Chorley Council

APPENDIX H i)

Report of	Meeting	Date
Chief Finance Officer & Section 151 Officer	Special Council	22 February 2022

TREASURY STRATEGY 2022/23 TO 2024/25

PURPOSE OF REPORT

1. To present the Prudential and Treasury Indicators and Treasury Management and Investment Strategies for 2022/23 to 2024/25, and the Minimum Revenue Provision (MRP) Policy Statement for 2022/23.

RECOMMENDATION(S)

2. That Council approve:
   - The capital expenditure Prudential Indicators for 2022/23 to 2024/25 in Tables 1 to 5.
   - The annual Minimum Revenue Provision (MRP) Policy statement starting at paragraph 37.
   - The Treasury Management Strategy and treasury management Prudential Indicators for 2022/23 to 2024/25, in Tables 6 to 10.
   - The Annual Investment Strategy 2022/23 including Investment Counterparties starting at paragraph 73.

EXECUTIVE SUMMARY OF REPORT

3. This report incorporates the implications for treasury management of both financial and non-financial (income generating assets) investments. The wider approach to non-financial investments and to the capital expenditure as a whole is set out in more detail in the Capital Strategy report, which appears as Appendix G to the Budget report.

4. The report presents the Prudential Indicators in respect of capital expenditure and financing, the forecast levels of external borrowing and investments.

5. A review of the Council's Minimum Revenue Provision (MRP) policy has been undertaken. As a result of this review, the proposed MRP Policy for 2022/23 is amended, compared to that for 2021/22. The policy continues to be based on the current Statutory Guidance, as issued in February 2019 and effective from 1 April 2019. The Government is currently consulting on proposed changes to the regulations, but neither of the proposed changes would impact upon the Council's proposed or previous MRP policies.

6. The proposed list of investment counterparties for 2022/23 and associated limits per institution are unchanged from those for 2021/22.

7. Following the cessation of the publication of LIBOR/LIBID figures, which were previously used to set an investment performance benchmark, the Council is recommended to adopt a new benchmark rate based on the SONIA (Sterling Overnight Index Average) 7-day compounded rate.

Confidential report Please bold as appropriate	Yes	**No**

Key Decision? Please bold as appropriate	Yes	**No**

REASONS FOR RECOMMENDATIONS

8. Approval of the Prudential Indicators, Treasury Management Strategy, Treasury Indicators, Annual Investment Strategy, and Annual MRP Policy Statement is necessary to comply with statutory requirements.

ALTERNATIVE OPTIONS CONSIDERED AND REJECTED

9. None.

CORPORATE PRIORITIES

10. This report relates to the following Strategic Objectives:

Involving residents in improving their local area and equality of access for all		A strong local economy	
Clean, safe and healthy homes and communities		An ambitious council that does more to meet the needs of residents and the local area	✓

BACKGROUND

11. At its meeting on 23 February 2021, Council approved the Treasury Management Strategy for 2021/22, including Prudential and Treasury Indicators, the Treasury Management and Investment Strategies, and the annual Minimum Revenue Provision (MRP) Policy Statement for 2021/22. Treasury Management activities during the year have been overseen by the Governance Committee.

12. This report updates the Prudential and Treasury Indicators for financial years 2021/22 to 2024/25. It presents updated Treasury Management and Investment Strategies, including a revised list of Investment Counterparties, and proposes the Minimum Revenue Provision (MRP) Policy Statement for 2022/23.

13. 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.

14. 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 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.

15. The Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as *"The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."*

16. The Treasury Management Policy Statement for 2022/23 is based upon the Chief Finance Officer (s151 officer) and Treasury Officers' views on interest rates supplemented by leading market forecasts. The policy statement covers:
    a) The policy for managing capital borrowing and debt rescheduling
    b) The annual investment strategy for treasury management investments
    c) Reporting arrangements
    d) Training arrangements
    e) Performance indicators
    f) Minimum Revenue Provision (MRP) Policy
    g) Use of treasury management advisors

CAPITAL STRATEGY

17. Under the latest Prudential and Treasury Management Codes, in addition to the Treasury Management Strategy, all local authorities are now required to prepare an additional report, a Capital Strategy report, which is intended to provide the following:
    - a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
    - an overview of how the associated risk is managed
    - the implications for future financial sustainability

18. The aim of this report is to ensure that all elected members on the full council fully understand the overall strategy, governance procedures and risk appetite entailed by this Strategy. The Strategy both complements and supplements the Treasury Management Strategy and the two documents should be read in conjunction.

19. The Capital Strategy for 2022/23 appears at Appendix G to the 2022/23 budget report.

TREASURY MANAGEMENT STRATEGY 2022/23

20. The strategy for 2022/23 covers two main areas:

Capital issues

- the capital plans and the associated Prudential Indicators;
- the Minimum Revenue Provision (MRP) policy.

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.

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

TRAINING

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

23. The training needs of treasury management officers are reviewed periodically. Both CIPFA and Link Asset Services provide workshops and seminars.

TREASURY MANAGEMENT CONSULTANTS

24. The Council uses Link Asset Services, Treasury Solutions as its external treasury management advisors. The advisors provide access to specialist skills and resources including
    - Technical support on treasury matters and capital finance issues.
    - Economic and interest rate analysis.
    - Debt services, which includes advice on the timing of borrowing.
    - Debt rescheduling advice surrounding the existing portfolio.
    - Generic investment advice on interest rates, timing and investment instruments.
    - Credit ratings/market information service comprising the three main credit rating agencies.

25. 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 our external service providers.

26. It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The 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.

CAPITAL PRUDENTIAL INDICATORS 2022/23 – 2024/25 AND MRP STATEMENT

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.

Capital expenditure

28. 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.

Table 1 - Capital Expenditure	2021/22 Revised £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000
A Strong Local Economy	11,579	9,452	1,300	300
An Ambitious Council	2,804	1,570	0	0
Clean, Safe and Healthy Homes & Communities	12,107	12,724	875	875
Involving Residents	2,112	489	0	0
Capital Expenditure Total	**28,602**	**24,235**	**2,175**	**1,175**

29. 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.

Table 2 - Capital Financing	2021/22 Revised £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000
Capital expenditure from Table 1	28,602	24,235	2,175	1,175
Capital Receipts	(300)	(1,000)	0	0
Grants & Contributions	(12,307)	(6,129)	(775)	(775)
Revenue and Reserves	(1,025)	(1,795)	0	0
Net financing needed for year	**14,970**	**15,311**	**1,400**	**400**

The Council's borrowing need (the Capital Financing Requirement)

30. 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, will increase the CFR.

31. 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 assets life, and so charges the economic consumption of capital assets as they are used.

32. The Council is asked to approve the CFR projections below:

Table 3 - Capital Financing Requirement	**2021/22 Revised £000**	**2022/23 Estimate £000**	**2023/24 Estimate £000**	**2024/25 Estimate £000**
Opening CFR	89,271	103,027	116,843	116,461
Net financing need for the year (Table 2)	14,970	15,311	1,400	400
Less MRP/VRP	(1,214)	(1,495)	(1,782)	(1,845)
Closing CFR	**103,027**	**116,843**	**116,461**	**115,016**

Minimum Revenue Provision (MRP) Policy Statement

33. The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the Minimum Revenue Provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

34. DLUHC regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision.

35. In setting the 2022/23 Budget, the Council has reviewed its approach to MRP, key changes are summarised in the table below;

	Previous Approach	Proposed Approach
Pre 2008 Debt	The Council has charged the MRP on pre-2008 debt in “equal annual instalments”; this is a **prudent** approach as it ensures debt is cleared fully.	No change
Post 2008 Debt	The Council has adopted a varied approach; charging MRP largely in equal instalments over the life of an asset; however using an annuity basis for income generating schemes. The annuity basis recognises the “real terms” value of money over time (£1 now being worth less in future years). The annuity method is considered to be more equitable.	On the grounds of adopting a **consistent**, and more **equitable** approach, it is proposed to adopt the “annuity basis” for <u>all</u> post 2008 debt. The proposed change remains **prudent** as it still spreads the MRP fully over the life of the asset.
Asset Lives	The Council has adopted varying asset lives for new income generating assets; some with a life of 40 years (Logistics House, Primrose Court); others with a life of 50 years (Market	To ensure a **consistent** approach, it is proposed that an asset life of 50 years is adopted for all new income generating

	Walk / Strawberry Fields).	assets.

36. The Council is recommended to approve the following MRP Policy Statement:

Annual Statement of MRP Policy 2022/23

37. The aim of the policy is to ensure that MRP is charged over a period that is reasonably commensurate with the period over which the capital expenditure which gave rise to the debt provides benefits.

38. MRP shall commence in the financial year following that in which the capital expenditure is incurred, or in the year following that in which the relevant asset becomes operational.

39. In respect of the proportion of the Capital Financing Requirement which relates to debt incurred prior to 2008/09, MRP shall be charged in equal annual instalments over the life of assets (Equal instalment method). This generates a series of equal annual amounts over the life of each asset that is financed by borrowing, with the life determined upon acquisition. This means that the charge to revenue closely matches the period of economic benefit of the asset. This method is considered prudent as it ensures the debt is cleared in full over the life of the asset.

40. The MRP liability on debt incurred from 2008/09 onwards shall be based on the estimated useful life of the asset. The MRP shall be calculated using the annuity basis where the principal repayments increase over the life of the asset to reflect the “real terms” value of money over time.

41. Estimated life periods shall be determined under delegated powers, with reference to the guidance and advice of appropriate professional advisers, in the year that MRP commences. As some types of capital expenditure are not capable of being related to an individual asset, the MRP shall be assessed on a basis which most reasonably reflects the anticipated period of benefit arising from the expenditure.

42. The change in MRP policy has the following financial impact;

Years	Saving (-) / Additional Cost (£)
0 – 5	-477,314
6 – 10	48,921
11 – 15	51,655
16 – 20	41,309
21 – 25	48,891
26 – 30	55,738
31 - 35	62,637
36 – 40	1,512,695*
41 – 45	-136,218
46 - 50	-1,208,315*
TOTAL	0

Notes:

- * Relates to the extension of asset lives for Logistics House & Primrose Court (40 to 50 Years)
- The overall effect of the changes is NIL – essentially this is a reprofiling exercise to reflect the real terms value of money over time.
- Figures are based upon current forecasts of Capital Expenditure; inevitably these will change as schemes slip / new schemes are introduced; for this reason, the MRP Policy and budgets are reviewed annually.

43. The Government (DLUHC) is currently consulting on proposed changes to MRP regulation as follows;
    - Capital receipts may not be used in place of the revenue charge. The intent is to prevent authorities avoiding, in whole or part, a prudent charge to revenue. It is not the intention to prevent authorities using capital receipts to reduce their overall debt position, which may have the effect of reducing the MRP made with respect to the remaining debt balance.
    - Prudent MRP must be determined with respect to the authority's total capital financing requirement. The intent is to stop the intentional exclusion of debt from the MRP determination because it relates to an investment asset or capital loan. Authorities should still be able to charge MRP over the period in which their capital expenditure provides benefits and begin charging MRP in the year following capital expenditure, in accordance with proper accounting practices set out in the government's statutory guidance on Minimum Revenue Provision.

44. Neither of these changes impact upon either the current or proposed MRP Policy at the Council.

45. Members will be informed of the outcome of this consultation and if there are any relevant changes to the Council's MRP Policy in the mid-year Treasury Management Review Report 2022/23.

Affordability prudential indicators

46. 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

47. 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.

Table 4 - Ratio of Financing Costs to Net Revenue Stream	2021/22 Estimate %	2022/23 Estimate %	2023/24 Estimate %	2024/25 Estimate %
Ratio	17.12	23.82	28.73	28.70

48. The estimates of financing costs include current commitments and the proposals in the revenue and capital budget report.

49. This table now includes within the Net Revenue Stream not only income from taxation (Council Tax and Business Rates) and general government grants, but also that from income-generating assets. The Financing Costs also include the debt repayment and interest in respect of such assets. Table 4A below compares the income derived from these assets against the total financing cost incurred by the Council. It is emphasised that the comparison

is against the total financing cost and not only that which relates to the assets themselves. Further detail is contained in the Capital Strategy.

Table 4A - Investment Income in Excess of Borrowing	2021/22 Estimate %	2022/23 Estimate %	2023/24 Estimate %	2024/25 Estimate %
Total Borrowing Costs	2,775	3,405	3,354	3,320
Net Income From Non-Financial Investments	(4,003)	(4,910)	(5,800)	(5,796)
Investment Income in Excess of Borrowing Costs	(1,228)	(1,505)	(2,446)	(2,476)

Core funds and expected investment balances

50. The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.).

Table 5 - Year-End Resources	2021/22 Revised £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000
Core Funds/Working Balances	(28,781)	(20,963)	(22,045)	(22,997)
Under/(over) borrowing (Table 6)	22,781	18,963	20,045	20,997
Expected investments	**(6,000)**	**(2,000)**	**(2,000)**	**(2,000)**

BORROWING

51. The capital expenditure plans set out in paragraph 28 above 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 / Prudential Indicators, the current and projected debt positions and the annual Investment Strategy.

Current portfolio position

52. The Council's projected treasury portfolio position is summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement – CFR), highlighting any over or under borrowing.

Table 6 - Portfolio Position	2020/21 Actual £000	2021/22 Revised £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000
Debt at 1 April	64,026	62,156	80,231	97,865	96,401
Other long-term liabilities (OLTL)	15	15	15	15	15
Total gross debt 1 April	64,041	62,171	80,246	97,880	96,416
Expected change in Debt	(1,870)	18,075	17,634	(1,464)	(2,397)
Expected change in OLTL	0	0	0	0	0
Expected change in gross debt	(1,870)	18,075	17,634	(1,464)	(2,397)
Gross debt 31 March	62,171	80,246	97,880	96,416	94,019
Capital Financing Requirement (Table 3)	89,271	103,027	116,843	116,461	115,016
Under / (over) borrowing	**27,100**	**22,781**	**18,963**	**20,045**	**20,997**

53. The figures for long-term liabilities in the above table relates to leases which the Council has entered into, based on current accounting requirements. Currently, a new accounting standard for leasing, IFRS 16, is due to be introduced for application in the Council's 2022/23 financial statements. The impact of this on those statements will be fully assessed during the year and, if necessary, a revision to the figures shown here may be brought to Council for approval. However, CIPFA is currently undertaking a review which may result in the further deferment of the implementation of IFRS 16 to 2023/24 or even to 2024/25.

Treasury Indicators: limits to borrowing activity

54. Within the prudential indicators there are two key indicators to ensure that the Council operates its activities within well-defined limits. These are the Operational Boundary and the Authorised Limit. The principal aim is to ensure that borrowing is only undertaken in respect of previous and approved future capital spending and not for revenue or speculative purposes. This is achieved by setting limits which restrict the amount of borrowing which can be undertaken to that required to finance the current underlying borrowing requirement (ie the CFR), plus the impacts of approved capital schemes for each of the coming three financial years. This is the Operational Boundary. To allow for some operational flexibility in the timing of borrowing, scope is provided for some headroom above this, but this is only to be used on a short-term basis and is subject to a maximum limit which may not be exceeded. This is the Authorised Limit. Further detail of both indicators is set out below.

55. The S151 Officer reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

56. **The Operational Boundary.** This is the limit 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.

Table 7 - Operational Boundary	2021/22 Revised £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000
Debt	84,200	102,600	101,300	98,900
Other long-term liabilities	15	15	15	15
Operational Boundary	**84,215**	**102,615**	**101,315**	**98,915**

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

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

58. The Council is asked to approve the following Authorised Limit:

Table 8 - Authorised Limit	2021/22 Revised £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000
Debt	88,500	107,800	106,400	103,900
Other long-term liabilities	15	15	15	15
Authorised Limit	**88,515**	**107,815**	**106,415**	**103,915**

Maturity structure of borrowing

59. 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.

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

Table 9 - Maturity Structure of Borrowing			
Maturity structure of fixed interest rate borrowing 2021/22			
	31/3/22	**Lower**	**Upper**
Under 12 months	3%	0%	30%
12 months to 2 years	3%	0%	30%
2 years to 5 years	9%	0%	40%
5 years to 10 years	15%	0%	50%
Over 10 years	70%	0%	80%

61. The column headed 31/3/22 is the forecast split of borrowing as at the end of the current **financial** year and includes estimated temporary borrowing. The column for the Upper limit is in respect of borrowing in 2022/23. It indicates that borrowing is likely to be for a range of maturities.

It is not anticipated that any borrowing will be taken at variable interest rates.

Control of interest rate exposure

62. Please see the summary in this report and the advice of Link Assets Services on prospects for interest rates in Appendix H2.

63. The table in Appendix H2 compares the forecast of a year ago with that prepared for the mid-year review, and the current forecast.

Prospects for borrowing interest rates

64. The Bank of England's Monetary Policy Committee (MPC) made a significant move at its meeting in the first week of February 2022, raising Bank Rate by another 0.25% to 0.50% and only narrowly deciding against a 0.50% increase by a 5-4 voting margin. The Council's treasury advisor's forecast now expects the MPC to deliver another 0.25% increase in March; with its position seeming to be to go for sharp increases to get address its objectives quickly. The March increase is expected to be followed by an increase to 1.0% in May and then to 1.25% in November. The Committee is currently much more closely focused on combating inflation than on protecting economic growth.

65. In respect of PWLB rates, the advice received is that the yield curve has flattened out considerably, with the view being that the markets as have already built in nearly all the effects on gilt yields of the likely increases in Bank Rate. Since the start of 2021, there has been a lot of volatility in gilt yields, and hence in PWLB rates. Current forecasts show little overall increase in gilt yields during the forecast period to March 2025 but there will doubtless be a lot of unpredictable volatility during this forecast period.

66. Based upon the capital plans set out above, the Council will need to enter into further long-term external borrowing during the term of this strategy.

Borrowing strategy

67. The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (ie 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.

68. Against this background and the risks within the economic forecast, caution will be adopted with the 2022/23 treasury operations. The Section 151 Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

    - *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*, perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity, or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

69. Any decisions will be reported at the next available opportunity.

Policy on borrowing in advance of need

70. 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.

71. 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.

ANNUAL INVESTMENT STRATEGY

Investment Policy – management of risk

72. The DLUHC and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with financial investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy at Appendix H to the Budget report.

The Council's investment policy has regard to

- the DLUHC's Guidance on Local Government Investments ("the Guidance"),
- CIPFA's Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2021 ("the CIPFA TM Code"), and
- CIPFA Treasury Management Guidance Notes 2021.

73. The Council's investment priorities will be **S**ecurity first, portfolio **L**iquidity second, and only then return (**Y**ield).

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

- 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.

- **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.

- **Other information sources** used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

- This Council has defined the list of **types of investment instruments** that the treasury management team are authorised to use.

    - **Specified investments** are those with a high level of credit quality and subject to a maturity limit of 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.

- **Non-specified investments limit.** The Council has determined that it will limit the maximum total exposure to non-specified investments as being £4 million. See Table 10 below.

- **Lending limits**, (amounts and maturity), for each counterparty will be set through applying the matrix table in paragraph 86.

- **Transaction limits** are set for each type of investment in paragraph 86.

- This authority will set a limit for the amount of its investments which are invested for **longer than 365 days**, (see Table 10).

- Investments will only be placed with UK counterparties.

- This authority has engaged **external consultants** to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.

- All investments will be denominated in **sterling**.

Creditworthiness policy

75. The Council applies the creditworthiness service provided by Link Asset Services. 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:

    - credit watches and credit outlooks from credit rating agencies;
    - CDS spreads to give early warning of likely changes in credit ratings;
    - sovereign ratings to select counterparties from only the most creditworthy countries.

76. This modelling approach combines credit ratings, credit Watches and credit Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour 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
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

77. 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.

78. The Link Asset Services' 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.

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

80. All credit ratings will be monitored weekly and will be checked at the time of placing investments. The Council is alerted to changes to ratings of all three agencies through its use of the Link Asset Services' creditworthiness service, and has access to the websites of Fitch, Moody's and Standard & Poor's.

- 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 benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

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

UK banks – ring fencing

82. The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), are required, by UK law, to separate core retail banking services from their investment and international banking activities. This is known as "ring-fencing". Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.

83. Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and "riskier" activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity's core activities are not adversely affected by the acts or omissions of other members of its group.

84. While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

Counterparties and investment limits 2022/23

85. The proposed counterparties and investment limits for 2022/23 are unchanged from those for 2021/22 and are shown in the following table.

Investment Counterparties 2022/23

Category	Institutions	LAS Colour Code	Maximum Period	Limit per Institution
Banks & Building Societies: Call Accounts /Term Deposits / Certificates of Deposit (CDs)				
Government related/guaranteed entities	DMADF (DMO)	Yellow	6 months	Unlimited
	UK Local Authority	Yellow	1 year 2 years	£3m per LA £2m per LA; £4m in total
UK part-nationalised institutions	Royal Bank of Scotland group	Blue	1 year	£4m per group
UK-incorporated Institutions	UK banks and building societies of high credit quality	Orange Red Green	1 year 6 months 3 months	£5m per group (or institution if independent)
Money Market Funds				
Money Market Funds	MMFs of high credit quality - AAA rated		Instant access	£5m per fund

Investment strategy

In-house funds

86. 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. However, as Table 6 indicates, the Council is currently under-borrowed, which means that it is using its own cash balances to avoid taking external borrowing at higher rates of interest than it would achieve if it invested the cash. Cash balances are held only to manage the ups and down of cash flow, and in general they are held only in highly liquid accounts such as bank current accounts and Money Market Funds.

Investment returns expectations

87. Bank Rate is forecast to reach 0.75% by the end of March 2022, rising to 1.25% by the end of March 2023, before then remaining steady across the whole of the remaining period covered by this strategy report. Current Bank Rate forecasts for financial year ends (March) are shown below, compared to those from twelve months ago:

2021/22	0.75%	Was 0.10% in 2021/22 Treasury Strategy report
2022/23	1.25%	Was 0.10%
2023/24	1.25%	Was 0.10%
2024/25	1.25%	

88. 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:

	Now	**2021/22 report**
2022/23	1.00%	0.10%
2023/24	1.25%	0.10%
2024/25	1.25%	0.10%
2025/26	1.25%	0.20%
Following five years	1.50%	2.00%
Long-term later years	2.00%	2.00%

89. The overall balance of risks to economic growth in the UK is now to the downside. This includes risks from Covid and its variants, both domestically and their potential effects worldwide.

90. It is not expected that Bank Rate will go up fast after the initial rate sharp rises over the next few months, as the supply potential of the economy is not likely to have taken a major hit during the pandemic. It should, therefore, be able to cope well with meeting demand after supply shortages subside over the next year, without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the MPC's 2% target after a spike up to around 5%. The forecast includes four increases in Bank Rate over the three-year forecast period to March 2025, ending at 1.25%. However, it is likely that these forecasts will need changing within a relatively short timeframe for the following reasons: -
- We do not know how severe an impact continuing variants of the virus may have on the
- Some of the current key supply shortages may spill over into causing economic activity in some sectors to take a significant hit.
- Rising gas and electricity prices in October and next April and increases in other prices caused by supply shortages and increases in taxation next April, are already going to deflate consumer spending power without the MPC having to take any action on Bank Rate to cool inflation.
- It looks as if the economy coped well with the end of furlough on 30th September. It is estimated that there were around 1 million people who came off furlough then and there was not a huge spike up in unemployment. The other side of the coin is that vacancies have been hitting record levels so there is a continuing acute shortage of workers. This is a potential danger area if this shortage drives up wages.
- There could be further severe impacts from continuing Covid variations.

91. In summary, with the high level of uncertainty prevailing on several different fronts and the expectation is that forecasts will have to be revised again during the year.

92. **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.

93. The Council is asked to approve the treasury indicator and limit:

Table 10 - Maximum Principal Sums Invested > 365 Days	2021/22 Revised £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000
UK Government	0	0	0	0
UK Local Authorities **	4,000	4,000	4,000	4,000
UK Banks & Building Societies	0	0	0	0
Non-UK Banks	0	0	0	0
Total	**4,000**	**4,000**	**4,000**	**4,000**

** Maximum of £2 million per local authority

For its cash flow generated balances, the Council will seek to utilise its business reserve instant access and notice accounts, Money Market Funds and short-dated deposits (overnight to 100 days) in order to benefit from the compounding of interest.

Investment Risk Benchmarking

94. The Council has previously set its investment performance benchmark based on the 7-day LIBID compounded rate. As was expected at the time when the 2021/22 Strategy was approved, the publication of official LIBOR figures and related LIBID calculations ceased at the end of December 2021. The replacement recommended by the Council's treasury management advisors is SONIA (Sterling Overnight Index Average), which is the risk-free rate for sterling markets administered by the Bank of England. SONIA is based on actual transactions and reflects the average of the interest rates that banks pay to borrow sterling overnight from other financial institutions and other institutional investors.

95. SONIA is the Working Group on Sterling Risk Free Reference Rates' preferred benchmark for the transition to sterling risk-free rates from LIBOR/LIBID. To support this transition, the Bank of England began publishing the SONIA Compounded Index from 3 August 2020. This simplifies the calculation of compounded interest rates and in doing so provides a standardised basis through its publication as an official source.

96. Going forwards, the Council's advisors will be providing compounded SONIA rates to clients in the same way that they previously did with LIBOR / LIBID rates. Rates will be available for overnight, 7 day, 1, 3, 6 or 12 month compounded / SONIA, allowing a choice of the benchmark rate which is the most appropriate to the individual council.

97. It is recommended that the Council adopt SONIA for investment performance benchmarking purposes and that it applies the 7-day compounded rate, as being the most suitable to the Council's cashflows, the typical pattern of which means that funds will only seldom be available for investment for fixed terms of one month or more.

End of Year Investment Report

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

IMPLICATIONS OF REPORT

99. This report has implications in the following areas and the relevant Directors' comments are included:

Finance	✓	Customer Services	
Human Resources		Equality and Diversity	
Legal	✓	Integrated Impact Assessment required?	
No significant implications in this area		Policy and Communications	

COMMENTS OF THE STATUTORY FINANCE OFFICER

100. These are contained in the report.

COMMENTS OF THE MONITORING OFFICER

101. The recommendations are appropriate as explained in the body of the report.

LOUISE MATTINSON
CHIEF FINANCE OFFICER AND SECTION 151 OFFICER

Background Papers			
Document	**Date**	**File**	**Place of Inspection**
CIPFA Treasury Management in the Public Services: Code of Practice & Guidance Notes (2021)			Town Hall
CIPFA Prudential Code for Capital Finance in Local Authorities (2021)			Town Hall
CIPFA Treasury Management in the Public Services: Guidance Notes for Local Authorities (2021)			Town Hall
CIPFA Standards of Professional Practice: Treasury Management			Town Hall
DLUHC Guidance on Local Government Investments			Town Hall
DLUHC Guidance on Minimum Revenue Provision			Town Hall

Report Author	Ext	Date	Doc ID
Tony Furber	5027	8th February 2021	