2023/24 Treasury Management Strategy, Annual Investment Strategy, Prudential and Treasury Management Indicators and Minimum Revenue Provision (Paul French – Corporate Head of Finance)

Synopsis of report:

The report sets out the Treasury Management Strategy, Prudential and Treasury Management Indicators, and Minimum Revenue Provision Statement for 2023/24.

All the information required under the relevant legislation and professional codes of practice is set out in the report including:

- **training requirements**
- **the policy on use of external service providers**
- **the Council's prudential indicators**
- **the minimum revenue provision (MRP) policy**
- **the current treasury position**
- **prospects for interest rates**
- **the borrowing strategy**
- **policy on borrowing in advance of need**
- **debt rescheduling**
- **the investment strategy**

The Council currently invests between £70m-£90m and finding suitable homes for this money is becoming more difficult. Section 10 of the report therefore requests amending the counterparty limits set out in the Investment Strategy.

The updated Treasury Management Code has introduced a requirement to set out Liability Benchmark and Proportionality indicators so that members and officers can easily see the borrowing commitments the Council has and the extent to which the Council is reliant on its property related income. These are set out in Appendix C.

This report should be read in conjunction with the Capital Strategy report set out elsewhere on this agenda

Recommendations to Full Council on 9 February 2023:

i) **The proposed 2023/24 Treasury Management Strategy encompassing the Annual Investment Strategy as set out in this report be approved**

ii) **The Prudential and Treasury Management Indicators for 2023/24 set out in this report be approved**

iii) **The revised Treasury Management Policy Statement and Treasury Management Practices set out in the Appendices be approved**

iv) **The authorised limit for external borrowing by the Council in 2023/24, be set at £700,613,000 (this being the statutory limit determined under Section 3 (1) of the Local Government Act 2003.**

v) **The Council's MRP statement for 2023/24 remain as follows:**

"The Council will use the asset life method as its main method for calculating MRP.

In normal circumstances, MRP will be set aside from the date of acquisition. However, in relation to capital expenditure on property purchases and/or development, we will start setting aside an MRP provision from the date that the asset becomes operational and/or revenue income is generated".

I. GENERAL

1. Context of report

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

1.2 The second main function of the treasury management function 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 the Council can meet its capital spending obligations. This management of longer-term cash flow 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.

1.3 The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

1.4 The Council recognises that effective financial planning, option appraisal, risk management and governance processes are essential in achieving a prudent approach to capital expenditure, investment and debt. Therefore, all investment decisions (treasury and non-treasury) are taken in light of the Council's Corporate Business Plan, Medium Term Financial Strategy, Capital Strategy and Treasury Management Strategy.

1.5 The Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as:

"The management of the local authority's borrowing, investments and cashflows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks".

1.6 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.

2. Treasury reporting requirements

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

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) 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, for next year, the Corporate Management and Overview & Scrutiny Committees will receive quarterly update reports.

c) 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.

2.2 In addition to the three major reports detailed above, from 2023/24 quarterly reporting (end of June/end of December) is also required. Although these additional reports do not have to be reported to Full Council, they must be adequately scrutinised.

2.3 The Council has delegated responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Corporate Management Committee, and for the execution and administration of treasury management decisions to the Assistant Chief Executive, who will act in accordance with the Council's Treasury Policy Statement and Treasury Management Practices (TMP).

2.4 These reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Overview and Scrutiny Select Committee which will be considering this report at its meeting on 2 February 2023.

2.5 A glossary of treasury terms has been included at Appendix "A" to assist Members with understanding some of the terms used in this report.

3. Treasury management strategy for 2023/24

3.1. The strategy for 2023/24 covers the requirements of the Local Government Act 2003, DLUHC Investment Guidance, DLUHC MRP Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code.

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

- a high-level long term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial sustainability

3.3. The aim of the Capital Strategy is to ensure that all elected members on the full council fully understand the overall long-term policy objectives and resulting Capital Strategy requirements, governance procedures and risk appetite.

3.4. The Council's Capital & Investment Strategy is reported separately from the Treasury Management Strategy Statement to ensure the separation of the core treasury function under security, liquidity and yield principles, and the policy and commercial investments usually driven by expenditure on an asset.

3.5. To demonstrate the proportionality between the treasury operations and the non-treasury operation, high-level comparators are shown throughout this TMS report.

4. Training

4.1. 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.

4.2. Furthermore, the Code states 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".

4.3. The scale and nature of this depends on the size and complexity of the organisation's treasury management needs. It is up to councils to consider how to assess whether treasury management staff and members have the required knowledge and skills to undertake their roles and whether they have been able to maintain those skills and keep them up to date.

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

- Record attendance at training and ensure action is taken where poor attendance is identified.
- Prepare tailored learning plans for treasury management officers and council members.
- Require treasury management officers and council members to undertake self-assessment against the required competencies.
- Have regular communication with officers and members, encouraging them to highlight training needs on an ongoing basis."

4.5. In further support of the revised training requirements a self-assessment by members responsible for the scrutiny of treasury management has been created and is set out in Appendix B. This was sent to Members of the Overview and Scrutiny Committee in December for their comments in order to create an Action Plan to improve/develop their understanding.

4.6. Two training courses on Treasury Management have been carried out for the Council members in October 2022 (one arranged by the Council's Finance officers and another one run by the Link Group). 15 Members attended one or both of the sessions. Further training will be arranged as required.

4.7. The needs of the Council's treasury management staff for training in investment management are assessed every year as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change. Relevant training courses, seminars and conferences are provided by a range of organisations including Link and CIPFA.

4.8. A formal record of the training received by officers central to the Treasury function is maintained by the Corporate Head of Finance. Similarly, a formal record of the treasury management/capital finance training received by Council members is maintained by Democratic Services.

5. Treasury management consultants

5.1. The Council Link Treasury Services Limited (part of the Link Group) as its external treasury management advisor.

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

5.3. 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.

5.4. The quality of this service is controlled by the Assistant Chief Executive assessing the quality of advice offered and other services provided by Link. In particular, the Assistant Chief Executive holds regular meetings with Link (normally 3 times a year) where, in addition to discussing treasury strategy, the performance of the consultants is reviewed

6. Capital Prudential Indicators 2023/24 – 2025/26

6.1. The Authority's capital expenditure plans are the key driver of treasury management activity and are set out in the Capital & Investment Strategy report presented to the Corporate Management Committee each January. 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. These are set out in Appendix C

6.2. The Code requires all local authorities to look at capital expenditure and investment plans in light of the overall organisational strategy and resources and make sure that decisions are being made with sufficient regard to the long run financial implications and potential risks to the authority. The key objectives of the Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable; that treasury management decisions are taken in accordance with good professional practice; and that local strategic planning, asset management planning and proper option appraisal are supported.

6.3. The Council recognises that effective financial planning, option appraisal, risk management and governance processes are essential in achieving a prudent approach to capital expenditure, investment and debt. Therefore, all investment decisions (treasury and non-treasury) are taken in light of the Council's Corporate Business Plan, Medium Term Financial Strategy, Capital & Investment Strategy, Asset Management Strategy and Treasury Management Strategy.

7. Minimum Revenue Provision (MRP) Policy Statement

7.1. When a Council funds capital expenditure by borrowing, the costs are charged to the Council Taxpayers in future years, reflecting the long-term use of the assets. Unlike a mortgage where amounts of principal are repaid each month, the borrowing undertaken by a Council is usually repayable on maturity at an agreed future date. The interest on borrowing is charged in the year it is payable.

7.2. To reflect this, the Council is required to pay off an element of the accumulated General Fund capital spend each year through a revenue charge (the Minimum Revenue Provision – MRP), although it is also allowed to undertake additional voluntary payments if required (Voluntary Revenue Provision – VRP). The MRP exists as a charge to revenue each year in order to have sufficient monies set aside to meet the future repayment of principle on any borrowing undertaken. There isn't an earmarked reserve for MRP, it is represented in the accounts as increased cash.

7.3. There is no requirement on the Housing Revenue Account (HRA) to make MRP.

7.4. Revised statutory guidance from the DLUHC requires local authorities to have Full Council approval of MRP Policy Statement in advance of each year. The aim of the DLUHC Investment Guidance is to ensure that debt is repaid over a period that is commensurate with that over which the capital expenditure provides benefits. The guidance recommends four options for calculating a prudent MRP as follows:

1. Regulatory Method
2. CFR Method
3. Asset Life Method (repayment over the useful life of the asset)
4. Depreciation Method (cost less estimated residual value)

Options 1 and 2 should normally only be used for Government-supported borrowing with options 3 and 4 being used for self-financed borrowing.

7.5. In December 2014 the Council set an MRP Statement to relate to prudent provisions and the relevant useful lives of assets, these will be unique to each asset borrowed against and as such will not affect the overall method chosen for calculating MRP. The current MRP Policy is as follows:

"The Council will use the asset life method as its main method for calculating MRP.

In normal circumstances, MRP will be set aside from the date of acquisition. However, in relation to capital expenditure on property purchases and/or development, we will start setting aside an MRP provision from the date that the asset becomes operational and/or revenue income is generated".

7.6. Any charges made over the statutory MRP, VRP or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, the Council's MRP policy must disclose the cumulative overpayment made each year. Up until the 31 March 2021 the Council had made no such VRP overpayments.

8. Economic data

Interest Rates

8.1. Part of Link Group's service is to assist the Council to formulate a view on interest rates. Link provided the following forecasts on 08.11.22. These are forecasts for certainty rates, gilt yields plus 80 basis points.

Link Group Interest Rate View	08.11.22												
	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
BANK RATE	3.50	4.25	4.50	4.50	4.50	4.00	3.75	3.50	3.25	3.00	2.75	2.50	2.50
3 month ave earnings	3.60	4.30	4.50	4.50	4.50	4.00	3.80	3.30	3.00	3.00	2.80	2.50	2.50
6 month ave earnings	4.20	4.50	4.60	4.50	4.20	4.10	3.90	3.40	3.10	3.00	2.90	2.60	2.60
12 month ave earnings	4.70	4.70	4.70	4.50	4.30	4.20	4.00	3.50	3.20	3.10	3.00	2.70	2.70
5 yr PWLB	4.30	4.30	4.20	4.10	4.00	3.90	3.80	3.60	3.50	3.40	3.30	3.20	3.10
10 yr PWLB	4.50	4.50	4.40	4.30	4.20	4.00	3.90	3.70	3.60	3.50	3.40	3.30	3.20
25 yr PWLB	4.70	4.70	4.60	4.50	4.40	4.30	4.10	4.00	3.90	3.70	3.60	3.50	3.50
50 yr PWLB	4.30	4.40	4.30	4.20	4.10	4.00	3.80	3.70	3.60	3.40	3.30	3.20	3.20

Additional notes by Link on this forecast table:

8.2 Our central forecast reflects a view that the MPC will be keen to demonstrate its anti-inflation credentials by delivering a succession of rate increases. This has happened throughout 2022, but the new Government's policy of emphasising fiscal rectitude will probably mean Bank Rate does not now need to increase to further than 4.5%.

8.3 Further down the road, we anticipate the Bank of England will be keen to loosen monetary policy when the worst of the inflationary pressures have lessened – but that timing will be one of fine judgment: cut too soon, and inflationary pressures may well build up further; cut too late and any downturn or recession may be prolonged.

8.4 The CPI measure of inflation will peak at close to 11% in Q4 2022. Despite the cost-of-living squeeze that is still taking shape, the Bank will want to see evidence that wages are not spiralling upwards in what is evidently a very tight labour market. Wage increases, excluding bonuses, are currently running at 5.7%.

8.5 Regarding the plan to sell £10bn of gilts back into the market each quarter (Quantitative Tightening), this has started but will focus on the short to medium end of the curve for the present. This approach will prevent any further disruption to the longer end of the curve following on from the short-lived effects of the Truss/Kwarteng unfunded dash for growth policy.

8.6 In the upcoming months, our forecasts will be guided not only by economic data releases and clarifications from the MPC over its monetary policies and the Government over its fiscal policies, but the on-going conflict between Russia and Ukraine. (More recently, the heightened tensions between China/Taiwan/US also have the potential to have a wider and negative economic impact.)

8.7 On the positive side, consumers are still estimated to be sitting on over £160bn of excess savings left over from the pandemic so that will cushion some of the impact of the above challenges. However, most of those are held by more affluent people whereas lower income families already spend nearly all their income on essentials such as food, energy and rent/mortgage payments.

PWLB rates

8.8 Yield curve movements have become less volatile under the Sunak/Hunt government. PWLB 5 to 50 years Certainty Rates are, generally, in the range of 3.75% to 4.50%. The medium to longer part of the yield curve is currently inverted (yields are lower at the longer end of the yield curve compared to the short to medium end).

8.9 Link view the markets as having built in, already, nearly all the effects on gilt yields of the likely increases in Bank Rate and the poor inflation outlook but markets are volatile and further whipsawing of gilt yields across the whole spectrum of the curve is possible.

The balance of risks to the UK economy:

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

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

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

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

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

8.10 Further economic background data can be found in Appendix D

9. Borrowing Strategy

9.1. The Prudential Code considers that legitimate examples of prudent borrowing include:

- financing capital expenditure primarily related to the delivery of a local authority's functions
- temporary management of cash flow within the context of a balanced budget
- securing affordability by removing exposure to future interest rate rises
- refinancing current borrowing, including replacing internal borrowing, to manage risk or reflect changing cash flow circumstances.

9.2. The Prudential Code determines certain acts or practices that are not prudent activity for a local authority and incurs risk to the affordability of local authority investment. To this extent the guidance states "An authority **must not** borrow to invest for the primary purpose of commercial return". These principles apply to prudential borrowing for capital financing, such as externalising internal borrowing for the primary purpose of commercial return.

9.3. Access to the PWLB is essential for the Council to ensure liquidity and cheap borrowing. The Government's new rules for access to PWLB lending introduced at the start of 2021 require statutory Chief Finance Officers to certify that their Council's capital spending plans do not include the acquisition of assets primarily for yield, reflecting the view that local authority borrowing powers are granted to finance direct investment in local service delivery (including housing, regeneration and local infrastructure) and for cash flow management rather than to add gearing to return-seeking investment activity. Local authorities should not borrow to finance acquisitions where obtaining commercial returns is a primary aim.

9.4. In general, the Council will borrow for one of two purposes – to finance cash flow in the short term or to fund capital investment over the longer term. 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 investment returns are low and counterparty risk is still an issue that needs to be considered.

9.5. A key aim of the Treasury Management Strategy is to minimise the cost of the Council's loan portfolio whilst ensuring that the obligation to repay the loan is spread over a period. This reduces the impact on the revenue budget of interest payments.

9.6. The Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period which the funds are required. Against this background and the risks within the economic forecast, caution will be adopted with the 2023/24 treasury operations. The Assistant Chief Executive will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

9.7. Short term borrowing is the cheapest option but leaves the Council exposed to refinancing risk, which can be divided into interest rate risk (the risk that rates will rise) and availability risk (the risk that no-one will lend to the Council).

9.8. The Council's strategy for long term borrowing is currently as follows:

<u>Sources of borrowing</u>
The approved sources of long-term and short-term borrowing will be:

- Public Works Loan Board (PWLB)
- any institution approved for investments
- any other bank or building society approved by the Financial Conduct Authority
- UK public and private sector pension funds and Insurance Companies (except the Surrey Pension Fund)
- Capital market bond investors
- UK Municipal Bond Agency plc and other special purpose companies created to enable joint local authority bond issues (subject to committee report).

Other sources of borrowing will be investigated during the year and will be the subject of future committee reports before being submitted for approval at full Council.

Debt instruments
Borrowing will be arranged by one of the following debt instruments:

- fixed term loans at fixed or variable rates of interest, subject to the limits in the treasury management indicators
- bonds

9.9. Any proposed borrowing will only be undertaken on a phased basis in accordance with agreed plans and requirements at that time. The borrowing of money purely to invest or lend-on to make a return is unlawful.

Policy on Borrowing in Advance of Need

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

9.11. 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. In determining whether borrowing will be undertaken in advance of need the Council will:

- Ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need.
- Ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered.
- Evaluate the economic and market factors that might influence the manner and timing of any decision to borrow.
- Consider the merits and demerits of alternative forms of funding.

9.12. The total amount borrowed will not exceed the authorised borrowing limit. The maximum period between borrowing and expenditure is expected to be no more than six months, although the Council does not link particular loans with particular items of expenditure.

Debt restructuring

9.13. From time to time there may be potential opportunities to generate savings by switching from long term debt to short term debt and vice versa. Any such debt restructuring will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

9.14. The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- to enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

9.15. All rescheduling will be reported to the Council, at the earliest meeting following its action.

10. Annual Investment Strategy

10.1. DLUHC and CIPFA have extended the meaning of ‘investments’ to include both financial and non-financial investments (see section 12 below). This report deals solely with financial investments. Non-financial investments are held for two purposes, to generate income and to meet a strategic priority. These are entered into outside of normal treasury management activities, but nevertheless the TMS comes into play in their financing. The Council recognises that investment in other financial investments taken for non-treasury management purposes, requires careful investment management and all such investments are covered in the Capital & Investment Strategy.

10.2. Local authorities must draw up an “Annual Investment Strategy” for the following financial year. This strategy may be revised at any time, but full Council must approve the revisions. Both the TM Code and the DLUHC Investment Guidance place a high priority on the management of risk and require the Council to invest its funds prudently and to have regard to the security and liquidity of its investments before seeking high returns (yield). This approach is inherent in our treasury management strategy.

10.3. In accordance with the above guidance, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration of risk.

10.4. The DLUHC Investment Guidance requires local authorities to cover a number of issues in their Annual Investment Strategy and the Council’s strategy fully complies with these requirements. The Council approved its Annual Investment Strategy for 2022/23 in February 2022 and an updated Strategy for 2023/24 (taking account of the suggested changes set out below) is set out at Appendix E.

10.5. The Council’s cash balances will increase over time as money is set aside in MRP. The knock-on effects of this is that there is more money to invest until the principal sums borrowed are due for repayment which means the Council needs to increase its counterparty limits and/or seek additional investment vehicles for its money. Estimated cumulative MRP balances built up over the next couple of years are anticipated to be as follows:

MRP cumulative balance at 31 March	£’000
2023	20,922
2024	25,534
2025	30,396

10.6. As previously reported to Members, with the increased MRP balances, the existing counterparty list is proving to be inadequate, and the Council has struggled to find homes for its investments in the last year. Officers have been in discussions with Link as to the best way to overcome this. Extending the number of counterparties by adding a lower credit rating band to the Investment Strategy, thereby increasing the potential risk of default, is not recommended. Officers are therefore requesting that the £Limits placed with the existing bands for Specified Investments” be increased as follows:

Fitch Long term Rating (or equivalent)	Current £ Limit	Current Duration	Proposed £ Limit	Proposed Duration
AA- or higher	-	-	**£7.5m**	**365 days**
A+	£5.0m	365 days	**£6.0m**	365 days
A	£4.0m	189 days	**£5.0m**	189 days
A-	£3.0m	98 days	**£4.0m**	**100 days**

10.7. Having discussed this proposal with our Treasury advisors, Link stated that "the Council has c£80m of investments so using a maximum cap of c£8m for any one high credit quality counterparty does not seem unreasonable".

10.8. In addition to this, the Council is currently limited to placing a maximum of £1 million to be placed with any non-UK country (which has a minimum sovereign long term rating of AAA or AA+) at any one time. Again, this is proving too restrictive and the Council is missing out several counterparties that have high quality credit ratings because of it. Officers are therefore proposing that the current limit to place a maximum of £1 million to be placed with a non-UK countertparty (with the country sovereign rating of AA- or higher) be increased to £3million but that the £Limits for each rated bank be as follows:

Fitch Long term Rating (or equivalent)	Current £ Limit	Current Duration	Proposed £ Limit	Proposed Duration
AA- or higher	-	-	**£3.0m**	**365 days**
A+	£1.0m	365 days	**£2.0m**	365 days
A	£1.0m	189 days	£1.0m	189 days
A-	£1.0m	98 days	£1.0m	**100 days**

2023/24 Treasury Activity

10.9. Link's suggested budgeted earnings rates for investments up to about three months' duration in each financial year are as follows:

Average earnings in each year	
2023/24	4.40%
2024/25	3.30%
2025/26	2.60%
2026/27	2.50%
Years 6 to 10	2.80%

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

10.10. The Council's treasury portfolio position as at 31 December 2022 comprised of:

	31 Mar 22 £'000	**31 Dec 22 £'000**
Borrowing		
Fixed Rate - PWLB	599,000	599,000
Fixed Rate - Money Market	54,731	44,181
TOTAL BORROWING	**653,731**	**643,181**
Specified Investments		
Banking sector	23,000	33,000
Building societies	16,000	13,000
Local Authorities	24,500	12,000
Money Market Funds	9,820	25,700
Unspecified Investments		
Pooled Funds & Collective Investment Schemes	4,000	4,000
Funding Circle	104	58
TOTAL INVESTMENTS	**77,424**	**87,758**
NET BORROWING	**576,307**	**555,423**

10.11. All Investments are made with reference to the Council's core balances and cash flow requirements which are derived from the annual budget, the Medium Term Financial Strategy, the Capital Programme and Capital & Investment Strategy, 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. While most cash balances are required in order to manage the ups and downs of cash, 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.

10.12. It is important that the Council manages its treasury management activities to maximise investment income and reduce debt interest, whilst managing its exposure to risk and maintaining appropriate liquidity to meet its needs. Based on the above forecasts, the 2023/24 estimate for investment income and debt interest split between the General Fund and Housing Revenue Account (HRA) is as follows:

	General Fund £'000	HRA £'000	Total £'000
Gross external investment income	3,517	1,239	4,756
Interest on loans to RBC companies	2,036	0	2,036
Dividend income	120	0	120
Interest paid on deposits and other balances	(11)	0	(11)
Net Investment Income	**5,662**	**1,239**	**6,901**
Debt Interest	(13,351)	(3,379)	(16,730)
Management Expenses	(26)	0	(26)
Net Investment Income / (Debt interest)	**(7,715)**	**(2,140)**	**(9,855)**

10.13. The estimate is based on achieving the assumed interest rates set out in paragraph 10.9 above and using the level of revenue and capital reserves for 2023/24 as set out in the latest capital and revenue budgets contained in the Medium Term Financial Strategy and HRA Business Plan.

Interest charge to the Housing Revenue Account (HRA)

10.14 The Council operates a two-pooled approach to its loans portfolio, which means we separate HRA and General Fund long-term loans. Interest payable and other costs or income arising from long-term loans (for example premiums and discounts on early redemption) are charged or credited to the respective revenue account.

10.15 Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. We will calculate an average balance for the year and interest will be transferred between the General Fund and HRA at the Council's weighted average return on all its investments, adjusted for credit risk. This credit risk adjustment reflects the risk that any investment default will be a charge to the General Fund regardless of whether it was HRA cash that was lost.

11 Treasury Management Risks

11.1 Treasury management activity involves risks which cannot be eliminated but need to be managed. Treasury management risks could be defined as: The ongoing activity of adjusting the authority's treasury exposures due to changing market or domestic circumstances, to manage risks and achieve better value in relation to the authority's objectives. The effective identification and management of these risks are integral to the Council's treasury management objectives. All treasury activity needs to be managed to maximise investment income and reduce debt interest whilst maintaining the Council's exposure to risk.

11.2 Overall responsibility for treasury management risk remains with the Council at all times. None of the regulations or guidance prescribes any particular treasury management strategy for local authorities to adopt. The Council's lending & borrowing list is regularly reviewed during the financial year and credit ratings are monitored throughout the year to minimise future risks.

11.3 DLUHC issued revised statutory guidance on Local Government Investments in 2018, the DLUHC Investment Guidance, and this forms the structure of the Council's policies. The key intention of the DLUHC Investment Guidance is to maintain the current requirement for councils to invest prudently, and that priority is given to security and liquidity before yield. This means that first and foremost the Council must ensure the security of the principal sum invested (i.e. ensure the full investment is returned), then ensure that we have the liquidity we need (i.e. ensure we have the funds available when we need them), and only then should the yield on return be considered. In order to facilitate this objective, the DLUHC Investment Guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes (2021 Edition) (TM Code).

11.4 The Prudential and Treasury Codes set as a prime policy objective the security of funds, and the avoidance of exposing public funds to unnecessary or unqualified risk. All authorities should consider a balance between security, liquidity and yield which reflects their own appetite, but which prioritises security over yield.

11.5 In accordance with the TM Code, the key treasury risks are discussed in detail in the Council's Treasury Management Practices (TMPs) and an updated version of both the Council's Treasury Management Policy Statement and the Council's TMPs, taking in the required changes from the latest TM Code is set out in Appendix F with the changes highlighted.

12 Non-Treasury Management Investment

12.1 The Prudential and Treasury codes state that all investments and investment income must be attributed to one of the following three purposes:

- Treasury Management
- Service Delivery
- Commercial return

Treasury Management

12.2 Treasury Management income arises from the Council'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. This is what the Treasury Management Strategy is designed to cover. Explanations of the other two areas are set out below.

Service Investments

12.3 The Council may lend money to its subsidiaries, its suppliers, local businesses, local charities or housing associations etc. to support local public services and stimulate local economic growth. 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". Such loans are treated as capital expenditure for accounting purposes. The rules and risks surrounding these are set out in the Council's Capital & Investment Strategy.

Commercial Investments

12.4 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. "An authority must not borrow to invest primarily for financial return".

12.5 Although it has done so in the past, the Council no longer invests in new commercial property if it is held primarily to generate income. The Council will invest in the commercial property only where the main purposes are to regenerate areas of the borough, encourage private investment and to create or retain local jobs. The rules and risks surrounding these are set out in the Council's Capital & Investment Strategy and Asset management Strategy.

13 Legal Implications

13.1 The powers for a local authority to borrow and invest are governed by the Local Government Act 2003 (LGA 2003) and associated Regulations. A local authority may borrow or invest for any purpose relevant to its functions, under any enactment, or for the purpose of the prudent management of its financial affairs. The Regulations also specify that authorities should have regard to the CIPFA Treasury Management Code and the DLUHC Investment Guidance when carrying out their treasury management functions.

13.2 Part 1 of the LGA 2003 established the legislative framework for the prudential capital finance system for local authorities.

13.3 The LGA 2003 requires each Council to set an affordable borrowing limit. The Full Council must carry out this duty; it cannot be delegated. Having set this limit the Council may not exceed it except for specified temporary purposes. However, the Council can make a new limit at any time.

13.4 Regulations require local authorities to have regard to The Prudential Code when carrying out their duties under Part 1 of the LGA 2003. The Code requires that all prudential indicators are set, and revised, only by the Full Council. This is because the need for Members to approve prudential indicators for capital finance is regarded as an important part of the governance responsibilities of a local authority.

13.5 The LGA 2003 provides the Government with reserve powers to set borrowing limits for local authorities that override their locally determined limits. This could be in the form of a national limit – this can only be imposed for national economic reasons – or a specific limit to prevent an individual authority borrowing more than it could afford.

13.6 The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (as amended) state:

"A local authority shall determine for the current financial year an amount of minimum revenue provision which it considers to be prudent."

14 Environmental/Sustainability/Biodiversity implications

14.6 Ethical or Sustainable investing is becoming a more commonplace discussion within the wider investment community. There are currently a small, but growing number of financial institutions and fund managers promoting Environmental, Social and Governance (ESG) products however the types of products we can invest in are constrained to those set out in our Investment Strategy which is driven by investment guidance, both statutory and from CIPFA, making it clear that all investing must adopt SLY principles – Security, Liquidity and Yield: ethical issues must play a subordinate role to those priorities.

14.7 ESG investing means different things to different people and can be highly subjective. For instance, some funds may invest in products that are known to be harmful, such as tobacco and alcohol but will not touch those that engage in other legal but morally ambiguous products. Likewise, gas or electricity companies may be shunned by a fund that does not like it's green credentials, but which may turn a blind eye and invest in companies that have a poor attitude to labour and the working process.

14.8 As well as establishing what funds invest in, before investing in an ESG product, one of the most important issues is to understand the ESG "risks" that an entity is exposed to and evaluating how well it manages these risks which is not something that officers have the experience or available capacity to undertake. This is why, the Council predominantly invests in fixed term deposits with banks, building societies and other local authorities and uses Money Market Funds that predominantly do the same but on a much larger scale. However, all the rating agencies are now extoling how they incorporate ESG risks alongside more traditional financial risk metrics when assessing counterparty ratings and in using these, the Council is by default already using ESG metrics in its ordinary course of business.

14.9 The Council's Treasury Policy Statement and Treasury Management Practices (TMPs) have been amended to make reference to ESG principles in investing and these are set out in Appendix F.

15 Conclusions

15.1 The Council recognises that effective financial planning, option appraisal, risk management and governance processes are essential in achieving a prudent approach to capital expenditure, investment, and debt. Therefore, all investment decisions (treasury and non-treasury) are taken considering the Council's Corporate Business Plan, Medium Term Financial Strategy, Capital & Investment Strategy and Treasury Management Strategy.

15.2 We remain in a very difficult investment environment with several unknowns. Interest rates and market sentiment has still been subject to bouts of volatility and economic forecasts abound with uncertainty. You only need to look to 2022 to show just how quickly circumstances can change.

15.3 With rising interest rates, increasing global political risks and expected recessions in 2023, the investment policy and borrowing shall remain prudent in combinaiton with rigorous risk management practices.

(To recommend to Full Council on 9 February 2023)

Background Papers

- Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes – 2021 Edition
- The Prudential Code for finance in local authorities - 2021 Edition
- Ministry for Housing, Communities and Local Government – MHCLG) Guidance on Local Authority Investments
- Local Authorities (Capital Finance and Accounting) (England) Regulations 2003