CABINET
8 FEBRUARY 2022

PRUDENTIAL INDICATORS AND TREASURY MANAGEMENT STRATEGY REPORT 2022/23

Responsible Cabinet Member -
Councillor Scott Durham, Resources Portfolio

Responsible Director -
Elizabeth Davison, Group Director of Operations

SUMMARY REPORT

Purpose of the Report

1. This report requests Cabinet to review and scrutinise the following prior to forwarding to Council for their approval and adoption:

   (a) The Prudential Indicators and Limits for 2022/23 to 2024/25 relating to capital expenditure and Treasury Management activity.

   (b) A policy statement relating to the Minimum Revenue Provision.

   (c) The Treasury Management Strategy 2022/23, which includes the Annual Investment Strategy for 2022/23.

2. The report outlines the Council's prudential indicators for 2022/23 – 2024/25 and sets out the expected treasury operations for this period. It fulfils key legislative and guidance requirements:

   (a) The reporting of the **prudential indicators** setting out the expected capital activities and treasury management prudential indicators included as treasury indicators in the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management Code of Practice.

   (b) The Council's **Minimum Revenue Provision (MRP) Policy**, which sets out how the Council will pay for capital assets through revenue each year.

   (c) The **treasury management strategy** statement which sets out how the Council's treasury service will support capital decisions taken above, the day to day treasury management and the limitations on activity through treasury prudential indicators.

   (d) The key indicator is the **authorised limit**, the maximum amount of debt the Council could afford in the short term, but which is not sustainable in the longer term.

(e) The **investment strategy** which sets out the Council's criteria for choosing the investment counterparties and limiting exposures to the risk of loss.

3. The information contained in the report regarding the Councils expenditure plans, Treasury Management and Prudential Borrowing activities indicate that they are:

   (a) Within the statutory framework and consistent with the relevant codes of practice.

   (b) Prudent, affordable and sustainable.

   (c) An integral part of the Council's Revenue and Capital Medium Term Financial Plans.

Recommendation

4. It is recommended that Cabinet examine the following and pass on any comments to Council in order that they approve:

   (a) The Prudential Indicators and limits for 2022/23 to 2024/25 summarised in Tables 1 and 2.

   (b) The Minimum Revenue Provision (MRP) statement (paragraphs 33 - 37).

   (c) The Treasury Management Strategy 2022/23 to 2024/25 as summarised in paragraphs 41 to 69.

   (d) The Annual Investment Strategy 2022/23 contained in paragraphs 70 to 107.

Reasons

5. The recommendations are supported by the following reasons:

   (a) In order to comply with the Prudential Code for Capital Finance in Local Authorities and the Department for Levelling Up, Housing & Communities (DLUHC) guidance on investments.

   (b) To comply with the requirements of the Local Government Act 2003.

   (c) To approve a framework for officers to work within when making investment decisions.

Elizabeth Davison
Group Director of Operations

Background Papers

(i) Annual Draft Statement of Account 2020/21
(ii) Draft MTFP (incl Capital MTFP 2022/23 to 2025/26)
(iii) Draft Capital Strategy
(iv) Link Asset Services Economic Report Dec 2021

Peter Carrick: Extension 5401

S17 Crime and Disorder	This report has no implications for S 17 Crime and Disorder.
Health and Well Being	This report has no implications for the Council's Health and Well being agenda.
Carbon Impact and Climate Change	This report has no implications for the Council's Carbon Emissions.
Diversity	This report has no implications for the Council's Diversity agenda.
Wards Affected	All Wards
Groups Affected	All Groups
Budget and Policy Framework	This report must be considered by Council.
Key Decision	This is not an executive decision
Urgent Decision	For the purposes of call in this report is not an urgent decision.
Council Plan	This report has no particular implications for the Council Plan.
Efficiency	The report refers to actions taken to reduce costs and manage risks.
Impact on Looked After Children and Care Leavers	This report has no impact on Looked After Children or Care Leavers.

MAIN REPORT

Information and Analysis

Background

6. 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."

7. 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 risk appetite, providing adequate liquidity initially before considering investment return

8. 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. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.

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

10. 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.

Reporting requirements

Capital Strategy

11. The 2017 CIPFA Prudential and Treasury Management Codes require all local authorities to prepare a capital strategy report, which will provide the following:

    (a) A high-level long term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services

    (b) An overview of how the associated risk is managed

    (c) The implications for future financial sustainability

12. 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. The Capital Strategy is reported separately to Council on an annual basis.

Treasury Management Reporting

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

Prudential and Treasury Indicators and Treasury Strategy (this report)

14. The first, and most important report is forward looking and covers:

(a) The capital plans (including prudential indicators);

(b) A minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);

(c) The treasury management strategy, (how the investments and borrowings are to be organised), including treasury indicators; and

(d) An investment strategy, (the parameters on how investments are to be managed).

A Mid-Year Treasury Management Report

15. This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether the treasury function is meeting the strategy or whether any policies require revision.

An Annual Treasury Report

16. 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.

17. These reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Audit Committee.

Treasury Management Strategy for 2022/23

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

(a) Capital Issues:

(i) The capital expenditure plans and the prudential indicators;

(ii) The minimum revenue provision (MRP) policy.

(b) Treasury Management Issues:

(i) The current treasury position;

(ii) Treasury indicators which will limit the treasury risk and activities of the Council;

(iii) Prospects for interest rates;

(iv) The borrowing strategy;

(v) Policy on borrowing in advance of need;

(vi) Debt rescheduling;

(vii) The investment strategy;

(viii) Creditworthiness policy; and

(ix) Policy on use of external service providers.

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

20. A summary of the key prudential indicators and limits are contained in Tables 1 and 2 and further details are contained further on in this report.

Table 1 – Capital Expenditure and Borrowing

	2021/22 Revised	2022/23 Estimated	2023/24 Estimated	2024/25 Estimated
Capital Expenditure Tables 3 and 4	£49.560m	£76.970m	£49.471m	£23.853m
Capital financing requirement - Table 5	£225.663m	£243.522m	£254.926m	£261.440m
Ratio of financing costs to net revenue stream – General Fund See paragraph 39 - Table 6	2.50%	2.14%	4.24%	4.21%
Ratio of financing costs to net revenue stream –HRA See paragraph 39 - Table 6	14.86%	14.79%	15.80%	16.14%
Operational boundary for external debt - Table 9	£174.081m	£187.966m	£201.860m	£215.761m
Authorised limit for external debt - Table 10	£236.946m	£255.698m	£267.672m	£274.512m

Table 2 – Treasury Management

	2022/23 Upper Limit	2023/24 Upper Limit	2024/25 Upper Limit
Limits on fixed interest rates	100%	100%	100%
Limits on variable interest rates	40%	40%	40%
Maximum principal sums invested > 364 days	£50m	£50m	£50m
Maturity Structure of fixed interest rate borrowing 2022/23			
		Lower Limit	**Upper Limit**
Under 12 months		0%	40%
12 months to 2 years		0%	50%
2 years to 5 years		0%	60%
5 years to 10 years		0%	80%
10 years and above		0%	100%

Training

21. 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. Training was undertaken by a number of Members during 2 sessions held in September 2021 and further training will be arranged as required. The training needs of treasury management officers are periodically reviewed.

Treasury Management Consultants

22. The Council uses Link Group, Treasury solutions as its external treasury management advisors. The Council recognises that responsibility for treasury decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon the services of our external service provider. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisors.

23. 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 officers of 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 subject to regular review.

The Capital Prudential Indicators 2022/23– 2024/25

24. 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

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

Table 3 Capital Expenditure

	2021/22 Revised £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
General Fund	28.098	40.231	24.399	7.899
HRA	11.989	32.980	24.869	20.081
Estimated Capital Expenditure	**40.087**	**73.211**	**49.268**	**27.980**
Loans to Joint Ventures	9.473	3.759	0.203	(4.127)
Total	**49.560**	**76.970**	**49.471**	**23.853**

26. The financing need above excludes other long-term liabilities, such as PFI and leasing arrangements which already include borrowing instruments.

27. 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 4 Financing of the Capital Programme

	2021/22 Revised £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
General Fund	28.098	40.231	24.399	7.899
HRA	11.989	32.980	24.869	20.081
Loans to Joint Ventures	9.473	3.759	0.203	(4.127)
Total Capital	**49.560**	**76.970**	**49.471**	**23.853**
Financed by:				
Capital receipts -General Fund	0.842	3.832	2.524	1.024
Capital receipts - Housing	0.303	0.303	0.303	0.303
Capital grants	23.715	4.575	3.875	3.875
Self financing - GF	0.000	20.000	18.000	3.000
Revenue Contributions (Housing)	10.573	17.618	16.491	16.693
Total excluding borrowing	**35.433**	**46.328**	**41.193**	**24.895**
Borrowing need	**14.127**	**30.642**	**8.278**	**(1.042)**

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

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

above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

29. 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.

30. The CFR includes any other long-term liabilities (e.g. PFI schemes & finance leases) brought onto the balance sheet. Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility by the PFI or lease provider and so the Council is not required to separately borrow for these schemes. The Council currently has £9.232m of such schemes within the CFR.

31. Under a new accounting standard (IFRS 16) the Council will be required to add any finance leases to its balance sheet and therefore increase its CFR accordingly, this standard was due to be introduced from 1 April 2021 but has been deferred to 1 April 2022 when the Council will include any identified elements on its balance sheet and hence increase its CFR.

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

Table 5 – CFR Projections

	2021/22 Revised £m	**2022/23 Estimate £m**	**2023/24 Estimate £m**	**2024/25 Estimate £m**
CFR – General Fund	135.961	141.661	144.561	147.061
CFR – PFI and Finance leases	9.232	8.117	7.011	5.912
CFR - housing	67.709	77.225	86.631	95.871
CFR - Loans to JV's	12.761	16.520	16.723	12.596
Total CFR	**225.663**	**243.523**	**254.926**	**261.440**
Movement in CFR		**17.860**	**11.403**	**6.514**

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). It is also allowed to undertake additional voluntary payments if desired (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. It is proposed that Darlington Borough Council's MRP policy statement for 2022/23 will be:

(a) For Capital expenditure incurred before 1 April 2008 and expenditure which was granted through credit approvals since that date MRP will be calculated on an annuity basis (2%) over 50 years or the useful life of the asset.

(b) Capital Expenditure from 1 April 2008 for all unsupported borrowing MRP will be based on the estimated life of the assets, repayments will be on an annuity basis (2%).

(c) Repayments relating to the PFI scheme will be based on the life of the asset of 60 years from 1 April 2008 on an annuity basis (2%).

(d) Where MRP has been overcharged in previous years, the recovery of the overcharge will be affected by reducing the MRP charges, due in full or in part for 2022/23 and in future years, which would otherwise have been made. The MRP adjustment for 2022/23 and in future years charge will be done in such a way as to ensure that:-

(i) The total MRP after applying the adjustment will not be less than zero in any financial year,

(ii) The cumulative amount adjusted for will never exceed the amount over-charged,

(iii) The extent of the adjustment will be reviewed on an annual basis.

36. There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made.

37. Repayments included in annual PFI or finance leases are applied as MRP.

38. **MRP Overpayments** - A change introduced by the revised DLUHC MRP Guidance was the allowance that any charges made over the statutory minimum revenue provision (MRP), voluntary revenue provision (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, this policy must disclose the cumulative overpayment made each year. Up until the 31.3.21 there were no VRP overpayments made.

Affordability Prudential Indicators

39. 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.

Estimates of the ratio of financing costs to net revenue stream

40. 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 6 - Ratio of financing costs to net revenue stream

	2021/22 Revised	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
General Fund	2.50%	2.14%	4.24%	4.21%
HRA	14.86%	14.79%	15.80%	16.14%

41. The estimates of financing costs include current commitments and the proposals in this year's MTFP report.

Treasury Management Strategy

Borrowing

42. The capital expenditure plans set out in the previous paragraphs 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 approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

Under Borrowing position

43. Over the last ten years the Council had maintained an underborrowed position, i.e. the amount of our gross external borrowing has been less than our balance sheet Capital Financing Requirement. This strategy has served the Council well in a period where returns on investment have been low and borrowing costs have been relatively high. This has also meant that we have had less in the form of investments and so reduced counterparty risk. To support the MTFP it was agreed that longer term investments would be pursued as these would give a return over and above the cost of any additional borrowing that would be taken. Following due diligence the Council has 3 Property Funds with £10 million in each fund and these are expected to bring a net return of around 1.5% over the life of the MTFP. Additional borrowing of £25m was undertaken which resulted in the underborrowed position being reduced.

Current Portfolio Position

44. The overall treasury management portfolio as at 31 March 2021 and for the position as at 31 December 2021 are shown below for both borrowings and investments.

Table 7 – Treasury Portfolio

TREASURY PORTFOLIO				
	Actual 31/03/2021 £m's	Actual 31/03/2021 %	Current 31/12/2021 £m's	Current 31/12/2021 %
Treasury Investments				
banks	8.000	13.5	16.000	23.8
local authorities	10.000	16.8	10.000	14.9
money market funds	11.400	19.2	11.200	16.7
Total managed in house	**29.400**	**49.5**	**37.200**	**55.4**
property funds	29.999	50.5	29.999	44.6
Total managed externally	**29.999**	**50.5**	**29.999**	**44.6**
Total treasury investments	**59.399**	**100.0**	**67.199**	**100.0**
Treasury external borrowing				
local authorities	20.000	12.4	13.000	8.7
PWLB	128.865	79.8	124.115	82.9
LOBO's	12.600	7.8	12.600	8.4
Total external borrowing	**161.465**	**100.0**	**149.715**	**100.0**
Net treasury borrowing	**102.066**		**82.516**	

45. The Council's expected treasury portfolio position at 31 March 2022, with forward projections is summarised below at Table 8. 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 8 - Gross Borrowing to CFR

	2021/22 Revised £m	**2022/23 Estimate £m**	**2023/24 Estimate £m**	**2024/25 Estimate £m**
Debt at 31 March	150.088	161.329	176.126	195.253
Loans to Joint Ventures	12.761	16.520	16.723	12.596
Other long-term liabilities (OLTL)	9.232	8.117	7.011	5.912
Gross Actual debt at 31 March	**172.081**	**185.966**	**199.860**	**213.761**
The Capital Financing Requirement from Table 5	**225.663**	**243.522**	**254.926**	**261.440**
Under / (over) borrowing	**53.582**	**57.556**	**55.066**	**47.679**

46. Within the range of prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2022/23 and the following two financial years. This allows some flexibility for limited early borrowing for future years but ensures that the borrowing is not undertaken for revenue or speculative purposes.

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

Treasury Indicators: Limits to Borrowing Activity

The Operational Boundary

48. This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

Table 9 - Operational Boundary

	2021/22 Revised £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
Debt from Table 8 (incl JV's)	162.849	177.849	192.849	207.849
Other long-term liabilities	9.232	8.117	7.011	5.912
Prudential Borrowing for leasable assets	1.000	1.000	1.000	1.000
Prudential Borrowing under Directors Delegated Powers	1.000	1.000	1.000	1.000
Operational Boundary	**174.081**	**187.966**	**201.860**	**215.761**

The Authorised Limit for external debt

49. This is a key prudential indicator and represents a control on the maximum level of borrowing. This represents a legal limit beyond which external debt is prohibited, and this limit needs to be set or revised by full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term:

50. 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.

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

Table 10 – Authorised Limit

	2021/22 Revised £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
CFR	225.663	243.522	254.926	261.440
Additional Headroom @ 5%	11.283	12.176	12.746	13.072
Authorised Limit	**236.946**	**255.698**	**267.672**	**274.512**

52. It is proposed that the additional headroom for years 2022/23 to 2024/25 is 5% above the CFR, this would allow for any additional cashflow needs throughout the years.

Prospects for Interest Rates

53. The Council has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives Link Asset Services's central view for future interest rates and the economic background to that view is shown at **Appendix 1.**

Table 11 – Interest rates

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including *certainty rate adjustment)			
		5 year	10 year	25 year	50 year
Mar 2022	0.25	1.50	1.70	1.90	1.70
Jun 2022	0.50	1.50	1.80	2.00	1.80
Sep 2022	0.50	1.60	1.80	2.10	1.90
Dec 2022	0.50	1.60	1.90	2.10	1.90
Mar 2023	0.75	1.70	1.90	2.20	2.00
Jun 2023	0.75	1.80	2.00	2.20	2.00
Sep 2023	0.75	1.80	2.00	2.20	2.00
Dec 2023	0.75	1.80	2.00	2.30	2.10
Mar 2024	1.00	1.90	2.10	2.30	2.10
Jun 2024	1.00	1.90	2.10	2.40	2.20
Sep 2024	1.00	1.90	2.10	2.40	2.20
Dec 2024	1.00	2.00	2.20	2.50	2.30
Mar 2025	1.25	2.00	2.30	2.50	2.30

* *The certainty rate adjustment is a reduced rate by 0.20% for those councils like Darlington Borough Council who have submitted more detail on future borrowing requirement to the Treasury*

54. Over the last 2 years the coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings until raising it to 0.25% at its meeting on 16 December 2021.

55. As shown in the forecast table above, the forecast for Bank Rate now includes four increases, one in quarter 2 of 2022 to 0.50%, quarter 1 of 2023 to 0.75%, quarter 1 of 2024 to 1.00% and, finally, one in quarter 1 of 2025 to 1.25%.

56. As the interest forecast table for PWLB certainty rates above shows, there is likely to be a steady rise over the forecast period, with some degree of uplift due to rising treasury yields in the US.

57. There are potentially significant risks to the above forecasts and they are shown in more detail in **Appendix 2.**

Investment and borrowing rates

58. Investment returns are likely to improve in 2022/23. However while markets are pricing in a series of Bank Rate hikes, actual economic circumstances may see the MPC fall short of these elevated expectations.

59. Borrowing interest rates fell to historically very low rates as a result of the COVID crisis and the quantitative easing operations of the Bank of England and still remain at historically low levels. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years.

60. While the Council will not be able to avoid borrowing to finance new capital expenditure, to replace maturing debt and the rundown of reserves, there will be a cost of carry (the difference between higher borrowing costs and lower investment returns), so any new short or medium-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

Borrowing Strategy

61. 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 to be considered.

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

(a) If it was felt that there was a significant risk of a sharp FALL in borowing rates (eg due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

(b) 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.

63. Any decisions would be reported to the appropriate Committee at the next available opportunity.

Treasury Management Limits on Activity

64. There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive, they will impair the opportunities to reduce costs/improve performance. The indicators are:

(a) Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments

(b) Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;

(c) Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing and are required for upper and lower limits. The Council is asked to approve the following treasury indicators and limits:

Table 12 - Interest Rate Exposure

	2022/23	2023/24	2024/25
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	40%	40%	40%
Maturity Structure of fixed interest rate borrowing 2022/23			
		Lower	**Upper**
Under 12 months		0%	40%
12 months to 2 years		0%	50%
2 years to 5 years		0%	60%
5 years to 10 years		0%	80%
10 years and above		0%	100%

Policy on Borrowing in Advance of Need

65. 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 of need 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 through its investment strategy.

66. 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.

Debt Rescheduling

67. Rescheduling of current borrowing in our debt portfolio is unlikely to occur as there is still a very large difference between premature redemption rates and new borrowing rates, even though the general margin of PWLB rates over gilt yields was reduced by 100 bps in November 2020.

68. If there was a possibility the reasons for any rescheduling to take place will include:

(a) The generation of cash savings and / or discounted cash flow savings;

(b) Helping to fulfil the treasury strategy;

(c) Enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

69. Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

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

New Financial Institutions as a source of borrowing

71. Currently the PWLB Certainty Rate is set at gilts + 80 basis points for both HRA and Non-HRA borrowing. However, consideration may still need to be given to sourcing funding from the following sources for the following:

(a) Local authorities (primarily shorter dated maturities out to 3 years or so – still cheaper than the Certainty Rate)

(b) Financial institutions (primarily insurance companies and pension funds but also some banks, out of forward dates where the objective is to avoid a ‘cost of carry’ or to achieve refinancing certainty over the next few years)

(c) Municipal Bond Agency (possibly still a viable alternative depending on market circumstances prevailing at the time).

72. Our advisors will keep us informed as to the relative merits of each of these alternative funding sources.

Annual Investment Strategy

Investment and Creditworthiness Policy

73. 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.

74. The Council's investment policy has regard to the following:

    (a) DLUHC's Guidance on Local Government Investments ("the Guidance")

    (b) CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the Code")

    (c) CIPFA Treasury Management Guidance Notes 2018

75. The Council's investment priorities will be security first, liquidity second and then yield (return). The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the Council's risk appetite. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs. However, where appropriate (from an internal as well as external perspective), the Council will also consider the value available in periods up to 12 months with high credit rated financial institutions, as well as wider range fund options.

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

    (a) Minimum acceptable credit criteria are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentrtation risk. The key ratings used to monitorcounterparies are the short term and long-term ratings.

    (b) 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.

    (c) Other information sources used will include the financial press, share prices and other such information pertaining to the financial sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

(d) This Council has defined the list of types of investment instruments that the treasury management team are authorised to use. There are 2 lists in **Appendix 2** under the categories of 'specified' and 'non-specified' investments.

(i) Specified investments are those with a high level of credit quality and subject to a maturity limit of one year.

(ii) 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.

(e) Lending limits, (amounts and maturity), for each counterparty will be set through applying the matrix table in Table 13.

(f) Transaction limits are set for each type of investment in Table 13.

(g) This Council wil set a limit for the amount of its investments which are invested for longer than 365 days.

(h) Investments will be placed with counterparties from countries with a specified minimum sovereign rating.

(i) This Council 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 Council in the context of the expected level of cash balances and need for liquidity throughout the year.

(j) All investments will be denominated in sterling.

(k) As a result of the change in accounting standards for 2022/23 under International Financial Reporting Standard (IFRS) 9, this Council will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018 the Ministry of Housing, Communities and Local Government [MHCLG], concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for 5 years ending31 March 2023).

77. However, this Council will also pursue value for money in treasury mangement and will monitor the yield from investment income against appropriate benchmarks for investment performance. Regular monitoring of investment performance will be carried out during the year.

Changes in risk management policy from last year

78. The above criteria are unchanged from last year.

Investment Counterparty Selection Criteria

Creditworthiness policy

79. The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle the Council will ensure that:

    (a) It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and

    (b) It has sufficient liquidity in its investments. For this purpose, it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

80. The Group Director of Operations will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified (see Appendix 2 for definitions) as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

81. Credit rating information is supplied by the Link Group, our treasury advisors, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating Outlooks (notification of a longer-term bias outside the central rating view) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating Watch applying to a counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.

82. Any investment in Property Funds/ Corporate Bond Funds/ Asset Backed Investment Products will be subject to due diligence for each and every fund considered. The maximum amount invested in any one fund will be £20million with a maximum of £50million total for all funds.

83. The criteria for providing a pool of high-quality investment counterparties (both specified and non-specified investments) is:

    (a) Banks 1 - good credit quality – the Council will only use banks which:

        (i) Are UK banks; and/or;

        (ii) Are non-UK and domiciled in a country which has a minimum sovereign Long Term rating of AAand have, as a minimum, the following Fitch, Moody's and Standard & Poors credit ratings (where rated):

(i) Short Term – F1;

(ii) Long Term – A-

(b) Banks 2 – Part nationalised UK banks – Royal Bank of Scotland ring-fenced operations. These banks can be included provided they continue to be part nationalised or meet the ratings in Banks 1 above.

(c) Banks 3 – The Council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time invested.

(d) Building societies -The Council will use all societies which meet the ratings for the banks outlined above and have assets in excess of £1,000m.

(e) Money Market Funds (MMFs) CNAV – AAA

(f) Money Market Funds (MMF's) LNVAV – AAA

(g) Money Market Funds (MMF's) VNAV - AAA

(h) Ultra-Short Dated Bond Funds - AAA

(i) UK Government (including gilts, Treasury Bills and the DMADF)

(j) Local authorities, parish councils etc

(k) Supranational institutions

(l) Housing associations

(m) Property Funds, Corporate Bond Funds and Asset Backed Investment Products.

84. A limit of £50m will be applied to the use of non-specified investments.

Use of additional information other than credit ratings

85. Additional requirements under the Code require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating Watches/Outlooks) will be applied to compare the relative security of differing investment counterparties.

Time and monetary limits applying to investments

86. In order to determine time limits for investments the Council applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utlilising credit ratings from the three main credit rating agencies - Fitch, Moodys and Standard & Poors. The credit ratings of counterparties are supplemented with the following overlays:

    (a) Credit watches and credit outlooks from credit rating agencies;

    (b) Credit Default Swap price spreads to give early warning of likely changes in credit ratings;

    (c) Sovereign ratings to select counterparties from only the most creditworthy countries.

87. The Council will therefore use the following durational bands when applying time limits to investments

    (a) Yellow Maximum 2 years *This only relates to AAA rated government debt or its equivalent

    (b) Purple Maximum 2 years

    (c) Blue 1 year (only applies to nationalised or semi nationalised UK Banks)

    (d) Orange 1 year

    (e) Red 6 months

    (f) Green 3 months

88. The time and monetary limits for institutions on the Council's counterparty list are as follows (these will cover both specified and non-specified Investments).

Table 13 – Time and monetary limits applying to investments

	Fitch Long term Rating (or equivalent)	Money Limit	Time Limit
Banks 1 high quality	AA-	£5m	Maximum of 2 years Suggested duration using Link Group colour coding (CDS adjusted with manual override)
Banks 1 medium quality	A	£4m	Maximum of 1 year Suggested duration using Link Group colour coding (CDS adjusted with manual override)
Banks 1 lower quality	A-	£3m	Maximum of 1 year Suggested duration using Link Group colour coding (CDS adjusted with manual override)
Banks 2 category – part nationalised	N/A	£5m	Maximum of 1 years
Banks 3 category – Council's banker (not meeting Banks 1)		£3m	1 day
DMADF (Debt Management Office)	AAA	unlimited	6 months
UK Government Treasury Bills	UK sovereign rating	unlimited	Maximum of 1 year
Local authorities	N/A	£5m per Local Authority	Up to 2 years
Money market Funds (CNAV, LVNAV & VNAV) and Ultra Short Dated Bond Funds	AAA	£5m per Fund	liquid
Property Funds, Corporate Bond Funds and other Asset backed Investment products	Non Rated Due Diligence required	£20m per Fund	10 years

89. In addition to sterling deposits either on a fixed term call or notice basis deposits in banks or Building Societies which meet our criteria, may be made via certificates of deposits where appropriate.

90. The proposed criteria for Specified and Non-Specified investments are shown in Appendix 3 for approval.

91. All credit ratings will be monitored daily. The Council is alerted to changes to ratings of all three agencies through its use of the Link Group creditworthiness service.

(a) 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.

(b) In addition to the use of credit ratings the Council will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

92. 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 government support for banks and the credit ratings of that government support.

Investment Strategy

In-house funds

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

(a) If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping the most investments as being short term or variable.

(b) Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

Investment returns expectations

94. As seen from the above estimates the bank rate is likely to rise from 0.25% early in 2022.

95. 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:-

(a) 2022/23 0.50%
(b) 2023/24 0.75%
(c) 2024/25 1.00%
(d) 2025/26 1.25%
(e) Later years 2.00%

96. The overall balance of risks to economic growth in the UK is probably relatively even, but is subject to major uncertainty due to the virus. It may also be affected by what deal the UK agrees as part of Brexit.

Investment treasury indicator and limit

97. 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.

98. The Committee is asked to approve the treasury indicator and limit:

Table 14 – Maximum Principal sums invested

	2022/23	2023/24	2024/25
Principal sums invested greater than 365 days	£50m	£50m	£50m

99. For its cash flow generated balances, the Council will seek to utilise its instant access accounts, 30+ day notice accounts, money market funds and short-dated deposits (overnight to three months) in order to benefit from the compounding of interest.

Investment Risk Benchmarking

100. These benchmarks are simple guides to maximum risk, so they may be breached from time to time, depending on movements in interest rates and counterparty criteria. They relate to Investments that are not Property Funds. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the Mid-Year or Annual Report.

101. Security - The Council's maximum security risk benchmark for the current portfolio, when compared to these historic default tables, is:

    (a) 0.077% historic risk of default when compared to the whole portfolio.

102. Liquidity – in respect of this area the Council seeks to maintain:

    (a) Bank overdraft - £0.100m

    (b) Liquid short-term deposits of at least £3.000m available with a week's notice

    (c) Weighted Average Life benchmark is expected to be 1 year.

103. Yield - local measures of yield benchmarks are:

    (a) Investments – internal returns above the 7-day Sterling Overnight Index Average (SONIA) compounded rate

    (b) Investments – Longer term – capital investment rates returned against comparative average rates

104. In addition that the security benchmark for each individual year is:

Table 15 - Security Benchmark

	1 year	2 years
Maximum	0.077%	0.077%

Note: This benchmark is an average risk of default measure and would not constitute an expectation of loss against a particular investment.

105. The above reported benchmarks for Security Liquidity and Yield all relate to Deposits with Banks and Money Market Funds but would not relate to Property Funds.

106. It is proposed that property funds will be benchmarked for performance against the IPD All Balanced Fund index which is the universe of all property funds, data for this can be provided by our Treasury Management advisors Link Group.

End of year investment report

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

Outcome of Consultation

108. No consultation was undertaken in the production of this report.