22. In-house funds: The Authority's in-house managed funds are mainly cash-flow derived and investments will accordingly be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates.

4.23. Investment returns: Bank Rates has seen much upward activity during the last 12 months rising from 0.25% in February 2022 to the current 3.5% with the projection for further increases during the next 12 months. We have assumed that investment earnings from money market-related instruments will be in the region of 3.50%-4.00% for the next 12 months.

4.24. The suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year are as follows:

2023-24	3.50%
2024/25	3.00%
2025/26	2.50%
2026/27	2.50%
Later years	2.00%



- 4.25. **Investment treasury indicator and limit** - total principal funds invested for greater than 365 days. These limits are set with regard to the Authority's liquidity requirements and to reduce the need for early sale of an investment and are based on the availability of funds after each year-end.

<b>Maximum principal sums invested &gt; 365 days</b>			
<b>£m</b>	<b>2023-24</b>	<b>2023-24</b>	<b>2024-25</b>
Principal sums invested > 365 days	£5m	£5m	£5m

***End of year investment report***

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

***Treasury Management Scheme of Delegation***

***The Authority;***

- Receiving and reviewing reports on treasury management policies, practices and activities
- Approval of annual strategy
- Approval of/amendments to the Authority's adopted clauses, treasury management policy statement and treasury management practices
- Budget consideration and approval
- Approval of the division of responsibilities
- Approving the selection of external service providers and agreeing terms of appointment.
- Reviewing the treasury management policy and procedures and making recommendations to the Authority.

***Resources Committee;***

- Receiving and reviewing regular monitoring reports and acting on recommendations
- Review of annual strategy prior to recommendation to full authority

***Role of the Section 112 officer (Director of Finance, People and Estates/ Treasurer)***

- Recommending clauses, treasury management policy/practices for approval, 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.

## **5. SUMMARY AND RECOMMENDATIONS**

- 5.1. The Authority is required to consider and approve the treasury management strategy to be adopted prior to the start of the financial year. This strategy must also include proposed prudential indicators and a Minimum Revenue Provision statement. Approval of the strategy for 2023-24 as contained in this report will also incorporate the adoption of the revised CIPFA Treasury Management Code of Practice.

**Shayne Scott**  
**Director of Finance, People and Estates (Treasurer)**

## APPENDIX A TO REPORT DSFRA/23/7

PRUDENTIAL INDICATORS	INDICATIVE INDICATORS				
	2023/24 £m Estimate	2024/25 £m Estimate	2025/26 £m Estimate	2026/27 £m Estimate	2027/28 £m Estimate
<b>Capital Expenditure</b>					
Non - HRA	12.751	6.900	5.400	2.200	2.100
HRA (applies only to housing authorities)					
<b>Total</b>	<b>12.751</b>	<b>6.900</b>	<b>5.400</b>	<b>2.200</b>	<b>2.100</b>
<b>Ratio of financing costs to net revenue stream</b>					
Non - HRA	2.91%	3.02%	3.18%	2.68%	2.61%
HRA (applies only to housing authorities)	0.00%	0.00%	0.00%	0.00%	0.00%
<b>Capital Financing Requirement as at 31 March</b>	£000	£000	£000	£000	£000
Non - HRA	23,771	25,388	25,836	24,291	22,637
HRA (applies only to housing authorities)	0	0	0	0	0
Other long term liabilities	656	509	349	182	0
<b>Total</b>	<b>24,426</b>	<b>25,897</b>	<b>26,186</b>	<b>24,473</b>	<b>22,637</b>
<b>Annual change in Capital Financing Requirement</b>	£000	£000	£000	£000	£000
Non - HRA	(628)	1,471	289	(1,713)	(1,836)
HRA (applies only to housing authorities)	0	0	0	0	0
<b>Total</b>	<b>(628)</b>	<b>1,471</b>	<b>289</b>	<b>(1,713)</b>	<b>(1,836)</b>
<b>PRUDENTIAL INDICATORS - TREASURY MANAGEMENT</b>					
<b>Authorised Limit for external debt</b>	£000	£000	£000	£000	£000
Borrowing	25,553	27,215	27,321	27,151	26,475
Other long term liabilities	823	681	527	359	182
<b>Total</b>	<b>26,376</b>	<b>27,897</b>	<b>27,848</b>	<b>27,509</b>	<b>26,657</b>
<b>Operational Boundary for external debt</b>	£000	£000	£000	£000	£000
Borrowing	24,364	25,946	26,030	25,936	25,343
Other long term liabilities	791	656	509	349	182
<b>Total</b>	<b>25,155</b>	<b>26,602</b>	<b>26,539</b>	<b>26,286</b>	<b>25,525</b>
<b>Maximum Principal Sums Invested over 364 Days</b>					
Principal Sums invested > 364 Days	5,000	5,000	5,000	5,000	5,000

TREASURY MANAGEMENT INDICATOR	Upper Limit %	Lower Limit %
Limits on borrowing at fixed interest rates	100%	70%
Limits on borrowing at variable interest rates	30%	0%
Maturity structure of fixed rate borrowing during 2023/24		
Under 12 months	30%	2%
12 months and within 24 months	30%	2%
24 months and within 5 years	50%	14%
5 years and within 10 years	75%	1%
10 years and above	100%	81%

## **APPENDIX B TO REPORT DSFRA/23/7**

### **MINIMUM REVENUE STATEMENT 2023-24**

#### ***Supported Borrowing***

The Minimum Revenue Provision will be calculated using the regulatory method (option 1). Minimum Revenue Provision will therefore be calculated using the formulae in the old regulations, since future entitlement to RSG in support of this borrowing will continue to be calculated on this basis.

#### ***Un-Supported Borrowing (including un-supported borrowing prior to 1 April 2008)***

The Minimum Revenue Provision in respect of unsupported borrowing under the prudential system will be calculated using the asset life method (option 3). The Minimum Revenue Provision will therefore be calculated to repay the borrowing in equal annual instalments over the life of the class of assets which it is funding. The repayment period of all such borrowing will be calculated when it takes place and will be based on the finite life of the class of asset at that time and will not be changed.

#### ***Finance Lease and PFI***

In the case of Finance Leases and on balance sheet PFI schemes, the Minimum Revenue Provision requirement is regarded as met by a charge equal to the element of the annual charge that goes to write down the balance sheet liability. Where a lease of PFI scheme is brought, having previously been accounted for off-balance sheet, the Minimum Revenue Provision requirement is regarded as having been met by the inclusion of the charge, for the year in which the restatement occurs, of an amount equal to the write-down for the year plus retrospective writing down of the balance sheet liability that arises from the restatement. This approach produces a Minimum Revenue Provision charge that is comparable to that of the Option 3 approach in that it will run over the life of the lease or PFI scheme and will have a profile similar to that of the annuity method.

Minimum Revenue Provision will normally commence in the financial year following the one in which the expenditure was incurred. However, when borrowing to construct an asset, the authority may treat the asset life as commencing in the year in which the asset first becomes operational. It may accordingly postpone the beginning to make Minimum Revenue Provision until that year. Investment properties will be regarded as becoming operational when they begin to generate revenues.

#### ***Minimum Revenue Provision Overpayments***

A change introduced by the revised MHCLG Minimum Revenue Provision Guidance was the allowance that any charges made over the statutory Minimum Revenue Provision, Voluntary Revenue Provision or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year. Up until the 31 March 2020 the total Voluntary Revenue Provision overpayments were £nil.

## LINK TREASURY SOLUTIONS ECONOMIC REPORT

### ECONOMICS UPDATE

The third quarter of 2022/23 saw:

- A 0.5% m/m rise in GDP in October, mostly driven by the reversal of bank holiday effects;
- Signs of economic activity losing momentum as households increased their savings;
- CPI inflation fall to 10.7% in November after peaking at 11.1% in October;
- A small loosening in the labour market which pushed the unemployment rate up to 3.7% in October;
- Interest rates rise by 125bps over Q4 2022, taking Bank Rate to 3.50%;
- Reduced volatility in UK financial markets but a waning in global risk appetite.

GDP fell by 0.3% q/q in Q3 2022 (ending 30th September), which probably marked the start of the UK recession. About half of that decline was the effects of the extra bank holiday in September for the Queen's funeral. The unwinding of those bank holiday effects meant that GDP rebounded in October and explained at least 0.3 percentage points (ppts) of the 0.5% m/m rise. Accordingly, if GDP were to avoid falls of more than 0.2% m/m in November and December, then GDP over Q4 as a whole could avoid a contraction, which would prevent a recession in 2022.

However, at 49.0 in December, the flash composite activity PMI stayed below the "boom-bust" level of 50 and pointed to a small 0.1% q/q contraction in GDP in Q4. Consumer confidence was -42 in December and stayed close to its record low of -49 in September. Strike action could be another small drag and may mean that GDP is 0.0% to 0.5% lower than otherwise in December. GDP is projected to contract marginally in Q4 by around 0.1% q/q.

Meanwhile, the 0.4% m/m fall in retail sales volumes in November only reversed some of the 0.9% m/m rise in October. That left sales volumes 4.5% below their level at the start of the year. Indeed, the rise in the household saving rate from 6.7% in Q2 to 9.0% in Q3 implied that higher interest rates are encouraging households to save more. And a larger-than-usual £6.2bn rise in cash in household bank accounts in October may imply households have started to increase their precautionary savings.

There were signs that the labour market was loosening gradually going into the final quarter of 2022. Although employment in the three months to October rose by 27,000, the fall in the composite PMI employment balance in December took it into contractionary territory and suggests that labour demand will cool. Meanwhile, labour supply improved as inactivity fell by 76,000 in the three months to October. That helped drive a rise in the unemployment rate from 3.6% in September to 3.7% in October. The number of job vacancies in November fell for the sixth consecutive month and were 18% below their peak in May.

Crucially, though, wage growth remained resilient. Average earnings growth, excluding bonuses, grew by 0.7% m/m in October, above the 2022 monthly average of 0.5% m/m. That drove the 3my rate up to 6.2%, well above the rates of 3-3.5% consistent with inflation at its 2% target. Wage growth is likely to slow gradually in the coming months as the labour market loosens further but if extensive strike action is successful in achieving large pay increases, then wage growth could be a bit stronger for longer.

CPI inflation peaked in October at a 41-year high of 11.1% and fell to 10.7% in November. Goods price inflation, which is driven largely by global factors, has peaked. The sharp rises in energy prices in 2022 mean that energy price inflation will fall sharply in 2023. Meanwhile, the large fall in agricultural prices since May means that food price inflation should start to decline soon. What's more, upward pressure on goods price inflation from global supply shortages is fading quickly.

Domestic inflation pressures also eased in Q4. The 0.2% m/m rise in core CPI inflation in November was the smallest monthly gain since August 2020 and drove a fall in core CPI inflation from 6.5% in October to 6.3% in November. Services CPI inflation was stable at 6.3% in November despite the resilience of wage growth. And the easing of price expectations in the Bank of England's Decision Maker Panel survey in November suggests that inflation may become less persistent.

The Chancellor's Autumn Statement on 17th November succeeded in restoring the government's fiscal credibility in the eyes of the financial markets without deepening the recession. The total fiscal consolidation package of £54.9bn (1.8% of GDP) in 2027/28 made the outlook for fiscal policy much tighter than at the beginning of Q4. The package was heavily backloaded, with net handouts of £3.8bn (0.15% of GDP) in 2023/24 and £0.3bn (0.01% of GDP) in 2024/25, and most of the tightening kicking in after 2024/25. The largest fiscal support was the extension of the Energy Price Guarantee for another 12 months, until April 2024, although at a higher price cap of £3,000 from April 2023 rather than £2,500. At the same time, Chancellor Hunt loosened the fiscal rules by requiring debt as a percentage of GDP to be falling in five years' time, rather than three. The Office of Budget Responsibility (OBR) estimated that the Chancellor will meet this new rule with a slim £9.2bn (0.3% of GDP) to spare.

With fiscal policy now doing much less to fan domestic inflation pressures, we think Bank Rate will peak at 4.50%, or at least close to that figure. Despite stepping up the pace of policy tightening to a 75-basis point (bps) rate hike in November, taking Bank Rate from 2.25% to 3.00%, the MPC's communication was dovish. The MPC pushed back heavily against market rate expectations, which at the time were for Bank Rate to peak at 5.25%. The Bank's new forecasts predicted a deeper and longer recession than the analyst consensus, of eight quarters and with a peak-to-trough fall in real GDP of 2.9%.

The Bank sounded dovish again in December when it slowed the pace of tightening with a 50bps rate rise, from 3.00% to 3.50%. Two members, Dhingra and Tenreyro, voted to leave rates unchanged, judging that the current level of Bank Rate was sufficient to bring inflation back to target. That said, the rest of the MPC appeared to suggest that further rate hikes would be necessary. We expect that the majority of the MPC will need to see stronger signs that activity is slowing, the labour market is loosening, and wage growth is slowing before stopping rate rises.

As such, we expect that the MPC will deliver three further rate hikes in February, March and May, taking Bank Rate to a peak of 4.50% but with the pace of increase reducing to 25bps in March and May.

Gilt yields have fallen sharply since their highs following the “mini-budget” on 23rd September as government fiscal credibility has been largely restored with the resignation of Truss-Kwarteng and the fiscal consolidation package announced at the Autumn Statement on 17th November. Indeed, the 10-year yield fell from a peak of 4.55% to about 3.60% now, while the 30-year yield fell from 5.10% to 3.90%. Admittedly, yields rose by around 50bps in December, partially on the back of a global rise in yields. But if we are right in thinking Bank Rate will fall back in 2024 and 2025 then gilt yields will probably fall over the next two years, with the 10-year yield slipping from around 3.60% now to 3.30% by the end of 2023 and to 2.80% by the end of 2024.

Lower volatility in gilt markets in Q4 meant that the Bank of England was able to stop its purchases of long-term gilts for financial stability reasons as planned on 14th October. It was also able to begin active gilt sales in November, albeit with a focus on shorter dated gilts. So far quantitative tightening has had little influence on short-term money markets. But as it is still an experiment, the risk of a widespread tightening in financial conditions remains.

The restoration of fiscal credibility boosted the pound and the FTSE 100 early in Q4. While much of the benefit passed in the first half of Q4, sterling continued to rally against a softer dollar. Our colleagues at Capital Economics do not think that the global recession is fully priced into markets, and so expect a further fall in risk appetite to boost safe haven demand for the dollar and weigh on the pound. They are expecting the pound to fall from \$1.19 now to \$1.10 in mid-2023, before climbing to \$1.15 by the end of 2023 as the prospect of lower interest rates and a recovery in global economic growth buoys equity prices.

Through December, the rally in the FTSE 100 petered out as investors have become increasingly concerned by the prospect of a global recession. However, the relatively dovish tone of the Bank of England, compared to the Federal Reserve and the ECB meant that UK equities held up better than other developed market indices. Indeed, at 7,452 at the December month end, the FTSE 100 is only marginally below its peak of 7,568 on 5th December, while the S&P 500 is around 4% lower over the same period. Nevertheless, there is a great deal of uncertainty as to which direction markets will move in 2023 and at what pace. Continued volatility is anticipated.

### MPC meetings 3rd November and 15th December 2022

On 3rd November, the Bank of England’s Monetary Policy Committee (MPC) increased Bank Rate by 75 basis points to 3.00%, and on 15th December moved rates up a further 50 basis points to 3.50%. The later increase reflected a split vote – six members voting for a 50 basis points increase, one for 75 basis points and two for none.

Nonetheless, the UK government appears more settled now, with Rishi Sunak as Prime Minister, and Jeremy Hunt as Chancellor. Having said that, a multitude of strikes across several public services and the continued cost-of-living squeeze is going to make for a difficult backdrop to maintain fiscal rectitude without pushing the economy into anything worse than a mild recession.

Of course, what happens outside of the UK is also critical to movement in gilt yields. The US FOMC has led with increases of 425 basis points in 2022 and is expected to increase rates further in 2023. Similarly, the ECB has also started to tighten monetary policy, albeit from an ultra-low starting point, as have all the major central banks apart from Japan (although the BoJ has “tightened” its policy by widening the accepted yield levels for 10yr JGBs, from 0.25% to 0.5% on 20th December). Arguably, though, it is US monetary policies that are having the greatest impact on global bond markets.

What happens in Ukraine will also impact the global economy, but particularly in Europe. The search for alternative providers of energy, other than Russia, will take both time and effort. The weather will also play a large part in how high energy prices stay and for how long.