

## Treasury Management Strategy 2023/24

### Contents

#### 1.0 Introduction

1.1 Treasury Management Policy Statement

1.2 Background to treasury management

#### 2.0 External Context

2.1 Economic Background

2.2 Credit Outlook

2.3 Interest Rate Forecast

#### 3.0 Local Context

#### 4.0 Liability Benchmark

#### 5.0 Borrowing Strategy

5.1 Objectives

5.2 Strategy

5.3 Sources of Borrowing

5.4 Other Sources of Debt Finance

5.5 Municipal Bonds Agency

5.6 LOBOs

5.7 Short-Term and variable Rate Loans

5.8 Debt Rescheduling

#### 6.0 Investment Strategy

6.1 Objectives

6.2 Strategy

6.3 Environmental, Social, Governance

6.4 Business Models

6.5 Approved Counterparties

6.6 Government

- 6.7 Secured Investments
- 6.8 Banks and Building Societies Secured
- 6.9 Registered Providers
- 6.10 Money Market Funds
- 6.11 Strategic Pooled Funds
- 6.12 Real Estate Investment Trusts
- 6.13 Other Investments
- 6.14 Operational Bank Accounts
- 6.15 Risk Assessment and Credit Rating
- 6.16 Other Information on the Security of Investments
- 6.17 Investment Limits
- 6.18 Liquidity Management

## **7.0 Treasury Management Indicators**

- 7.1 Security
- 7.2 Liquidity
- 7.3 Interest rate Exposures
- 7.4 Maturity Structure of Borrowing
- 7.5 Principal Sums Invested for Periods Longer than a Year

## **8.0 Related Matters**

- 8.1 Financial Derivatives
- 8.2 Markets in Financial Instruments Directive

## **9.0 Financial Implications**

## **10.0 Other Options Considered**

## **Appendices**

**A** - Economic and Interest Rate Forecast

**B**- Local Context for Economic and Credit Environment

**C**- Investment and Debt Portfolio Position at 31<sup>st</sup> December 2022

**D**- Approved Investment counterparties and limits 2022/23

## **1.0 Introduction**

### **1.1 Treasury management policy statement**

- The council defines 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.
- The 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.

### **1.2 Background to treasury management**

Treasury management is the management of the Council's cash flows, borrowing and investments, and the associated risks. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Council's prudent financial management.

Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2021 Edition (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year. This report fulfils the Authority's legal obligation under the *Local Government Act 2003* to have regard to the CIPFA Code.

Investments held for service purposes or for commercial profit are considered in a different report, the Investment Strategy.

## **2.0 External Context (See also Appendix B)**

### **2.1 Economic background**

The ongoing impact on the UK from the war in Ukraine, together with higher inflation, higher interest rates, uncertain government policy, and a deteriorating economic outlook, will be major influences on the Authority's treasury management strategy for 2023/24.

The Bank of England (BoE) increased Bank Rate by 0.5% to 3.5% in December 2022. This followed a 0.75% rise in November which was the largest single rate hike since 1989 and the ninth successive rise since December 2021. The December decision was voted for by a 6-3 majority of the Monetary Policy Committee (MPC), with two dissenters voting for a no-change at 3% and one for a larger rise of 0.75%.

The November quarterly Monetary Policy Report (MPR) forecast a prolonged but shallow recession in the UK with CPI inflation remaining elevated at over 10% in the near-term. While the projected peak of inflation is lower than in the August report, due in part to the government's support package for household energy costs, inflation is expected remain higher for longer over the forecast horizon and the economic outlook remains weak, with unemployment projected to start rising.

The UK economy contracted by 0.3% between July and September 2022 according to the Office for National Statistics, and the BoE forecasts Gross Domestic Product (GDP) will decline 0.75% in the second half of the year due to the squeeze on household income from higher energy costs and goods prices. Growth is then expected to continue to fall throughout 2023 and the first half of 2024.

CPI inflation is expected to have peaked at around 11% in the last calendar quarter of 2022 and then fall sharply to 1.4%, below the 2% target, in two years' time and to 0% in three years' time if the Bank Rate follows the path implied by financial markets at the time of the November MPR (a peak of 5.25%). However, the BoE stated it considered this path to be too high, suggesting that the peak in interest rates will be lower, reducing the risk of inflation falling too far below target. Market rates have fallen since the time of the November MPR.

The labour market remains tight for now, with the most recent statistics showing the unemployment rate was 3.7%. Earnings were up strongly in nominal terms by 6.1% for both total pay and for regular pay but factoring in inflation means real pay for both measures was -2.7%. Looking forward, the November MPR shows the labour market weakening in response to the deteriorating outlook for growth, leading to the unemployment rate rising to around 6.5% in 2025.

Interest rates have also been rising sharply in the US, with the Federal Reserve increasing the range on its key interest rate by 0.5% in December 2022 to 4.25%-4.5%. This rise follows four successive 0.75% rises in a pace of tightening that has seen rates increase from 0.25%-0.50% in March 2022. Annual inflation has been slowing in the US

but remains above 7%. GDP grew at an annualised rate of 3.2% (revised up from 2.9%) between July and September 2022, but with official interest rates expected to rise even further in the coming months, a recession in the region is widely expected at some point during 2023.

Inflation rose consistently in the Euro Zone since the start of the year, hitting a peak annual rate of 10.6% in October 2022, before declining to 10.1% in November. Economic growth has been weakening with an upwardly revised expansion of 0.3% (from 0.2%) in the three months to September 2022. As with the UK and US, the European Central Bank has been on an interest rate tightening cycle, pushing up its three key interest rates by 0.50% in December, following two consecutive 0.75% rises, taking its main refinancing rate to 2.5% and deposit facility rate to 2.0%.

## **2.2 Credit outlook**

Credit default swap (CDS) prices have generally followed an upward trend throughout 2022, indicating higher credit risk. They have been boosted by the war in Ukraine, increasing economic and political uncertainty and a weaker global and UK outlook, but remain well below the levels seen at the beginning of the Covid-19 pandemic.

CDS price volatility was higher in 2022 compared to 2021 and the divergence in prices between ringfenced (retail) and non-ringfenced (investment) banking entities has emerged once again.

The weakening economic picture during 2022 led the credit rating agencies to reflect this in their assessment of the outlook for the UK sovereign as well as several local authorities and financial institutions, revising them from to negative from stable.

There are competing tensions in the banking sector which could impact bank balance sheet strength going forward. The weakening economic outlook and likely recessions in many regions increase the possibility of a deterioration in the quality of banks' assets, while higher interest rates provide a boost to net income and profitability.

However, the institutions on our adviser, Arlingclose's, counterparty list remain well-capitalised and their counterparty advice on both recommended institutions and maximum duration remain under constant review and will continue to reflect economic conditions and the credit outlook.

### **2.3 Interest rate forecast**

The Authority's treasury management adviser Arlingclose forecasts that Bank Rate will continue to rise in 2022 and 2023 as the Bank of England attempts to subdue inflation which is significantly above its 2% target.

While interest rate expectations reduced during October and November 2022, multiple interest rate rises are still expected over the forecast horizon despite looming recession. Arlingclose expects Bank Rate to rise to 4.25% by June 2023 under its central case, with the risks in the near- and medium-term to the upside should inflation not evolve as the Bank forecasts and remains persistently higher.

Yields are expected to remain broadly at current levels over the medium-term, with 5-, 10- and 20-year gilt yields expected to average around 3.6%, 3.7%, and 3.9% respectively over the 3-year period to December 2025. The risks for short, medium and longer-term yields are judged to be broadly balanced over the forecast horizon. As ever, there will undoubtedly be short-term volatility due to economic and political uncertainty and events.

A more detailed economic and interest rate forecast provided by Arlingclose is in Appendix A.

### **3.0 Local Context**

On 31st December 2022, the Authority held £34.4m of borrowing and £63.0m of treasury investments. This is set out in further detail at Appendix C. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance sheet summary and forecast

	<b>31.3.22 Actual £m</b>	<b>31.3.23 Forecast £m</b>	<b>31.3.24 Estimate £m</b>	<b>31.3.25 Estimate £m</b>	<b>31.3.26 Estimate £m</b>
General Fund CFR	70.4	71.5	75.3	73.6	73.0
<b>CFR</b>	<b>70.4</b>	<b>71.5</b>	<b>75.3</b>	<b>73.6</b>	<b>73.0</b>
Less: Other debt liabilities <sup>(1)</sup>	0.6	0.6	0.6	0.6	0.6
Less: External borrowing <sup>(2)</sup>	38.9	34.4	34.3	34.3	34.3
<b>Internal borrowing</b>	<b>30.9</b>	<b>36.5</b>	<b>40.4</b>	<b>38.7</b>	<b>38.1</b>
Less: Balance Sheet Resources	78.0	80.0	75.0	70.0	65.0
<b>(Investments) or New borrowing</b>	<b>(47.1)</b>	<b>(43.5)</b>	<b>(34.6)</b>	<b>(31.3)</b>	<b>(26.9)</b>

<sup>(1)</sup> Finance lease of Phoenix Court commercial property.

<sup>(2)</sup> Reduced borrowing due to the loans being repaid which were financing the Places for People Loan.

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), balance sheet resources are the underlying sums, available for investment. The Council's current strategy is to maintain borrowing and investments below their underlying levels, known as internal borrowing.

The Council has an increasing CFR due to the capital programme, but has investments and balance sheet resources, and will therefore not be required to borrow up to 2024/25.

CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Council expects to comply with this recommendation during 2023/24.

#### **4.0 Liability Benchmark**

To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as table 1 above, but that cash and investment balances are kept to a minimum level of £10m at each year-end to maintain enough liquidity but minimise credit risk.

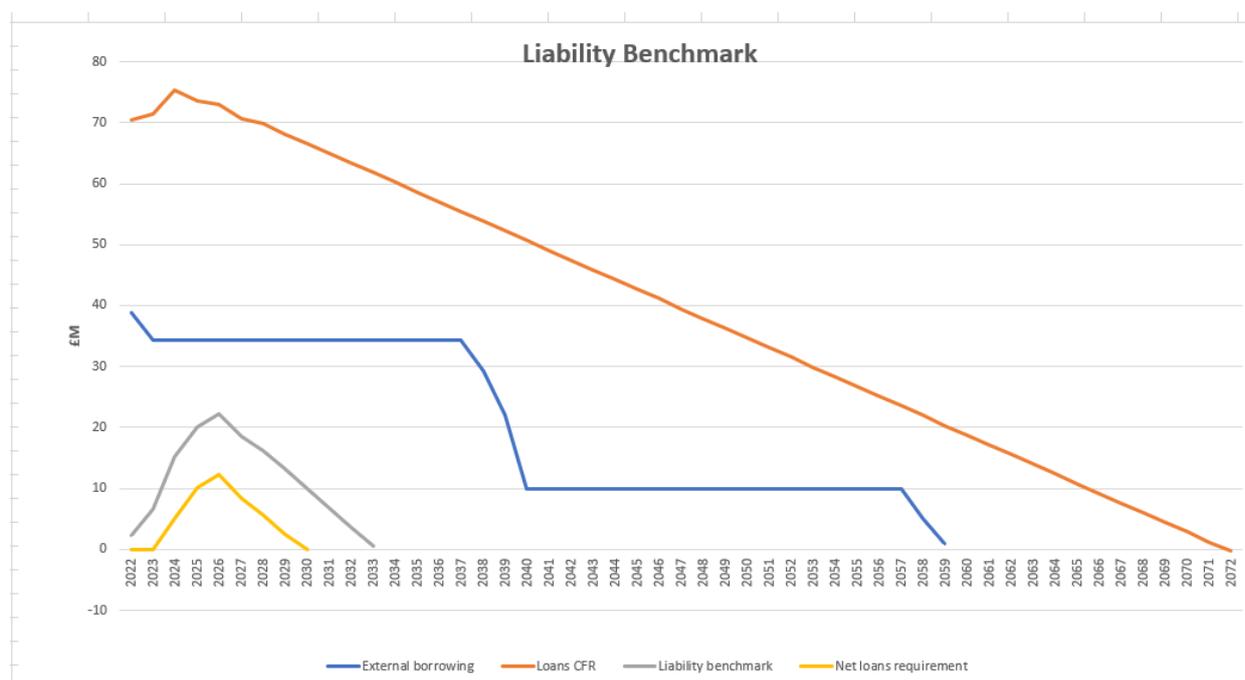
The liability benchmark is an important tool to help establish whether the Council is likely to be a long-term borrower or long-term investor in the future, and so shape its strategic focus and decision making. The liability benchmark itself represents an estimate of the cumulative amount of external borrowing the Council must hold to fund its current capital

and revenue plans while keeping treasury investments at the minimum level required to manage day-to-day cash flow.

**Table 2: Prudential Indicator: Liability benchmark**

	<b>31.3.22 Actual £m</b>	<b>31.3.23 Forecast £m</b>	<b>31.3.24 Estimate £m</b>	<b>31.3.25 Estimate £m</b>	<b>31.3.26 Estimate £m</b>
CFR	70.4	71.5	75.3	73.6	73.0
Less: Balance Sheet Resources	78.0	74.9	70.2	63.5	60.8
Plus: Liquidity Allowance	10.0	10.0	10.0	10.0	10.0
<b>Liability Benchmark</b>	<b>2.4</b>	<b>6.6</b>	<b>15.1</b>	<b>20.1</b>	<b>22.2</b>

Following on from the medium-term forecasts in table 2 above, the long-term liability benchmark assumes capital expenditure funded by borrowing of £34m a year, minimum revenue provision on new capital expenditure based on asset lives and income, expenditure and reserves all increasing by inflation of 2.5% a year. This is shown in the chart below together with the maturity profile of the Authority’s existing borrowing:



The purpose of this indicator is to compare the council’s existing loans (External Borrowing line) against its future need for loan debt, the liability benchmark. As the borrowing line is above the liability benchmark the council has more debt than it needs (based on current budgets), and the excess will be invested, this also suggests that the council has no immediate need to borrow. If there were a need to borrow the liability

benchmark would assist in deciding the amount of borrowing and the duration (this would be indicated by the liability benchmark being above the borrowing line at a point in time).

It should be noted the liability benchmark makes no assumptions about capital budgets not yet set, and so is based on current spending plans.

The chart also shows that the council meets the requirement of the Prudential Code, for borrowing to remain below the CFR (Capital Financing Requirement), borrowing should mature as the CFR is reduced over the years by MRP.

## **5.0 Borrowing Strategy**

The Council currently holds £34.4m of loans (31/12/2022), as part of its strategy for funding previous years' capital programmes and Commercial Investment Strategy. The balance sheet forecast in table 1 shows that the Council does not expect to need to borrow in 2023/24. The Council may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £135.0m.

### **5.1 Objectives**

The Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

### **5.2 Strategy**

Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

By doing so, the Council can reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal and short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Council with this 'cost of carry' and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2023/24 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

The Authority has previously raised almost all of its long-term borrowing from the PWLB but will consider long-term loans from other sources including banks, pensions and local

authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Authority intends to avoid this activity in order to retain its access to PWLB loans.

Alternatively, the Council may arrange forward starting loans during 2023/24, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

In addition, the Council may borrow short-term loans to cover unplanned cash flow shortages.

### **5.3 Sources of Borrowing**

The approved sources of long-term and short-term borrowing are:

- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- any other UK public sector body
- UK public and private sector pension funds
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

### **5.4 Other sources of debt finance**

In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- leasing
- hire purchase
- Private Finance Initiative
- sale and leaseback

### **5.5 Municipal Bonds Agency**

UK Municipal Bonds Agency (UK MBA) plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It issues bonds on the capital markets and lends the proceeds to local authorities at a rate below PWLB. This is a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a joint and several guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a

lead time of several months between committing to borrow and knowing the interest rate payable. When the Council makes the decision to borrow, the option will be taken to consider whether the PWLB or the Municipal Bonds Agency are the most effective and efficient lender. Prior to approval to borrow from the UK MBA, separate approval will be sought from Cabinet.

## **5.6 LOBOs**

The Council does not hold any LOBOs (Lender's Option Borrower's Option) loans. This is where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost.

## **5.7 Short-Term and Variable Rate Loans**

These loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below.

## **5.8 Debt rescheduling**

The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk. The recent rise in interest rates means that more favourable debt rescheduling opportunities should arise than in previous years.

## **6.0 Investment Strategy**

The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In the year 2022/23 to December, the Council's investment balance has ranged between £39m in April 2022 and £63m in December 2022, these levels are expected to reduce in the forthcoming year.

## **6.1 Objectives**

The CIPFA Code requires the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal

or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested. The Authority aims to be a responsible investor and will consider environmental, social and governance (ESG) issues when investing.

## **6.2 Strategy**

As demonstrated by the liability benchmark above, the Authority expects to be a long-term investor and treasury investments will therefore include both short-term low risk instruments to manage day-to-day cash flows and longer-term instruments where limited additional risk is accepted in return for higher investment income to support local public services.

The CIPFA Code does not permit local authorities to both borrow and invest long-term for cash flow management. But the Authority may make long-term investments for treasury risk management purposes, including to manage interest rate risk by investing sums borrowed in advance for the capital programme for up to three years; to manage inflation risk by investing usable reserves in instruments whose value rises with inflation; and to manage price risk by adding diversification to the strategic pooled fund portfolio.

## **6.3 Environmental, Social and Governance (ESG)**

ESG considerations are increasingly a factor in global investors' decision making, but the framework for evaluating investment opportunities is still developing and therefore the Authority's ESG policy does not currently include ESG scoring or other real-time ESG criteria at an individual investment level. When investing in banks and funds, the Authority will prioritise banks that are signatories to the UN Principles for Responsible Banking and funds operated by managers that are signatories to the UN Principles for Responsible Investment, the Net Zero Asset Managers Alliance and/or the UK Stewardship Code.

## **6.4 Business models**

Under the new IFRS 9 standard, the accounting for certain investments depends on the Council's "business model" for managing them. The Council aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

## **6.5 Approved counterparties**

The Council may invest its surplus funds with any of the counterparty types in table 3 below, subject to the cash limits (per counterparty) and the time limits shown.

For 2023/24 some of the limits in the table below have been reduced, as a response to the more uncertain financial environment over the next few years, (please refer to appendix D for the changes).

Table 3: Approved investment counterparties and limits

Sector	Time Limit	Counterparty Limit	Sector Limit
UK Government including DMO	50 years	unlimited	n/a
Other government entities	5 years	£4m	Unlimited
Local Authorities	5 years	£2m	Unlimited
Secured investments*	1 year	£2m	Unlimited
Banks (unsecured)*	6 months	£2m	Unlimited
Transactional Bank (Natwest)	Overnight	£4m	Unlimited
Building Societies (unsecured)*	6 months	£1m	£10m
Registered providers (unsecured)*	1 Year	£1m	£10m
Money Market Funds*	n/a	£4m	Unlimited
Strategic pooled funds	n/a	£5m	£20m
Real Estate investment trusts	n/a	£5m	£15m

\* **Minimum credit rating:** Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating is no lower than A-. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

For entities without published credit ratings, investments may be made either (a) where external advice indicates the entity to be of similar credit quality; or (b) to a maximum of £500,000 per counterparty as part of a diversified pool e.g. via a peer-to-peer platform.

This table must be read in conjunction with the notes below

## 6.6 Government

Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

## 6.7 Secured investments

Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they

are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

### **6.8 Banks and building societies unsecured**

Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

### **6.9 Registered providers**

Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are tightly regulated by the Regulator of Social Housing. As providers of public services, they retain the likelihood of receiving government support if needed. This does not include service loans which are subject to separate authorisation by Cabinet.

### **6.10 Money Market Funds**

Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the Authority will always take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

### **6.11 Strategic Pooled funds**

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

### **6.12 Real estate investment trusts**

Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as

the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.

### **6.13 Other investments**

This covers treasury investments not listed above, for example unsecured corporate bonds and company loans. Non-bank companies cannot be bailed-in but can become insolvent placing the Authority's investment at risk.

### **6.14 Operational Bank Accounts**

The Council may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances (not available on a daily basis) will therefore be kept low and only contain balances sufficient for operational purposes. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.

### **6.15 Risk assessment and credit ratings**

Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

### **6.16 Other information on the security of investments**

The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Council's treasury management

adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council’s cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned but will protect the principal sum invested.

### 6.17 Investment Limits

The Council’s revenue reserves (including general fund and earmarked) available to cover investment losses are forecast to be £12.9m on 31<sup>st</sup> March 2023 and £12.6m on 31<sup>st</sup> March 2024. In order that no more than 50% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £5m. Overnight deposits with the transactional bank, Natwest, are limited to £4m.

A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers’ nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table 4: Additional Investment limits

	<b>Cash limit</b>
Any group of pooled funds under the same management eg Blackrock, HSBC, CCLA etc.	£5m per manager
Negotiable instruments held in a broker’s nominee account	£4m per broker
Foreign countries	£2m per country

### 6.18 Liquidity management

The Council uses cash flow forecasting spreadsheets to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet

its financial commitments. Limits on long-term investments are set by reference to the Council's medium-term financial plan and cash flow forecast.

## 7.0 Treasury Management Prudential Indicators

The Council measures and manages its exposures to treasury management risks using the following indicators.

### 7.1 Security

The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

Credit risk indicator	Target
Portfolio average credit rating	A-

### 7.2 Liquidity

The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling 3 month period, without additional borrowing.

Liquidity risk indicator	Target
Total cash available within 3 months	£10m

### 7.3 Interest Rate Exposures

This indicator is set to control the Council's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates will be:

Interest rate risk indicator	Limit
Upper limit on one-year revenue impact of a 1% <u>rise</u> in interest rates	£630,000
Upper limit on one-year revenue impact of a 1% <u>fall</u> in interest rates	£630,000

The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at new market rates. £0.63m is a 5% impact on forecast reserves of £12.6m.

## 7.4 Maturity structure of borrowing

This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing will be:

<b>Refinancing rate risk indicator</b>	<b>Upper limit</b>	<b>Lower limit</b>
Under 12 months	80%	0%
12 months and within 24 months	80%	0%
24 months and within 5 years	80%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%
20 years and above	100%	0%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

## 7.5 Long Term Treasury Management Investments

The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The prudential limits on the long-term treasury management investments will be:

<b>Price risk indicator</b>	<b>2023/24</b>	<b>2024/25</b>	<b>2025/26</b>	<b>No fixed date</b>
Limit on principal invested beyond year end	£12m	£10m	£8m	£6m

Long-term investments with no fixed maturity date include strategic pooled funds and real estate investment trusts but exclude money market funds and bank accounts with no fixed maturity date as these are considered short-term.

## 8.0 Related Matters

The CIPFA Code requires the Council to include the following in its treasury management strategy.

### 8.1 Financial Derivatives

Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward

deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the *Localism Act 2011* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

In line with the CIPFA Code, the Authority will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.

## **8.2 Markets in Financial Instruments Directive**

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

## **9.0 Financial Implications**

The budget for investment income in 2023/24 is £0.1m. The budget for debt interest paid in 2023/24 is £1.0m. If actual levels of investments and borrowing, or actual interest rates, differ from that forecast, performance against budget will be correspondingly different. There is also a small budget for short-term borrowing if required of £5,000.

## **10.0 Other Options Considered**

The CIPFA Treasury Management Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Financial Officer, having consulted the Executive Councillor for Strategic Resources believes that the above strategy represents an appropriate balance between risk management and cost

effectiveness. Alternative strategies, with their financial and risk management implications, are listed below.

<b>Alternative</b>	<b>Impact on income and expenditure</b>	<b>Impact on risk management</b>
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

### Arlingclose Economic & Interest Rate Forecast November 2022

#### Underlying assumptions:

- The influence of the mini-budget on rates and yields continues to wane following the more responsible approach shown by the new incumbents of Downing Street.
- Volatility in global markets continues, however, as investors seek the extent to which central banks are willing to tighten policy, as evidence of recessionary conditions builds. Investors have been more willing to price in the downturn in growth, easing financial conditions, to the displeasure of policymakers. This raises the risk that central banks will incur a policy error by tightening too much.
- The UK economy is already experiencing recessionary conditions and recent GDP and PMI data suggests the economy entered a technical recession in Q3 2022. The resilience shown by the economy has been surprising, despite the downturn in business activity and household spending. Lower demand should bear down on business pricing power – recent data suggests the UK has passed peak inflation.
- The lagged effect of the sharp tightening of monetary policy, and the lingering effects of the mini-budget on the housing market, widespread strike action, alongside high inflation, will continue to put pressure on household disposable income and wealth. The short- to medium-term outlook for the UK economy remains bleak.
- Demand for labour appears to be ebbing, but not quickly enough in the official data for most MPC policymakers. The labour market remains the bright spot in the economy and persisting employment strength may support activity, although there is a feeling of borrowed time. The MPC focus is on nominal wage growth, despite the huge real term pay cuts being experienced by the vast majority. Bank Rate will remain relatively high(er) until both inflation and wage growth declines.
- Global bond yields remain volatile as investors price in recessions even as central bankers push back on expectations for rate cuts in 2023. The US labour market remains tight and the Fed wants to see persistently higher policy rates, but the lagged effects of past hikes will depress activity more significantly to test the Fed's resolve.
- While the BoE appears to be somewhat more dovish given the weak outlook for the UK economy, the ECB seems to harbour (worryingly) few doubts about the short term direction of policy. Gilt yields will be broadly supported by both significant new bond supply and global rates expectations due to hawkish central bankers, offsetting the effects of declining inflation and growth.

#### Forecast:

- The MPC raised Bank Rate by 50bps to 3.5% in December as expected, with signs that some members believe that 3% is restrictive enough. However, a majority of

members think further increases in Bank Rate might be required. Arlingclose continues to expect Bank Rate to peak at 4.25%, with further 25bps rises February, March and May 2023.

- The MPC will cut rates in the medium term to stimulate a stuttering UK economy, but will be reluctant to do so until wage growth eases. We see rate cuts in the first half of 2024.
- Arlingclose expects gilt yields to remain broadly steady over the medium term, although with continued volatility across shorter time periods.
- Gilt yields face pressures to both sides from hawkish US/EZ central bank policy on one hand to the weak global economic outlook on the other. BoE bond sales and high government borrowing will provide further underlying support for yields.

	Current	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>Official Bank Rate</b>													
Upside risk	0.00	0.50	0.75	1.00	1.00	1.00	1.25	1.50	1.75	1.50	1.25	1.25	1.25
Arlingclose Central Case	3.50	4.00	4.25	4.25	4.25	4.25	4.00	3.75	3.50	3.25	3.25	3.25	3.25
Downside risk	0.00	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00
<b>3-month money market rate</b>													
Upside risk	0.00	0.50	0.75	1.00	1.00	1.00	1.25	1.50	1.75	1.50	1.25	1.25	1.25
Arlingclose Central Case	3.00	4.40	4.40	4.40	4.35	4.30	4.25	4.00	3.75	3.50	3.40	3.40	3.40
Downside risk	0.00	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00
<b>5yr gilt yield</b>													
Upside risk	0.00	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.43	3.60	3.80	3.80	3.80	3.70	3.60	3.50	3.40	3.30	3.30	3.30	3.30
Downside risk	0.00	0.80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
<b>10yr gilt yield</b>													
Upside risk	0.00	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.47	3.50	3.60	3.60	3.60	3.60	3.50	3.50	3.50	3.50	3.50	3.50	3.50
Downside risk	0.00	0.80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
<b>20yr gilt yield</b>													
Upside risk	0.00	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.86	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85
Downside risk	0.00	0.80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
<b>50yr gilt yield</b>													
Upside risk	0.00	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.46	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60
Downside risk	0.00	0.80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00

### Local Context for Economic and Credit Environment

#### Economic Background

The forecast reduction in national economic activity is likely to have an adverse effect on the Council's trading operations (e.g. Commercial Property, Markets, Car Parks, Building Control, Development Control, One Leisure etc ) as well as receipts from business rates and council tax.

In addition, restricted economic growth will increase financial strain on households which may result in increased demand for Council services such as benefits, homelessness, and housing services.

Inflationary pressures will start to effect council spending. As a result, there is likely to be pressure on some budgets where costs are rising. There will also be increased pressure in the MTFS to mitigate this pressure through changes in spending and income generation.

#### Credit Outlook

The Council monitors credit ratings and credit default swaps rates using the treasury management advisor's monthly updates. These are used to make decisions about which institutions to invest with, based on the parameters set within the Treasury Management strategy.

The monthly listing from the treasury management advisors (Arlingclose) shows, the rates and recommended durations for a range of financial institutions. The Council's investments are in most part of short duration therefore (apart from the DMO), therefore any adverse movements in credit ratings would be a signal to remove investments from those institutions.

Some of the counterparty limits set within this strategy have been lowered as a response to the potential (although unlikely) failure of some financial institutions due to possible increases in bad debts.

The Council uses Natwest for its transactional banking but keeps the investment balance held with Natwest to sufficient levels to meet upcoming operational needs.

#### Interest Rate Forecast

The increase in the Bank of England rate has had a positive impact on all market rates including Money Market Funds and deposit accounts rates. As a result, interest received has increased during the year 2022/23. The downside is that borrowing from the PWLB and other sources is becoming more expensive, therefore any projects involving the requirement to borrow will be subject to extensive modelling to determine the total life cost and benefits.

Investment & Debt Portfolio Position 31<sup>st</sup> December 2022

	<b>31/12/22 Actual Portfolio £m</b>	<b>31/12/22 Average Rate %</b>
<b>External borrowing:</b>		
Public Works Loan Board	34.4	<b>2.8</b>
Local authorities	0	
Other loans	0.1	
<b>Total external borrowing</b>	<b>34.5</b>	
<b>Other long-term liabilities:</b>		
Finance Leases	0.6	
<b>Total other long-term liabilities</b>	<b>0.6</b>	
<b>Total gross external debt</b>	<b>35.1</b>	
<b>Treasury investments:</b>		
Banks & building societies (unsecured)	1.2	0.80
Government - DMO	38.5	1.99
Money Market Funds	19.3	1.06
Pooled property fund	4.0	3.98
<b>Total treasury investments</b>	<b>63.0</b>	
<b>Net investments</b>	<b>27.9</b>	

## Appendix D

### Approved Investment counterparties and limits 2022/23 (Previous Year)

These limits have been superseded by those detailed in section 6.5 of this strategy. The changes are in bold.

#### 2022/23 Approved investment counterparties and limits

Sector	2022/23 Time Limit	2023/24 Time Limit	2022/23 Counterparty Limit	2023/24 Counterparty Limit	Sector Limit
UK Government	50 years	50 years	unlimited	unlimited	n/a
Other government entities	25 years	<b>5 years</b>	£4m	£4m	Unlimited
Local Authorities	25 Years	<b>5 years</b>	£4m	<b>£2m</b>	
Secured investments	25 years	<b>1 year</b>	£4m	<b>£2m</b>	Unlimited
Banks (unsecured)	13 months	<b>6 months</b>	£4m	<b>£2m</b>	Unlimited
Transactional Bank (Natwest)	Overnight	Overnight	£22m	<b>£4m</b>	Unlimited
Building Societies (unsecured)	13 months	<b>6 months</b>	£4m	<b>£1m</b>	£10m
Registered providers (unsecured)	5 Years	<b>1 Year</b>	£4m	<b>£1m</b>	£10m
Money Market Funds	n/a	n/a	£4m	£4m	Unlimited
Strategic pooled funds	n/a	n/a	£5m	£5m	£20m
Real Estate investment trusts	n/a	n/a	£5m	£5m	£15m