

Treasury Management Strategy 2024/25
(Including the Annual Investment Strategy)

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Key Considerations

2021 revised CIPFA Treasury Management Code and Prudential Code – changes which will impact on future TMSS/AIS reports and the risk management framework.

CIPFA published the revised Codes on 20th December 2021 and stated that revisions need to be included in the reporting framework from the 2023/24 financial year. This Council, therefore, has to have regard to these Codes of Practice when it prepares the Treasury Management Strategy Statement and Annual Investment Strategy, and also related reports during the financial year, which are taken to Full Council for approval.

The revised Treasury Management Code required all investments and investment income to be attributed to one of the following three purposes: -

Treasury management

Arising from the organisation's cash flows or treasury risk management activity, this type of investment represents balances which are only held until the cash is required for use. Treasury investments may also arise from other treasury risk management activity which seeks to prudently manage the risks, costs or income relating to existing or forecast debt or treasury investments.

Service delivery

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

Commercial return

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

The revised Treasury Management Code requires a council to implement the following: -

- 1. Adopt a liability benchmark treasury indicator** to support the financing risk management of the capital financing requirement; this is to be shown in chart form for a minimum of ten years, with material differences between the liability benchmark and actual loans to be explained;
- 2. Long-term treasury investments**, (including pooled funds), are to be classed as commercial investments unless justified by a cash flow business case;

3. **Pooled funds** are to be included in the indicator for principal sums maturing in years beyond the initial budget year;
4. Amendment to the **knowledge and skills register** for officers and members involved in the treasury management function - to be proportionate to the size and complexity of the treasury management conducted by each council;
5. **Reporting to members is to be done quarterly.** Specifically, the Chief Finance Officer (CFO) is required to establish procedures to monitor and report performance against all forward-looking prudential indicators at least quarterly. The CFO is expected to establish a measurement and reporting process that highlights significant actual or forecast deviations from the approved indicators. However, monitoring of prudential indicators, including forecast debt and investments, is not required to be taken to Full Council and should be reported as part of the Council's integrated revenue, capital and balance sheet monitoring;
6. **Environmental, social and governance (ESG)** issues to be addressed within the Council's treasury management policies and practices (TMP1).

The main requirements of the Prudential Code relating to service and commercial investments are: -

1. The risks associated with service and commercial investments should be proportionate to their financial capacity – i.e. that plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services;
2. A council must not borrow to invest for the primary purpose of commercial return;
3. It is not prudent for local authorities to make any investment or spending decision that will increase the CFR, and so may lead to new borrowing, unless directly and primarily related to the functions of the Council, and where any commercial returns are either related to the financial viability of the project in question or otherwise incidental to the primary purpose;
4. An annual review should be conducted to evaluate whether commercial investments should be sold to release funds to finance new capital expenditure or refinance maturing debt;
5. A prudential indicator is required for the net income from commercial and service investments as a proportion of the net revenue stream;
6. Create new Investment Management Practices to manage risks associated with non-treasury investments, (similar to the current Treasury Management Practices).

A council's Capital Strategy or Annual Investment Strategy should include:

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1. The Council's approach to investments for service or commercial purposes (together referred to as non-treasury investments), including defining the Council's objectives, risk appetite and risk management in respect of these investments, and processes ensuring effective due diligence;
2. An assessment of affordability, prudence and proportionality in respect of the Council's overall financial capacity (i.e., whether plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services);
3. Details of financial and other risks of undertaking investments for service or commercial purposes and how these are managed;
4. Limits on total investments for service purposes and for commercial purposes respectively (consistent with any limits required by other statutory guidance on investments);
5. Requirements for independent and expert advice and scrutiny arrangements (while business cases may provide some of this material, the information contained in them will need to be periodically re-evaluated to inform the Council's overall strategy);
6. State compliance with paragraph 51 of the Prudential Code in relation to investments for commercial purposes, in particular the requirement that a council must not borrow to invest primarily for financial return.

As this TMSS and AIS deals solely with treasury management investments, the categories of service delivery and commercial investments will be addressed as part of the Capital Strategy and Investment Strategy.

1.0 Introduction

1.1 Policy Statement and Background

1.1.1 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.

1.1.2 Background

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

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning, to ensure that it can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet risk or cost objectives.

The contribution the treasury management function makes to the Council is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and

balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

CIPFA defines treasury management as:

“The management of the local council’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.”

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

1.2 Reporting Requirements

1.2.1 Capital Strategy

The CIPFA 2021 Prudential and Treasury Management Codes require all local authorities to prepare a Capital Strategy report which will provide the following:

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- 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

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

1.2.2 Treasury Management Reporting

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

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

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

- an Annual Investment Strategy, (the parameters on how investments are to be managed)
- b. **A mid-year treasury management report** – This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision. In addition, this Council 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.

Scrutiny

The above reports are required to be adequately scrutinised before being recommended to the Full Council. This role is undertaken by the Overview and Scrutiny Panel (Performance and Growth).

Quarterly reports – In addition to the three major reports detailed above, from 2023/24 quarterly reporting (end of June/end of December) is also required. However, these additional reports do not have to be reported to Full Council/Board but do require to be adequately scrutinised. This role is undertaken by the Overview and Scrutiny Panel (Performance and Growth). (The reports, specifically, should comprise updated Treasury/Prudential Indicators.)

1.3 Treasury Management Strategy for 2024/25

The strategy for 2024/25 covers two main areas:

Capital issues

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

Treasury management issues

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

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

1.4 Training

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

Furthermore, pages 47 and 48 of the Code state that they expect “all organisations to have a formal and comprehensive knowledge and skills or training policy for the effective acquisition and retention of treasury management knowledge and skills for those responsible for management, delivery, governance and decision making. The scale and nature of this will depend on the size and complexity of the organisation’s treasury management needs.

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

- Prepare tailored learning plans for treasury management officers and councillors.
- Require treasury management officers and councillors to undertake self-assessment against the required competencies.
- Have regular communication with officers and councillors, encouraging them to highlight training needs on an ongoing basis.”

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

The training needs of treasury management officers are periodically reviewed. A formal record of the training received by officers central to the Treasury function will be maintained as part of the officer’s CPD record.

1.5 Treasury Management Consultants

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

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

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

2. THE CAPITAL PRUDENTIAL INDICATORS 2024/25 – 2026/27

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

2.1 Capital Expenditure and Financing

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

Capital expenditure £000s	2022/23 Actual	2023/24 Forecast	2024/25 Budget	2025/26 Budget	2026/27 Budget
Property, Plant and Equipment	2,526	4,050	6,603	2,888	1,313
Investment Property	29	2,857	0	0	0
Intangible Assets	60	556	243	20	70
REFCUS	7,441	11,467	19,110	4,306	4,306
Infrastructure Assets	139	3	17	0	0
Community Assets	0	501	0	0	0
Loans	0	100	100	0	0
Total	10,195	19,534	26,073	7,214	5,689

⁽¹⁾REFCUS is Revenue Expenditure Financed from Capital Under Statute, this would include DFGs and other grants given.

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

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

Financing of capital expenditure £000s	2022/23 Actual	2023/24 Forecast	2024/25 Budget	2025/26 Budget	2026/27 Budget
Capital receipts	662	440	300	250	200
Capital grants	1,710	8,426	17,410	1,501	1,501
Capital reserves	3,370	4,615	3,228	2,706	2,706
S106	15	0	0	0	0
MRP	2,556	2,660	3,006	3,204	3,525
Total Financing	8,313	16,141	23,944	7,661	7,932
Internal Borrowing	1,882	3,393	2,129	(447)	(2,243)
Total	10,195	19,534	26,073	7,214	5,689

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

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

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

The CFR includes any other long-term liabilities (e.g. finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of schemes include a borrowing facility provided by the lease provider and so the Council is not required to separately borrow for these schemes. The Council currently has £0.6m of such schemes within the CFR.

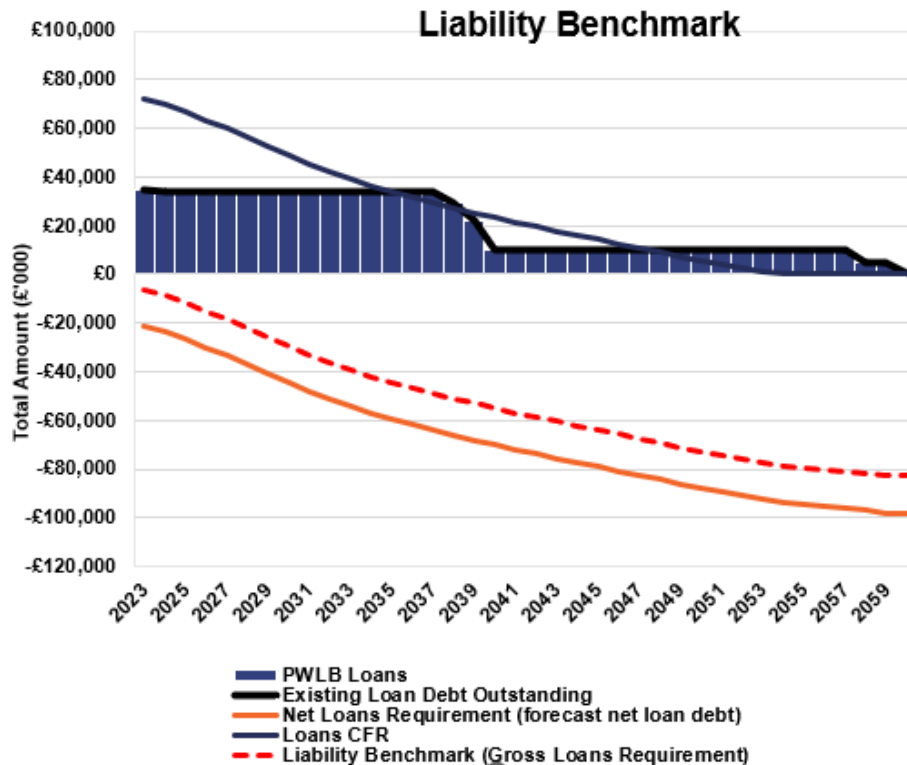
The Council is asked to approve the CFR projections below:

£000s	2022/23 Actual	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate
Capital Financing Requirement					
General Fund	72,260	75,653	77,783	77,336	75,093
Total CFR	72,260	75,653	77,783	77,336	75,093
Movement in CFR	1,882	3,393	2,129	(447)	(2,243)

Movement in CFR represented by					
Net financing need for the year (above)	4,439	6,053	5,135	2,757	1,282
Less MRP/VRP and other financing movements	(2,557)	(2,660)	(3,006)	(3,204)	(3,525)
Movement in CFR	1,882	3,393	2,129	(447)	(2,243)

2.3 Liability Benchmark

The Council is required to estimate and measure the Liability Benchmark (LB) for the forthcoming financial year and the following two financial years, as a minimum.



There are four components to the LB: -

1. **Existing loan debt outstanding:** the Council's existing loans that are still outstanding in future years.
2. **Loans CFR:** this is calculated in accordance with the loans CFR definition in the Prudential Code and projected into the future based on approved prudential borrowing and planned MRP. This includes only current borrowing not future unplanned borrowing.
3. **Net loans requirement:** this will show the Council's gross loan debt less treasury management investments at the last financial year-end, projected into the future and based on its approved prudential borrowing, planned MRP and any other major cash flows forecast.
4. **Liability benchmark** (or gross loans requirement): this equals net loans requirement plus short-term liquidity allowance. In practice this is the amount required to pay the regular precept payments.

The Council is currently in an under-borrowed position (external borrowing is less than the CFR, internal borrowing is being used ie reserves and working capital to fund capital expenditure), this according to the liability benchmark will

continue until the mid 2030s, although as plans evolve the CFR will likely move outwards. The CFR is being gradually reduced by application of the minimum revenue provision (MRP) charge to revenue, although as new expenditure plans are made the CFR line will reduce at a slower rate, and will not in reality reach zero.

The cash available to invest will increase as the MRP builds up in the cash balances. The liability benchmark line (dotted) is the cash available to invest less a liquidity buffer to meet any immediate cashflow needs.

2.4 Core Funds and Expected Investment Balances

The application of resources (e.g., capital receipts, reserves) 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 (e.g., asset sales). Detailed below are estimates of the year-end balances for each resource and anticipated day-to-day cash flow balances.

Year End Resources £000s	2022/23 Actual	2023/24 Forecast	2024/25 Budget	2025/26 Budget	2026/27 Budget
General Fund Balance	2,175	2,175	2,175	2,175	2,175
Earmarked Reserves	28,940	32,978	32,599	32,009	31,395
Capital Receipts Reserve	4,527	4,527	4,527	4,527	4,527
Capital Grants Unapplied	1,650	1,650	1,650	1,650	1,650
CIL Reserve	54,989	54,989	54,989	54,989	54,989
Total core funds	92,281	96,319	95,940	95,350	94,736
Balance Sheet Resources (Working capital) ⁽¹⁾	(5,692)	(5,000)	(5,000)	(5,000)	(5,000)
Under/over borrowing	(37,896)	(41,383)	(43,523)	(43,082)	(40,839)
Expected investments	48,693	49,936	47,417	47,268	48,897

⁽¹⁾Working capital balances shown are estimated year-end; these may be higher mid-year

3. BORROWING

The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity and the Council'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 and prudential indicators, the current and projected debt positions, and the Annual Investment Strategy.

3.1 Current Portfolio Position

The overall treasury management portfolio as at 31/3/2023 and for the position as at 31/12/2023 are shown below for both borrowing and investments.

TREASURY PORTFOLIO				
	actual 31.3.23	actual 31.3.23	current 31.12.23	current 31.12.23
	£000	%	£000	%
Treasury investments				
Banks	1,121	2	481	1
DMADF (H.M.Treasury)	40,000	72	56,350	74
Money Market Funds	10,400	19	15,600	20
Property Fund	4,000	7	4,000	5
Total treasury investments	55,521	100	76,431	100
Treasury external borrowing				
Local Authorities	0	0	0	0
PWLB	34,338	99.92	34,255	99.94
Salix	26	0.08	22	0.06
Total external borrowing	34,364	100	34,277	100
Net treasury investments / (borrowing)	21,157		42,154	

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

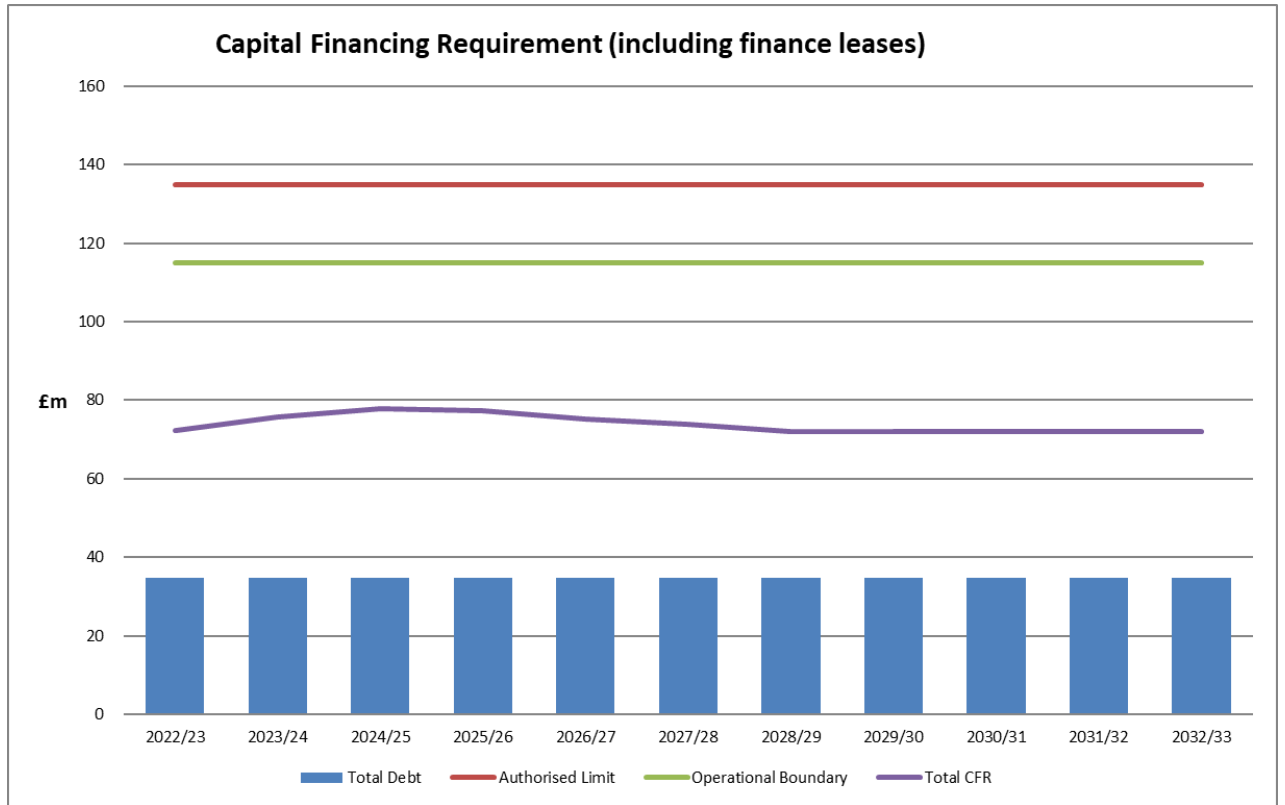
£m	2022/23 Actual	2023/24 Forecast	2024/25 Budget	2025/26 Budget	2026/27 Budget
External Debt					
Debt at 1 April	38.9	35.0	34.9	34.9	34.9
Expected change in Debt	(4.5)	(0.1)	0.0	0.0	0.0
Other long-term liabilities (OLTL)	0.6				
Expected change in OLTL	0.0	0.0	0.0	0.0	0.0
Actual gross debt at 31 March	35.0	34.9	34.9	34.9	34.9
The Capital Financing Requirement	72.3	75.6	77.8	77.3	75.1
Under / (over) borrowing	37.3	40.7	42.9	42.4	40.2

Within the range of prudential indicators there are several key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short-term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2024/25 and the following two financial years. This allows some flexibility for limited early borrowing for future years but ensures that borrowing is not undertaken for revenue or speculative purposes.

The Director of Finance and Resources reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes account of current commitments, existing plans and the proposals in this budget report.

3.2 Treasury Indicators: Limits to Borrowing Activity

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.



There may be some movement upwards in the CFR as a result of the changes in account regulations in relation to leases. The changes require leases where the Council is a lessee to be accounted for on the balance sheet from 2024/25, whereas previously they were just a revenue charge. The expectation is that the amount will not be significant.

3.3 Interest Rate Forecasts

The Council has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Link provided the following forecasts on 08 January 2024. These are forecasts for Bank Rate, average earnings and PWLB certainty rates, gilt yields plus 80 bps.

Link Group Interest Rate View 08.01.24													
	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27
BANK RATE	5.25	5.25	4.75	4.25	3.75	3.25	3.00	3.00	3.00	3.00	3.00	3.00	3.00
3 month ave earnings	5.30	5.30	4.80	4.30	3.80	3.30	3.00	3.00	3.00	3.00	3.00	3.00	3.00
6 month ave earnings	5.20	5.10	4.60	4.10	3.70	3.30	3.10	3.10	3.10	3.10	3.10	3.10	3.10
12 month ave earnings	5.00	4.90	4.40	3.90	3.60	3.20	3.10	3.10	3.10	3.10	3.10	3.20	3.20
5 yr PWLB	4.50	4.40	4.30	4.20	4.10	4.00	3.80	3.70	3.60	3.60	3.50	3.50	3.50
10 yr PWLB	4.70	4.50	4.40	4.30	4.20	4.10	4.00	3.90	3.80	3.70	3.70	3.70	3.70
25 yr PWLB	5.20	5.10	4.90	4.80	4.60	4.40	4.30	4.20	4.20	4.10	4.10	4.10	4.10
50 yr PWLB	5.00	4.90	4.70	4.60	4.40	4.20	4.10	4.00	4.00	3.90	3.90	3.90	3.90

Additional notes by Link on this forecast table: -

- Our central forecast for interest rates was previously updated on 7 November and reflected a view that the MPC would be keen to further demonstrate its anti-inflation credentials by keeping Bank Rate at 5.25% until at least the second half of 2024. We expect rate cuts to start when both the CPI inflation and wage/employment data are supportive of such a move, and when there is a likelihood of the overall economy enduring at least a slowdown or mild recession over the coming months (although most recent GDP releases have surprised with their on-going robustness).
- Naturally, timing on this matter will remain one of fine judgment: cut too soon, and inflationary pressures may well build up further; cut too late and any downturn or recession may be prolonged.
- In the upcoming months, our forecasts will be guided not only by economic data releases and clarifications from the MPC over its monetary policies and the Government over its fiscal policies, but also international factors such as policy development in the US and Europe, the provision of fresh support packages to support the faltering recovery in China as well as the on-going conflict between Russia and Ukraine, and Gaza and Israel.

PWLB RATES

- The short and medium part of the gilt curve has rallied since the start of November as markets price in a quicker reduction in Bank Rate through 2024 and 2025 than held sway back then. This reflects market confidence in inflation falling back in a similar manner to that already seen in the US and the Euro-zone. At the time of writing there is c70 basis points difference between the 5 and 50 year parts of the curve.

The balance of risks to the UK economy: -

- The overall balance of risks to economic growth in the UK is even.

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

- **Labour and supply shortages** prove more enduring and disruptive and depress economic activity (accepting that in the near-term this is also an upside risk to inflation and, thus, could keep gilt yields high for longer).
- **The Bank of England** has increased Bank Rate too fast and too far over recent months, and subsequently brings about a deeper and longer UK recession than we currently anticipate.
- **Geopolitical risks**, for example in Ukraine/Russia, the Middle East, China/Taiwan/US, Iran and North Korea, which could lead to increasing safe-haven flows.

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

- Despite the tightening in Bank Rate to 5.25%, the Bank of England allows inflationary pressures to remain elevated for a long period within the UK economy, which then necessitates Bank Rate staying higher for longer than we currently project.
- **The pound weakens** because of a lack of confidence in the UK Government's pre-election fiscal policies, resulting in investors pricing in a risk premium for holding UK sovereign debt.
- Projected **gilt issuance, inclusive of natural maturities and quantitative tightening**, could be too much for the markets to comfortably digest without higher yields compensating.

LINK GROUP FORECASTS

We expect the MPC will keep Bank Rate at 5.25% until the second half of 2024, to combat on-going inflationary and wage pressures, even if they have dampened somewhat of late. We do not think that the MPC will increase Bank Rate above 5.25%.

Gilt yields and PWLB rates

The overall longer-run trend is for gilt yields and PWLB rates to fall back over the timeline of our forecasts, as inflation continues to fall through 2024.

The target borrowing rates are set **two years forward** (as we expect rates to fall back) and the current PWLB (certainty) borrowing rates are set out below:

PWLB debt	Current borrowing rate as at 08.01.24 p.m.	Target borrowing rate now (end of Q4 2025)	Target borrowing rate previous (end of Q3 2025)
5 years	4.53%	3.70%	3.80%
10 years	4.67%	3.90%	3.80%
25 years	5.19%	4.20%	4.20%
50 years	4.97%	4.00%	4.00%

Borrowing advice: Our long-term (beyond 10 years) forecast for Bank Rate remains at 3% and reflects Capital Economics' research that suggests AI and general improvements in productivity will be supportive of a higher neutral interest rate. As all PWLB certainty rates are currently significantly above this level, borrowing strategies will need to be reviewed in that context. Overall, better value can be obtained at the shorter end of the curve and short-dated fixed Local Authority to Local Authority monies should be considered. Temporary borrowing rates will remain elevated for some time to come but may prove the best option whilst the market continues to factor in Bank Rate reductions for 2024 and later.

Our suggested budgeted earnings rates for investments up to about three months' duration in each financial year are set out below.

Average earnings in each year	Now	Previously
2023/24 (residual)	5.30%	5.30%
2024/25	4.55%	4.70%
2025/26	3.10%	3.20%
2026/27	3.00%	3.00%
2027/28	3.25%	3.25%
2028/29	3.25%	3.25%
Years 6 to 10	3.25%	3.25%
Years 10+	3.25%	3.25%

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

Our interest rate forecast for Bank Rate is in steps of 25 bps, whereas PWLB forecasts have been rounded to the nearest 10 bps and are central forecasts within bands of + / - 25 bps. Naturally, we continue to monitor events and will update our forecasts as and when appropriate.

3.4 Borrowing Strategy

One of the main functions of the treasury management service is the funding of the Council's capital plans. Capital plans provide a guide to the borrowing need of the Council and help ensure that the Council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short term loans or using longer term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.

The Council's main objective when borrowing money is to strike an appropriate balance between securing low interest costs and achieving cost certainty over the period for which funds are required. 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 long term stability of the debt portfolio.

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

Against this background and the risks within the economic forecast, caution will be adopted with the 2024/25 treasury operations. The Director of Finance and Resources will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances, if there were a requirement to borrow then;

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

3.5 Policy on Borrowing in Advance of Need

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

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

3.6 Rescheduling

Rescheduling of current borrowing in the Council’s debt portfolio may be considered whilst premature redemption rates remain elevated but only if there is surplus cash available to facilitate any repayment, or rebalancing of the portfolio to provide more certainty is considered appropriate.

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

3.7 New Financial Institutions as a Source of Borrowing and / or Types of Borrowing

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

- Local authorities (primarily shorter dated maturities out to 3 years or so – generally still cheaper than the Certainty Rate).
- Financial institutions (primarily insurance companies and pension funds but also some banks, out of forward dates where the objective is to avoid a “cost of carry” or to achieve refinancing certainty over the next few years).

The Council’s treasury advisors, Link, will keep the Council informed as to the relative merits of each of these alternative funding sources.

3.8 Approved Sources of Long and Short-term Borrowing

On Balance Sheet	Fixed	Variable
PWLB	●	●
UK Municipal Bond Agency	●	●
Local Authorities	●	●
Banks	●	●
Pension Funds	●	●
Insurance Companies	●	●
UK Infrastructure Bank	●	●
Market (long-term)	●	●

Market (temporary)	●	●
Market (LOBOs)	●	●
Stock Issues	●	●
Local Temporary Borrowing	●	●
Local Bonds	●	
Local Authority Bills	●	●
Overdraft		●
Negotiable Bonds	●	●
Internal (capital receipts & revenue balances)	●	●
Commercial Paper	●	
Medium Term Notes	●	
Finance Leases	●	●

4 ANNUAL INVESTMENT STRATEGY

4.1 Investment Policy – Management of Risk

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

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

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

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

In the current economic climate, it is considered appropriate to maintain a degree of liquidity to cover cash flow needs but to also consider “laddering” (staggered maturity dates to allow for reinvestment, potentially at a higher rate if rates are moving upwards) investments for periods up to 12 months with high credit rated financial institutions, whilst investment rates remain elevated, as well as wider range fund options.

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

1. Minimum acceptable **credit criteria** are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short-term and long-term ratings.
2. **Other information:** ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as “credit default swaps” and overlay that information on top of the credit ratings.
3. **Other information sources** used will include the financial press, share price and other such information pertaining to the financial sector in order

to establish the most robust scrutiny process on the suitability of potential investment counterparties.

4. This Council has defined the list of **types** of investment instruments that the treasury management team are authorised to use. There are two lists in Appendix 5.4 under the categories of 'specified' and 'non-specified' investments.

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

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

5. **Non-specified and loan investment limits.** The Council has determined that it will set a limit to the maximum exposure of the total treasury management investment portfolio to non-specified treasury management investments of £10m.
6. **Lending limits**, (amounts and maturity), for each counterparty will be set through applying the matrix table in paragraph 4.2. Although lower limits may be applied in times of market stress.
7. This Council will set a limit for its investments which are invested for **longer than 365 days**, (see paragraph 4.4).
8. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating**, (see paragraph 4.3).
9. This Council has engaged **external consultants**, (see paragraph 1.5), to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this Council in the context of the expected level of cash balances and need for liquidity throughout the year.
10. All investments will be denominated in **sterling**.
11. As a result of the change in accounting standards for 2023/24 under IFRS 9, this Council will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, the MHCLG, concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years ending 31.3.23. More recently, a further extension to the over-ride to 31.3.25 has been agreed by Government.

However, this Council will also pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see paragraph 4.5). Regular monitoring of investment performance will be carried out during the year.

Changes in risk management policy from last year.

Some limits have been increased due to the expected high cash balances in 2024/25, this allows further investment in the high quality counterparties already in use. As inflation and interest rates are expected to fall or at least remain steady in 2024/25 there will be less stress in the market allowing for more confidence in placing larger investments with selected counterparties.

The limit placed on Local Council investments has been increased back up to £4m (prior to 2023/24 limit) from £2m, but investments will be subject to due diligence on financial statements and advice from Link.

Bank investment limit has increased from £2m to £4m, this is so that access to a wider range of green funds and ESG investments is available, where counterparties impose a minimum investment limit above £2m.

Money market fund limits have been increased from £4m to £5m to reflect the wider spread of counterparties when compared to single counterparty investments e.g., banks. In addition this will allow for further investment if DMO interest rates fall faster than general market rates.

4.2 Creditworthiness Policy

This Council applies the creditworthiness service provided by the 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. The credit ratings of counterparties are supplemented with the following overlays: -

1. "watches" and "outlooks" from credit rating agencies;
2. CDS spreads that may give early warning of changes in credit ratings;
3. sovereign ratings to select counterparties from only the most creditworthy countries.

This modelling approach combines credit ratings, and any assigned Watches and Outlooks, in a weighted scoring system which is then combined with an overlay of CDS spreads. The end-product of this is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will, therefore, use counterparties within the following durational bands;

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

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

Typically, the minimum credit ratings criteria the Council uses will be a short-term rating (Fitch or equivalent) 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.

All credit ratings will be monitored as updates are received and taken into account for future investing. The Council 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 Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Council will be advised of information in movements in Credit Default Swap spreads against the iTraxx European Senior Financials benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

Sole reliance will not be placed on the use of this external service. In addition, this Council will also use market data and market information, as well as information on any external support for banks to help support its decision-making process.

Y	Pi1	Pi2	P	B	O	R	G	N/C
1	1.25	1.5	2	3	4	5	6	7
Up to 5yrs	Up to 5yrs	Up to 5yrs	Up to 2yrs	Up to 1yr	Up to 1yr	Up to 6mths	Up to 100days	No Colour

	Colour (and long-term rating where applicable)	Monetary Limit	Time limit
Banks⁽¹⁾	Yellow	£4m	5 years
Banks	Purple	£4m	2 years
Banks	Orange	£4m	1 year
Banks – part nationalised	Blue	£4m	1 year
Banks	Red	£4m	6 months
Banks	Green	£4m	100 days
Banks	No Colour	Not to be used	
Council’s banker (if “No Colour”)	No Colour	£4m	1 day
Building Societies	Orange	£1m	1 Year
DMADF	UK sovereign rating	Unlimited	5 Years DMO limit is currently 6 months
Other Government Entities	UK sovereign rating	£5m	5 Years
Local authorities	n/a	£4m	1 year
Housing associations	Colour bands	£1m	As per colour band up to 1 year
	Fund rating ⁽²⁾	Monetary Limit	Time Limit
Money Market Funds CNAV	AAA	£5m	liquid
Money Market Funds LVNAV	AAA	£5m	liquid
Money Market Funds VNAV	AAA	£5m	liquid
Ultra-Short Dated Bond Funds with a credit score of 1.25	Dark Pink / AAA	£2m	liquid

Ultra-Short Dated Bond Funds with a credit score of 1.50	Light Pink / AAA	£2m	liquid
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(1) Please note: the yellow colour category is for UK Government debt, or its equivalent, money market funds and collateralised deposits where the collateral is UK Government debt – see appendix 5.4.

(2) Please note: “fund” ratings are different to individual counterparty ratings (ie the counterparties the funds are invested with), coming under either specific “MMF” or “Bond Fund” rating criteria.

Creditworthiness.

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

CDS prices

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

4.3 Limits

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

- a. **Non-specified treasury management investment limit.** The Council has determined that it will limit the maximum total exposure of treasury management investments to non-specified treasury management investments as being £10m of the total treasury management investment portfolio.
- b. **Country limit.** The Council has determined that it will only use approved counterparties from the UK, and from countries with a **minimum sovereign credit rating of AA- from fitch or equivalent** . The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 5.5. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

Other limits. In addition: -

- no more than £2m will be placed with any non-UK country at any time (this applies to direct investments - MMFs may have exposure in excess of this)
- limits in place above will apply to a group of companies/institutions
- sector limits will be monitored regularly for appropriateness

4.4 Investment Strategy

In-house funds. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e., rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. The current shape of the yield curve suggests that is the case at present, but there is the prospect of Bank Rate having peaked in the second half of 2023 and possibly reducing as early as the second half of 2024 so an agile investment strategy would be appropriate to optimise returns.

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

Investment returns expectations.

The current forecast shown in paragraph 3.3, includes a forecast for Bank Rate to have peaked at 5.25%.

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

Average earnings in each year	
2023/24 (residual)	5.30%
2024/25	4.55%
2025/26	3.10%
2026/27	3.00%
2027/28	3.25%
Years 6 to 10	3.25%
Years 10+	3.25%

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

Investment treasury indicator and limit - total principal funds invested for greater than 365 days. These limits are set with regard to the Council'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.

The Council is asked to approve the following treasury indicator and limit: -

Upper limit for principal sums invested for longer than 365 days			
£m	2024/25	2025/26	2026/27
Principal sums invested for longer than 365 days	10.0	9.0	8.0
Current investments as at 31/12/2023 in excess of 1 year maturing in each year	4.0	4.0	4.0

4.5 Investment Performance and Risk Benchmarking

Through the normal reporting cycle the following indicators will be reported:

- Portfolio risk score
- Average credit rating
- Weighted average maturity
- Interest rate risk
- Rate of return

Security – The target for average credit rating is A-. This is the value weighted average credit rating of the investment portfolio.

Liquidity – The target is £15m of cash available for unexpected payments, over a 3 month rolling period.

Interest rate risk – The upper limit on the 1 year revenue impact of a 1% rise or fall in interest rates. The target is £630,000.

4.6 End of Year Investment Report

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

5. Annexes

1. Capital prudential and treasury indicators
2. Interest rate forecasts
3. Economic background
4. Treasury management practice 1 – credit and counterparty risk management
5. Approved countries for investments
6. Treasury management scheme of delegation
7. The treasury management role of the section 151 officer
8. Glossary

5.1 THE CAPITAL PRUDENTIAL AND TREASURY INDICATORS 2024/25 – 2026/27

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

5.1.1 Capital Expenditure

Capital expenditure £m	2022/23 Actual	2023/24 Forecast	2024/25 Budget	2025/26 Budget	2026/27 Budget
Property, Plant and Equipment	2,526	4,050	6,603	2,888	1,313
Investment Property	29	2,857	0	0	0
Intangible Assets	60	556	243	20	70
REFCUS	7,441	11,467	19,110	4,306	4,306
Infrastructure Assets	139	3	17	0	0
Community Assets	0	501	0	0	0
Loans	0	100	100	0	0
Total	10,195	19,534	26,073	7,214	5,689

⁽¹⁾REFCUS is Revenue Expenditure Financed from Capital Under Statute, this would include DFGs and other grants given.

5.1.2 Affordability Prudential Indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators: -

Ratio of Financing Costs to Net Revenue Stream

This indicator identifies the trend in the cost of capital, (borrowing and other long-term obligation costs net of investment income), against the net revenue stream.

	2022/23 Actual	2023/24 Forecast	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate
Net Revenue Stream	17,303	22,510	25,413	26,432	24,205
Financing Costs	2,103	1,047	2,344	2,842	3,411
Total	12%	5%	9%	11%	14%

The estimates of financing costs include current commitments and the proposals in this budget report.

5.1.3 Maturity Structure of Borrowing

Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large, fixed rate sums falling due for refinancing, and are required for upper and lower limits.

The Council is asked to approve the following treasury indicators and limits: -

Maturity structure of fixed interest rate borrowing 2024/25		
	Lower	Upper
Under 12 months	0%	80%
12 months to 2 years	0%	80%
2 years to 5 years	0%	80%
5 years to 10 years	0%	100%
10 years to 20 years	0%	100%
20 years to 30 years	0%	100%
30 years to 40 years	0%	100%
40 years to 50 years	0%	100%
Maturity structure of variable interest rate borrowing 2024/25		
	Lower	Upper
Under 12 months	0%	80%
12 months to 2 years	0%	80%
2 years to 5 years	0%	80%
5 years to 10 years	0%	100%
10 years to 20 years	0%	100%
20 years to 30 years	0%	100%
30 years to 40 years	0%	100%
40 years to 50 years	0%	100%

5.1.4. Control of Interest Rate Exposure

Please see paragraphs 3.3, 3.4 and 4.4.

5.2 INTEREST RATE FORECASTS 2023-2026

Link Group Interest Rate View 08.01.24													
	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27
BANK RATE	5.25	5.25	4.75	4.25	3.75	3.25	3.00	3.00	3.00	3.00	3.00	3.00	3.00
3 month ave earnings	5.30	5.30	4.80	4.30	3.80	3.30	3.00	3.00	3.00	3.00	3.00	3.00	3.00
6 month ave earnings	5.20	5.10	4.60	4.10	3.70	3.30	3.10	3.10	3.10	3.10	3.10	3.10	3.10
12 month ave earnings	5.00	4.90	4.40	3.90	3.60	3.20	3.10	3.10	3.10	3.10	3.10	3.20	3.20
5 yr PWLB	4.50	4.40	4.30	4.20	4.10	4.00	3.80	3.70	3.60	3.60	3.50	3.50	3.50
10 yr PWLB	4.70	4.50	4.40	4.30	4.20	4.10	4.00	3.90	3.80	3.70	3.70	3.70	3.70
25 yr PWLB	5.20	5.10	4.90	4.80	4.60	4.40	4.30	4.20	4.20	4.10	4.10	4.10	4.10
50 yr PWLB	5.00	4.90	4.70	4.60	4.40	4.20	4.10	4.00	4.00	3.90	3.90	3.90	3.90

PWLB forecasts are based on PWLB certainty rates.

5.3 ECONOMIC BACKGROUND

- The third quarter of 2023/24 saw:
 - A 0.3% month on month decline in real GDP in October, potentially partly due to unseasonably wet weather, but also due to the ongoing drag from higher interest rates. Growth for the second quarter, ending 30th September, was revised downwards to -0.1% and growth on an annual basis was also revised downwards, to 0.3%;
 - A sharp fall in wage growth, with the headline 3 month year on year rate declining from 8.0% in September to 7.2% in October, although the ONS “experimental” rate of unemployment has remained low at 4.2%;
 - CPI inflation continuing on its downward trajectory, from 8.7% in April to 4.6% in October, then again to 3.9% in November;
 - Core CPI inflation decreasing from April and May’s 31 years’ high of 7.1% to 5.1% in November, the lowest rate since January 2022;
 - The Bank of England holding Bank Rate at 5.25% in November and December;
 - A steady fall in 10-year gilt yields as investors revised their interest rate expectations lower.
- The revision of GDP data in Q2 to a 0.1% quarter on quarter fall may mean the mildest of recessions has begun. Indeed, real GDP in October fell 0.3% month on month which does suggest that the economy may stagnate again in Q3. The weakness in October may partly be due to the unseasonably wet weather. As the weakness was broad based it may also be the case that the ongoing drag from higher interest rates is more than offsetting any boost from the rise in real wages.
- However, the rise in the flash composite activity Purchasing Managers Index, from 50.7 in November to 51.7 in December, did increase the chances of the economy avoiding a contraction in Q3. The improvement was entirely driven by the increase in the services activity balance from 50.9 to 52.7. (Scores above 50 point to expansion in the economy, although only tepid in this instance.) The press release noted that this was primarily driven by a revival in consumer demand in the technological and financial services sectors. This chimes with the further improvement in the GfK measure of consumer confidence in December, from -24 to -22. The services PMI is now consistent with non-retail services output growing by 0.5% quarter on quarter in Q3, but this is in stark contrast to the manufacturing sector where the output balance slumped from 49.2 to 45.9 and, at face value, the output balance is consistent with a 1.5% quarter on quarter fall in manufacturing output in Q3.
- The 0.3% month on month fall in retail sales volumes in October means that after contracting by 1.0% quarter on quarter (which was downwardly revised from -0.8% quarter on quarter) in Q2, retail activity remained weak at the start of Q3. That suggests higher interest rates are taking a bigger toll on real consumer spending.
- Higher interest rates have filtered through the financial channels and weakened the housing market but, overall, it remains surprisingly resilient with the Halifax house price index recently pointing to a 1.7% year on year increase whilst Nationwide’s December data pointed to a -1.8% year on year decrease. However,

the full weakness in real consumer spending and real business investment has yet to come as currently it is estimated that around two thirds to a half of the impact of higher interest rates on household interest payments has yet to be felt.

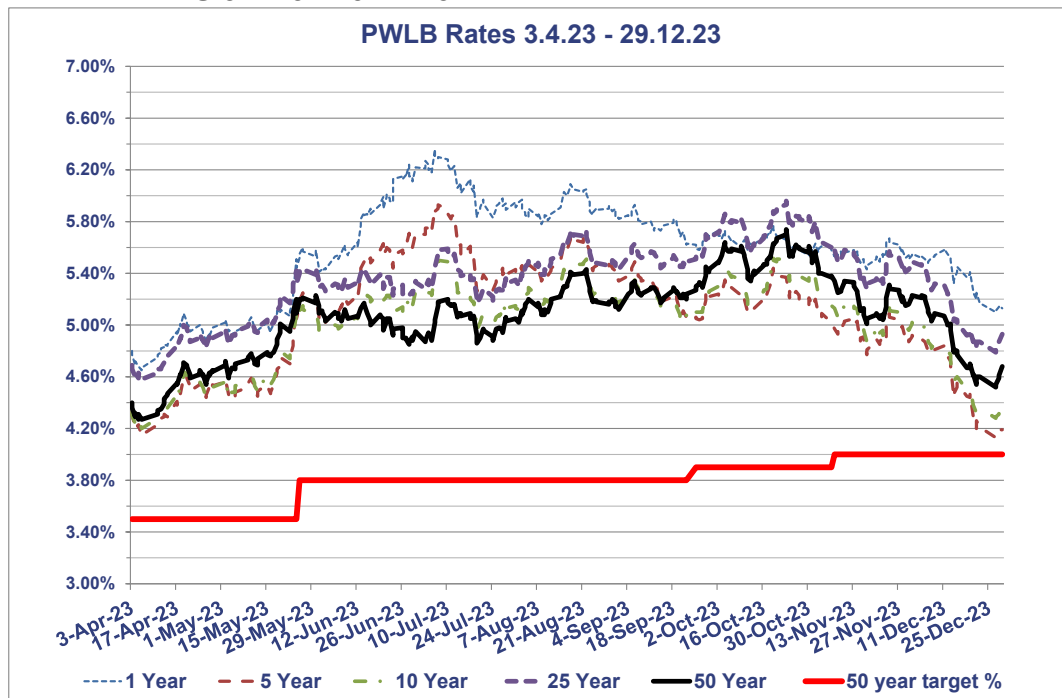
- Overall, we expect real GDP growth to remain subdued throughout 2024 as the drag from higher interest rates is protracted but a fading of the cost-of-living crisis and interest rate cuts in the second half of 2024 will support a recovery in GDP growth in 2025.
- The labour market remains tight by historical standards, but the sharp fall in wage growth seen in October will reinforce the growing belief in markets that interest rates will be cut mid-2024. Wage growth eased in October much faster than the consensus expected. Total earnings fell by 1.6% month on month, which meant the headline 3 monthly year on year rate eased from 8.0% in September to 7.2% in October. This news will be welcomed by the Bank of England. Indeed, the timelier three-month annualised rate of average earnings growth fell from +2.4% to -1.2%. Excluding bonuses, it fell from 5.3% to 2.0%. Furthermore, one of the Bank's key barometers of inflation persistence, regular private sector pay growth, dropped from 7.9% 3monthly year on year to 7.3%, which leaves it comfortably on track to fall to 7.2% by December, as predicted by the Bank in November.
- The fall in wage growth occurred despite labour demand being stronger in October than expected. The three-month change in employment eased only a touch from +52,000 in September to +50,000 in October. But resilient labour demand was offset by a further 63,000 rise in the supply of workers in the three months to October. That meant labour supply exceeded its pre-pandemic level for the first time, and the unemployment rate remained at 4.2% in October. In the three months to November, the number of job vacancies fell for the 17th month in a row, from around 959,000 in October to around 949,000. That has reduced the vacancy to unemployment ratio as demand for labour eases relative to supply, which may support a further easing in wage growth in the coming months.
- CPI inflation fell from 6.7% in September to 4.6% in October, and then again to 3.9% in November. Both these falls were bigger than expected and there are clear signs of easing in domestic inflationary pressures. The fall in core CPI inflation from 5.7% to 5.1% in November was bigger than expected (consensus forecast 5.6%). That's the lowest rate since January 2022. Some of the decline in core inflation was due to the global influence of core goods inflation, which slowed from 4.3% to 3.3%. But some of it was due to services inflation falling from 6.6% to 6.3%. The Bank views the latter as a key barometer of the persistence of inflation and it came in further below the Bank's forecast of 6.9% in its November Monetary Policy Report. This will give the Bank more confidence that services inflation is now on a firmly downward path.
- The Bank of England sprung no surprises with its December monetary policy committee (MPC) meeting, leaving interest rates at 5.25% for the third time in a row and pushing back against the prospect of near-term interest rate cuts. The Bank continued to sound hawkish, with the MPC maintaining its tightening bias saying that "further tightening in monetary policy would be required if there were evidence of more persistent inflationary pressures". And it stuck to the familiar script, saying that policy will be "sufficiently restrictive for sufficiently long" and that "monetary policy is likely to need to be restrictive for an extended period of time".

In other words, the message is that the MPC is not yet willing to endorse investors' expectations that rates will be cut as soon as May 2024.

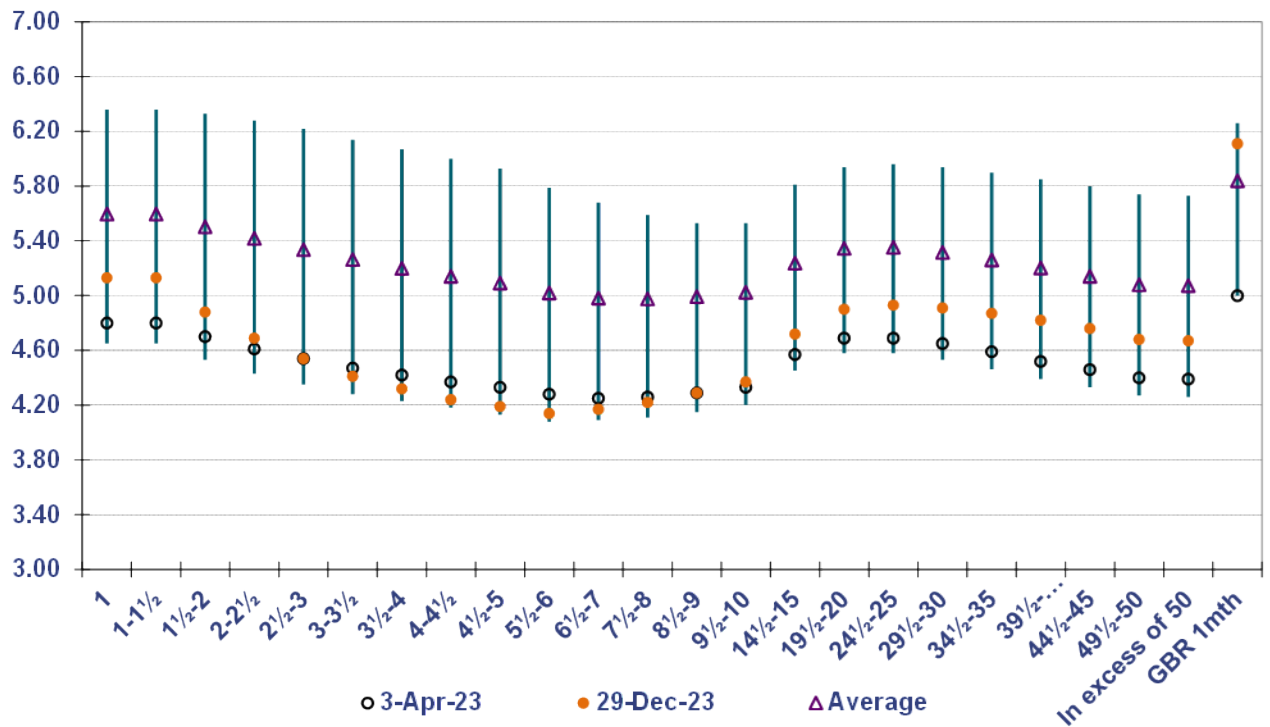
- Looking ahead, our colleagues at Capital Economics forecast that the recent downward trends in CPI and core inflation will stall over the next few months before starting to decline more decisively again in February. That explains why we think the Bank of England won't feel comfortable cutting interest rates until H2 2024.
- The fall in UK market interest rate expectations in December has driven most of the decline in 10-year gilt yields, which have fallen in line with 10-year US Treasury and euro-zone yields. 10-year gilt yields have fallen from 4.68% in October 2023 to around 3.70% in early January, with further declines likely if the falling inflation story is maintained.
- Investors' growing expectations that the Fed will cut interest rates soon has led to an improvement in risk sentiment, which has boosted the pound and other risky assets. In addition, the rise in the pound, from \$1.21 in November to \$1.27 now, has also been supported by the recent relative decline in UK wholesale gas prices.
- The further fall in 10-year real gilt yields in December has supported the recent rise in the FTSE 100. That said, the index remains 5% below its record high in February 2023. This modest rise in equities appears to have been mostly driven by strong performances in the industrials and rate-sensitive technology sectors. But UK equities have continued to underperform US and euro-zone equities. The FTSE 100 has risen by 2.2% in December, while the S&P 500 has risen by 3.8%. This is partly due to lower energy prices, which have been a relatively bigger drag on the FTSE 100, due to the index's high concentration of energy companies.

In the chart below, the rise in gilt yields across the curve in the first half of 2023/24, and therein PWLB rates, is clear to see, prior to the end of year rally based on a mix of supportive domestic and international factors.

PWLB RATES 3.4.23 - 29.12.23



PWLB Certainty Rate Variations 3.4.23 to 29.12.23



HIGH/LOW/AVERAGE PWLB RATES FOR 3.4.23 – 29.12.23

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	4.65%	4.13%	4.20%	4.58%	4.27%
Date	06/04/2023	27/12/2023	06/04/2023	06/04/2023	05/04/2023
High	6.36%	5.93%	5.53%	5.96%	5.74%
Date	06/07/2023	07/07/2023	23/10/2023	23/10/2023	23/10/2023
Average	5.60%	5.09%	5.03%	5.35%	5.08%
Spread	1.71%	1.80%	1.33%	1.38%	1.47%

MPC meetings 2nd November and 14th December 2023

- On 2nd November, the Bank of England’s Monetary Policy Committee (MPC) voted to keep Bank Rate on hold at 5.25%, and on 14th December reiterated that view. Both increases reflected a split vote, the latter by 6 votes to 3, with the minority grouping voting for an increase of 0.25% as concerns about “sticky” inflation remained in place.
- Nonetheless, with UK CPI inflation now at 3.9%, and core inflating beginning to moderate (5.1%), markets are voicing a view that rate cuts should begin in Q1 2024/25, some way ahead of the indications from MPC members. Of course, the data will be the ultimate determinant, so upcoming publications of employment, wages and inflation numbers will be of particular importance, and on-going volatility in Bank Rate expectations and the gilt yield curve can be expected.
- In addition, what happens outside of the UK is also critical to movement in gilt yields. The US FOMC has kept short-term rates in the range of 5.25%-5.50%, whilst the ECB has moved its Deposit rate to a probable peak of 4%. Markets currently expect both central banks to start cutting rates in 2024.

5.4 TREASURY MANAGEMENT PRACTICE (TMP1) – CREDIT AND COUNTERPARTY RISK MANAGEMENT

SPECIFIED INVESTMENTS: All such investments will be sterling denominated, with **maturities up to a maximum of 1 year**, meeting the minimum ‘high’ quality criteria where applicable. (Non-specified investments which would be specified investments apart from originally being for a period longer than 12 months, will be classified as being specified once the remaining period to maturity falls to under twelve months.)

NON-SPECIFIED INVESTMENTS: These are any investments which do not meet the specified investment criteria. A maximum of £10m will be held in aggregate in non-specified investment.

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 above categories.

The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

Specified Investments	Minimum credit criteria / colour band	£ limit per institution	Maximum maturity period
DMADF – UK Government	Yellow	Unlimited	5 Years (6 months max. is set by the DMO ⁽¹⁾ currently)
UK Gilts	Yellow	£2m	1 year
UK Treasury Bills	Yellow	£2m	364 days (max. is set by the DMO*)
Bonds issued by multilateral development banks	Yellow	£2m	1 year
Money Market Funds CNAV	AAA	£5m	Liquid
Money Market Funds LNAV	AAA	£5m	Liquid
Money Market Funds VNAV	AAA	£5m	Liquid
Ultra-Short Dated Bond Funds with a credit score of 1.25	Dark Pink/AAA	£2m	Liquid
Ultra-Short Dated Bond Funds with a credit score of 1.5	Light Pink/AAA	£2m	Liquid

Local Authorities	Yellow	£4m	1 year
Term Deposits with Housing Associations	Blue Orange Red Green No Colour	£1m	12 months 12 months 6 months 100 days Not for use
Term Deposits with Banks	Blue Orange Red Green No Colour	£4m	12 months 12 months 6 months 100 days Not for use
Term Deposits Building Societies	Orange Red Green No Colour	£1m	12 months 6 months 100 days Not for use
CDs or Corporate Bonds with Banks and Building Societies	Blue Orange Red Green No Colour	£4m	12 months 12 months 6 months 100 days Not for use
Collective Investment Schemes structured as Open-Ended Investment Companies (OEICs)			
Gilt Funds	UK sovereign rating	£2m	1 Year

⁽¹⁾ DMO – is the Debt Management Office of HM Treasury

Accounting treatment of investments. The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

Non-Specified Investments	Minimum Credit Criteria	£ Limit per institution	Max. maturity period
Maturities of any period			
Property Funds - the use of these investments may constitute capital expenditure, if this is the case the investment will be an application of capital resources	Yellow	£5m	Based on cash flow modelling
Maturities in excess of 1 year			
Term Deposits – local authorities	Purple	£4m	2 years
Term Deposits – banks	Purple	£4m	2 years

Term Deposits - building societies	Purple	£1m	2 years
UK Gilts	Yellow	£2m	2 years

Environmental, Social & Governance (ESG) Considerations

The CIPFA Treasury Management Code 2021 now requires ESG considerations to be incorporated into Treasury Management Practice 1, it states as follows “The organisation's credit and counterparty policies should set out its policy and practices relating to environmental, social and governance (ESG) investment considerations. This is a developing area, and it is not implied that the organisation's ESG policy will currently include ESG scoring or other real-time ESG criteria at individual investment level, ESG issues are increasingly significant for investors and investment managers. This is better developed in equity and bond markets than for short-term cash deposits, and there is a diversity of market approaches to ESG classification and analysis. This means that a consistent and developed approach to ESG for public service organisations is currently difficult. Organisations are therefore recommended to consider their credit and counterparty policies in light of ESG information and develop their own ESG investment policies and treasury management practices consistent with their organisation's own relevant policies, such as environmental and climate change policies.”

The prime consideration when assessing the suitability of counterparties and investments will continue to be Security, Liquidity and then Yield, in that order, followed by where appropriate ESG factors. The Council does not currently invest in bond or equity markets, therefore there is currently a lack of data available on which to base ESG considerations relevant to the Council's investments. The main ratings agencies (Fitch, Standard and Poors, Moodys) are increasingly including ESG risks alongside more traditional financial risk metrics when assessing counterparty ratings. Therefore ESG risks are already being incorporated into investment decisions by the use of credit ratings for investment decisions. It should also be noted that in general the banks and investment institutions the Council uses meet either the UN Principles for Responsible Banking or the UN Principles for Responsible Investments.

The Council's treasury advisors, Link, also continue to look at ways in which ESG factors can be incorporated into their creditworthiness assessment service for counterparties, and they have advised clients that they will review the options and will update clients as progress is made. The current focus for investing is on the governance segment of ESG as good governance is suggestive of good financial processes and controls, and therefore a good investment prospect.

5.5 APPROVED COUNTRIES FOR INVESTMENTS

This list is based on those countries which have sovereign ratings of AA- or higher, (the lowest rating from Fitch, Moody's and S&P) and also, (except - at the time of writing - for Hong Kong and Luxembourg), have banks operating in sterling markets which have credit ratings of green or above in the Link creditworthiness service.

This list is for direct investments, it is possible money market funds may be partly invested in countries outside this list as part of their strategy to spread risk, across many counterparties.

Based on lowest available rating

AAA

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

AA+

- Canada
- Finland
- U.S.A.

AA

- Abu Dhabi (UAE)

AA-

- Belgium
- France
- Qatar
- **U.K.**

5.6 TREASURY MANAGEMENT SCHEME OF DELEGATION

(i) Full Council

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.
- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;

(ii) Overview and Scrutiny Panel (Performance and Growth)

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

(iii) Cabinet

- receiving and reviewing regular monitoring reports and acting on recommendations;

5.7 THE TREASURY MANAGEMENT ROLE OF THE SECTION 151 OFFICER

The S151 (responsible) officer

- 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.
- preparation of a Capital Strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long-term timeframe.
- ensuring that the Capital Strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money.
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the Council.
- ensure that the Council has appropriate legal powers to undertake expenditure on non-financial assets and their financing.
- ensuring the proportionality of all investments so that the Council does not undertake a level of investing which exposes the Council to an excessive level of risk compared to its financial resources.
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long-term liabilities.
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees.
- ensuring that members are adequately informed and understand the risk exposures taken on by the Council.
- ensuring that the Council has adequate expertise, either in house or externally provided, to carry out the above.
- creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed, to include the following (TM Code p54): -
 - *Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;*
 - *Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;*

- *Decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;*
- *Reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken;*
- *Training and qualifications (TMP10 and schedules), including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.*

5.8 GLOSSARY

Bail in Risk

Bail in risk arises from the failure of a bank. Bondholders or investors in the bank would be expected to suffer losses on their investments, as opposed to the bank being bailed out by government.

Bank Equity Buffer

The mandatory capital that financial institutions are required to hold, in order to provide a cushion against financial downturns, to ensure the institution can continue to meet its liquidity requirements.

Bank Rate

The official interest rate of the Bank of England, this rate is charged by the bank on loans to commercial banks.

Bank Stress Tests

Tests carried out by the European Central Bank on 51 banks across the EU. The tests put banks under a number of scenarios and analyse how the bank's capital holds up under each of the scenarios. The scenarios include a sharp rise in bond yields, a low growth environment, rising debt, and adverse action in the unregulated financial sector.

Basis Point

1/100th of 1% i.e., 0.01%. 10 basis points is 0.1%.

Bonds

A bond is a form of loan, the holder of the bond is entitled to a fixed rate of interest (coupon) at fixed intervals. The bond has a fixed life and can be traded.

Call Account

A bank account that offers a rate of return and the funds are available to withdraw on a daily basis.

Capital Financing Requirement (CFR)

The CFR is a measure of the capital expenditure incurred historically but has yet to be financed; by for example capital receipts or grants funding. The current CFR balance is therefore financed by external borrowing, and internal borrowing (i.e., use of working capital on the balance sheet – creditors, cash etc).

Certificate of Deposit

Evidence of a deposit with a financial institution repayable on a fixed date. They are negotiable instruments, and have a secondary market, and can be sold before maturity.

Collar (Money Market Fund)

The fund "collar" forms part of the valuation mechanism for the fund. LVNAV funds allow investors to purchase and redeem shares at a constant NAV calculated to 2 decimal places, i.e., £1.00. This is achieved by the fund using amortised cost for valuation purposes, subject to the variation against the marked-to-market NAV being no greater

than 20 basis points (0.2%). (This compares to current Prime CNAV funds which round to 50 basis points, or 0.5%, of the NAV.)

Constant Net Asset Value (CNAV)

Constant Net Asset Value refers to funds which use amortised cost accounting to value all of their assets. They aim to maintain a Net Asset Value (NAV), or value of a share of the fund at £1 and calculate their price to 2 decimal places.

Counterparty

Another organisation with which the Council has entered into a financial transaction with, for example, invested with or borrowed from.

Credit Default Swaps (CDS)

A financial agreement that the seller of the CDS will compensate the buyer in the event of a loan default. The seller insures the buyer against a loan defaulting.

Credit Ratings

A credit rating is the evaluation of a credit risk of a debtor and predicting their ability to pay back the debt. The rating represents an evaluation of a credit rating agency of the qualitative and quantitative information, this result in a score, denoted usually by the letters A to D and including +/-.

DMADF

The Debt Management Account Deposit Facility. This is run by the UK's Debt Management Office and provides investors with the ability to invest with UK central government.

ECB

The European Central Bank, one of the institutions that makes up the EU. Its main function is to maintain price stability across the Eurozone.

ESG

Environmental, society, and governance investing, makes reference to a set of standards for an organisation's behaviour, which can be used by a socially aware investor to make investment decisions. Environmental factors include how an organisation safeguards the environment, social criteria look at how the organisation manages its relationships with the community, employees, suppliers, and customers, and governance deals with leadership, internal controls and audits.

Federal Reserve (Fed)

The central bank of the United States.

Forward Deal

The act of agreeing today to deposit/loan funds for an agreed time limit at an agreed date and rate.

Gilts

Bonds issued by the Government.

Link Group

The Council's treasury advisors, who took over from Arlingclose in March 2023.

Liquidity

The degree to which an asset can be bought or sold quickly.

LVNAV Money Market Fund

Low volatility net asset value. The fund will have at least 10% of its assets maturing on a daily basis and at least 30% of assets maturing on a weekly basis.

MiFID

Markets in Financial Instruments Directive, is a regulation that increases the transparency across the EU's financial markets and standardises the regulatory disclosures required. In force since 2008.

Minimum Revenue Provision (MRP)

An amount set aside from revenue to repay debt.

Money Market Funds

An open-ended mutual fund that invests in short-term debt securities. A deposit will earn a rate of interest, whilst maintaining the net asset value of the investment. Deposits are generally available for withdrawal on the day.

Public Works Loans Board (PWLB)

The PWLB is an agency of the Treasury, it lends to public bodies at fixed rates for periods up to 50 years. Interest rates are determined by gilt yields.

REFCUS

Revenue Expenditure Funded from Capital Under Statute. Expenditure which would normally be considered revenue expenditure, but has been statutorily defined as capital expenditure, including the giving of a loan, grant or other financial assistance to any person, whether for use by that person or by a third party, towards expenditure which would, if incurred by the council, be capital expenditure. Or expenditure incurred on the acquisition, production or construction of assets for use by, or disposal to, a person other than the council which would be capital expenditure if those assets were acquired, produced or constructed for use by the council.

SONIA

Sterling overnight index average interest rate. On each London business day, SONIA is measured as the trimmed mean, rounded to four decimal places, of interest rates paid on eligible sterling denominated deposit transactions.

Transactional Banking

Use of a bank for day-to-day banking requirement, e.g., provision of current accounts, deposit accounts and on-line banking.

UN Principles for Responsible Banking

Are a unique framework for ensuring that signatory banks' strategy and practice align with the vision society has set out for its future in the Sustainable Development Goals and the Paris Climate Agreement.

The framework consists of 6 Principles designed to bring purpose, vision and ambition to sustainable finance. They were created in 2019 through a partnership between founding banks and the United Nations. Signatory banks commit to embedding these 6 principles across all business areas, at the strategic, portfolio and transactional levels.

- Principle 1: Alignment, align business strategy with individual's goals as expressed in the sustainable development goals, the Paris Climate Agreement and national and regional frameworks.
- Principle 2: Impact and Target Setting, increase positive impacts and reduce negative impacts on, and managing the risks to people and environment.
- Principle 3: Clients and Customers, work with clients and customers to encourage sustainable practices and enable economic activities that create shared prosperity.
- Principle 4: Stakeholders, engage with stakeholders to achieve society's goals.
- Principle 5: Governance and Culture, implement the commitment to these principles through effective governance.
- Principle 6: Transparency and Accountability, periodic review of the implementation of these principles, and be transparent about and accountable for the positive and negative impacts, and the contribution to society's goals.

A 3-step process guides signatories through implementing their commitment:

1. Impact Analysis: identifying the most significant impacts of products and services on the societies, economies and environments that the bank operates in.
2. Target Setting: setting and achieving measurable targets in a banks' areas of most significant impact.
3. Reporting: publicly report on progress on implementing the Principles, being transparent about impacts and contributions.

UN Principles for Responsible Investments

The 6 principles for responsible investments offer possible actions for incorporating ESG issues into investment practice.

The principles that the signatories sign up to are;

- **Principle 1:** We will incorporate ESG issues into investment analysis and decision-making processes.
- **Principle 2:** We will be active owners and incorporate ESG issues into our ownership policies and practices.
- **Principle 3:** We will seek appropriate disclosure on ESG issues by the entities in which we invest.
- **Principle 4:** We will promote acceptance and implementation of the Principles within the investment industry.
- **Principle 5:** We will work together to enhance our effectiveness in implementing the Principles.
- **Principle 6:** We will each report on our activities and progress towards implementing the Principles.

The Principles for Responsible Investment were developed by an international group of institutional investors reflecting the increasing relevance of environmental, social and corporate governance issues to investment practices. The process was convened by the United Nations Secretary-General.