Treasury Management Strategy Statement (TMSS) 2023-24 **Appendix A**

1. Introduction

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

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

1.3 Investments held for service purposes or for commercial profit are considered in the Investment Strategy Report included with this TMSS report.

1.4 This TMSS forms part of the Council's overall budget strategy and financial management framework.

2 External Context

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

2.1 The Bank of England (BoE) increased Bank Rate by 0.5% to 3.25% in December 2022. This followed a 0.75% rise in November which was the largest single rate hike since 1989 and the ninth successive rise since December 2021. The December decision was voted for by a 6-3 majority of the Monetary Policy Committee (MPC), with two dissenters voting for a no-change at 3% and one for a larger rise of 0.75%.

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

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

2.4 Interest rates have also been rising sharply in the US, with the Federal Reserve increasing the range on its key interest rate by 0.5% in December 2022 to 4.25%-4.5%. This rise follows four successive 0.75% rises in a pace of tightening that has seen rates increase from 0.25%-0.5% in March 2022. Annual inflation has been slowing in the US but remains above 7%.

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

2.6 **Credit outlook**: Credit default swap (CDS) prices have generally followed an upward trend throughout 2022, indicating higher credit risk. CDS price volatility was higher in 2022 compared to 2021. The weakening economic picture during 2022 led the credit rating agencies to reflect this in their assessment of the outlook for the UK sovereign as well as several local authorities and financial institutions, revising them from stable to negative. The Council's counterparty list is based on institutions on our adviser Arlingclose's recommended counterparty list.

2.7 **Interest rate forecast:** The Council's treasury management advisor Arlingclose is forecasting that Bank Base Rate will continue to rise in 2023 as in 2022 due to the Bank of England's attempts to subdue inflation which is significantly above its 2% target.

2.8 Multiple interest rate rises are still expected over the continued forecast despite looming recession. Bank Rate central case forecast is expected to be 4.25% by June 2023 should inflation not evolve as the Bank forecasts and remains persistently higher.

3 Local Context

3.1 For the purpose of setting the Council's budget and MTFS, it has been assumed that new treasury investments in 2023-24 will be made at an average rate range of 3.30% - 3.70% depending on duration and future Bank of England rate rises, and that new long-term loans will be borrowed at an average rate of 4.5%. However, reduction in cash balances will significantly impact interest earned on cash balances.

On 31st December 2022, the Council held £68.7m of borrowing and £225.4m of treasury investments. Forecast changes in these sums are shown in the balance sheet analysis in Table 1. Future estimates are based on current use of reserve forecast below based on presented to Cabinet on 26 January 2023 and current capital program.

Table 1: Balance Sheet Summary Projections

£m	2021-22 Actual (draft) £m	2022-23 Current £m	2023-24 Forecast £m	2024-25 Forecast £m	2025-26 Forecast £m
General Fund CFR	365.673	387.658	394.281	410.305	407.511
HRA CFR	152.485	149.993	202.166	285.257	327.898
Total CFR	**518.158**	**537.651**	**596.447**	**695.562**	**735.409**
Other debt liabilities *	-53.483	-46.021	-41.286	-35.789	-29.673
Borrowing CFR	**464.675**	**491.63**	**555.161**	**659.773**	**705.736**
External Borrowing **	-69.872	-68.709	-68.709	-68.709	-68.709
Internal Borrowing (Under/Over Borrowing)	**394.803**	**422.921**	**486.452**	**591.064**	**637.027**
Balance Sheet Resources - Usable reserves	-600.9	-503.3	-322.4	-256.6	-206.7
Balance Sheet Resources - Working capital	-96.9	-96.9	-96.9	-96.9	-96.9
(Treasury Investments)/New Borrowing	**-302.997**	**-177.279**	**67.152**	**237.564**	**333.427**
Net Investments	**-233.125**	**-108.57**	**135.861**	**306.273**	**402.136**

* *leases and PFI liabilities that form part of the Council's total debt*

*** shows only loans to which the Council is committed*

3.1 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing. Actual internal borrowing on 31 March 2022 was £394.8m and forecast internal borrowing on 31 March 2023 is forecast at £422.9m. Internal borrowing represents the actual borrowing which is yet to be financed with external debt. By not borrowing to date the council has saved millions of pounds in debt interest. However, as level of reserves reduce and the capital program spend increases, the Council based on forecast is likely to borrow in 2023/24.

3.2 CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Council expects to comply with this recommendation between 2023-24 to 2025-26.

3.3 The Council has an increasing CFR due to the capital programme, but reducing investment balances and will therefore be required to borrow up to £637m over the forecast period (forecast internal borrowing to March 2026).

3.4 The table 2 below shows the Council's existing investment and debt portfolio on 31 December 2022.

Existing Investment & Debt Portfolio Position

£m	31.12.2022 Actual Portfolio £m	31.12.2022 Average Rate %
External Borrowings: • Public Works Loans Board • Other Loans	 51.209 17.500	 2.55 4.34
Total External Borrowings	**68.709**	**3.01**
Other Long-Term Liabilities: • Private Finance Initiative • Leases	 26.655 26.828	
Total Other Long-Term Liabilities	**53.483**	
Total Gross External Debt	**123.355**	
Treasury Investments: • Bank Call Accounts • Banks & Building Societies (unsecured) • Government • Local Authority • Money Market Funds • Cash-Plus Funds • Strategic Pooled Funds	 1.000 55.000 45.000 10.000 38.150 20.000 56.000	 1.03 3.31 2.16 0.31 3.24 1.26 3.27
Total Treasury Investments	**225.150**	**2.71**
Net Debt	**101.795**	

4 Borrowing Strategy

4.1 The Council currently holds £68.71m of external borrowing, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 1 shows that should the capital program fully spends forecast spend, the Council is likely to borrow in 2023/24. However, with slippage in the program the borrowing requirement is likely to be in 2024/25. However, current borrowing and future borrowing requirements by borrowing in advance of need, does not exceed the authorised limit for borrowing of £765.4m (2025-26).

4.2 **Liability benchmark:** To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as Table 1 above, but that cash and investment balances are kept to a minimum level of £56m at each year-end but minimise credit risk and maintain sufficient liquidity.

Table 3: Liability benchmark

	31.3.22 Actual £m	31.3.23 Estimate £m	31.3.24 Forecast £m	31.3.25 Forecast £m	31.3.26 Forecast £m
Loans CFR	464.675	491.63	555.161	659.773	705.736
Balance Sheet Resources - Useable capital	(600.900)	(503.300)	(322.400)	(256.600)	(206.700)
Balance Sheet Resources - Working capital	(96.900)	(96.900)	(96.900)	(96.900)	(96.900)
Net Loans Requirement	(233.125)	(108.57)	135.861	306.273	402.136
Liquidity Allowance	56.000	56.000	56.000	56.000	56.000
Liability benchmark	**(177.125)**	**(52.570)**	**191.861**	**362.273**	**458.136**

The liability benchmark suggests the Council will require a minimum level of borrowing in 2023-24 of £191.9m, to maintain the minimum investment level of £56m at year end. This £56m represents the nominal value of strategic funds the Council invested in for long term purposes, these can however be sold if need be. Current loss on these funds is £4.5m. The actual level of borrowing at year end depends on whether the Council's spending plans proceed as planned and on the actual timing of borrowing as well as level of internal cash.

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

4.4 **Strategy:** The Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently sightly lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

4.5 By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal borrowing or short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise and maintaining liquidity. Council officers are able to draw on borrowing advice as required to ascertain whether the Council borrows additional sums at long-term fixed rates in 2022/23 with a view to keeping future interest costs low.

4.6 The Council will seek to strike a balance between using internal resources, cheap short-term loans (currently available at around 3.5% - 4.30%) and long-term fixed rate loans where the future cost is known but higher. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield, the Council intends to avoid this activity in order to retain its access to PWLB loans. there are several other factors that the Council needs to consider when setting its borrowing strategy.

4.7 As shown in the table below, the Council is planning to significantly increase its capital expenditure over the next 3 years; the forecast capital programme expenditure is £628.2m over the next 3 financial years (2023-24 to 2025-26). This plan is for the programme to be partly funded by borrowing of £225.1m (£67.44m in the General Fund for 2023-24 to 2025-26 and £187.65m in the HRA for the same period). The plan is for the rest of the programme to be funded by other sources including payments from developers (Developers contributions – CIL, Section 106 and lease holder contributions), capital receipts, revenue contributions and Right to Buy/MRR receipts (the HRA). However, in previous years, the capital programme has had slippage, including the current year.

Table 4 demonstrating Capital Expenditure

Capital Expenditure	2021-22 Actual (draft) £m	2022-23 Estimate £m	2023-24 Estimate £m	2024-25 Estimate £m	2025-26 Estimate £m
Non-HRA	106.331	111.867	122.281	80.875	35.482
HRA	52.102	74.458	156.185	139.331	94.109
Total	**158.433**	**188.325**	**278.466**	**220.206**	**129.591**

4.8 The Council had previously raised the majority of its long-term borrowing from the PWLB but will consider long-term loans from other sources including banks, pension funds and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Council intends to avoid this activity in order to retain its access to PWLB loans.

4.9 If necessary and in rising interest rate environment, the Council may arrange forward starting loans, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period. The Council may additionally borrow short-term loans to cover unplanned cash flow shortages.

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

- HM Treasury’s PWLB Lending Facility (formerly the Public Works Loan Board)
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- any other UK public sector body
- UK public and private sector pension funds (except the London Borough of Tower Hamlets Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

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

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

4.12 **Municipal Bonds Agency:** UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It issues bonds on the capital markets and lends the proceeds to local authorities. This is a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to full Council.

4.13 **Short-term and variable rate loans**: These loans may leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below. The Council will avoid variable rate loans except on advice.

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

5 Treasury Investment Strategy

5.1 The Council holds significant invested funds, representing grants, CIL, S106 and other income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council's treasury investment balance has ranged between £200 million and £340 million a lot of which has been due to temporary increase in reserves, covid and related grants received not immediately spent.

5.2 The CIPFA Code requires the Council to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

5.3 **Strategy:** As demonstrated by the liability benchmark in table 3, since capital expenditure s not fully funded with Council resources, capital receipts or grants, the Council expects to be a long-term borrower and new or existing treasury investments will therefore be made primarily to manage day-to-day cash flows using short-term low risk instruments. The existing portfolio of strategic pooled funds will be maintained to diversify risks into different sectors and boast investment income as applicable.

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

5.5 **Environmental Social and Governance (ESG):** Environmental, social and governance (ESG) considerations are increasingly a factor in global investors' decision making, but the framework for evaluating investment opportunities is still developing. The CIPFA Treasury Management Code requires local authorities to consider their counterparty policies in light of ESG information, while recognising that there is not a developed approach to ESG for public sector organisations and not expecting authorities to use real-time ESG scoring/criteria for individual investments. There are currently no definitive criteria.

5.6 Where possible, the Council will consider banks and funds who are signatories to the UN Principles for Responsible Banking and funds operated by managers that are signatories to the UN Principles for Responsible Investment, the Net Zero Asset Manager Alliance and /or the UK Stewardship Code.

5.7 As at 31 December, five of the six banks the Council invested fixed deposits with are signatories of the UN Principles for Responsible Banking. Managers and Money Market Funds the Council has invested in are signatories of UN Principles for Responsible Investment, UK Stewardship Code 2020 and Net-Zero Asset Managers Initiative. However, the Funds themselves are not necessarily Climate or ESG fully compliant.

5.8 **Approved counterparties:** The Council may invest its surplus funds with any of the counterparty types in Table 5 below, subject to the limits shown.

Table 5: Recommended investment counterparties and limits

Sector	Time limit	Counterparty limit	Sector limit
The UK Government	50 years	Unlimited	n/a
Local authorities & other government entities *(subject to checks on their balance sheet position, current financial status and Statement of accounts depending on duration)*	25 years	£25m	Unlimited
Secured investments *	25 years	£25m	Unlimited
Banks (unsecured) *	13 months	£15m	Unlimited
Building societies (unsecured) *	13 months	£15m	£30m
Registered providers (unsecured) *	5 years	£15m	£75m
Money market funds *	n/a	£30m	Unlimited
Strategic pooled funds*	n/a	£30m	£150m
Real estate investment trusts	n/a	£35m	£75m
Other investments *	5 years	£15m	£30m

This table must be read in conjunction with the notes below

Minimum Credit rating: Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating is not lower than A-. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account during decision making. This is monitored on a regular basis in liaison with our Advisors.

For entities without published credit ratings, investments may be made where external advice indicates the entity to be of similar credit quality following an external credit assessment.

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

5.10 **Secured Investments:** These are investments secured on the borrower's assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments.

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

5.12 **Registered Providers:** Loans to, and bonds issued by or guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are tightly regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government, and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

5.13 **Money Market Funds (MMFs)**: Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the Council will exercise due care by diversifying its liquid investments across various providers, to ensure access to cash at all times. It is worth noting that in the event of very significant economic crashes when Central Banks reduce rates to the extent that rates become negative, MMFs will become Variable Net Asset Values and / or accumulating funds.

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

5.15 Real Estate Investment Trusts (REITS): Shares in companies that invest mainly in real estate and pay most of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties. Investments in REIT shares cannot be withdrawn but can be sold on the stock market to another investor.

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

5.17 **Operational Bank Accounts:** The Council may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services to any UK bank with credit ratings not lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £2m if it falls below the minimum bank credit rating referred to in 5.7. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.

5.18 **Risk Assessment and Credit Ratings**: Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. The credit rating agencies in current use are listed in the Treasury Management Practices document. Where an entity has its credit-rating downgraded so that it fails to meet the approved investment criteria then:

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

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

5.20 **Other information on the security of investments**: The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Council's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

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

5.21 **Investment limits**: In order that no more than approximately 25% of available reserves for credit losses will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £30 million. A group of banks under the same ownership will be treated as a single organisation for limit purposes.

5.22 Limits are also placed on fund managers, investments in brokers' nominee accounts, foreign countries, and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country since the risk is diversified over many countries.

Table 6 demonstrating Additional Investment limits

	Cash Limit
Any group of pooled funds under the same management	£75m per manager
Negotiable instruments held in a broker's nominee account	£75m per broker
Foreign countries	£30m per country

5.23 **Liquidity management**: The Council uses a cash flow forecasting model to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium-term financial plan and cash flow forecast. The Council will spread its liquid cash over at least four providers (e.g., bank accounts and money market funds) to ensure that access to cash is maintained in the event of operational difficulties at any one provider.

6 Treasury Management Indicators

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

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

Credit risk indicator	Target	Minimum
Portfolio average credit rating	A	A-

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

Liquidity risk indicator	Target
Total cash available within 3 months	£30m

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

Interest rate risk indicator	Limit
Upper limit on one-year revenue impact of a 1% rise in interest rates	£2m
Upper limit on one-year revenue impact of a 1% fall in interest rates	£2m

6.5 The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at new market rates.

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

Refinancing rate risk indicator	**Upper limit**	**Lower limit**
Under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	60%	0%
5 years and within 10 years	75%	0%
10 years and within 20 years	100%	0%
20 years and within 30 years	100%	0%
30 years and within 40 years	100%	0%
40 years and above	100%	0%

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

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

Price risk indicator	**2023-24**	**2024-25**	**2025-26**
Limit on principal invested beyond year end/ no fixed maturity date	£150m	£150m	£125m

7 Related Matters

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

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

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

7.4 Housing Revenue Account: The Council maintains two loan pools General Fund and HRA. Loans are assigned in their entirety to two pools. Interest payable and other costs/income arising from long-term loans (e.g., premiums and discounts on early redemption) are charged/credited to the respective revenue account. Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. This balance is measured each month and interest transferred between the General Fund and HRA at the Council's average interest rate on investments, adjusted for credit risk.

7.5 External Funds: From time to time, the Council may hold funds on behalf of other bodies will be separated where possible from the Council's cash via separate bank accounts or separate ledger codes. Where possible interest will be apportioned, and appropriate impairment losses applied as necessary.

7.6 **Markets in Financial Instruments Directive (MiFID)**: The Council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers, and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the Chief Financial Officer believes this to be the most appropriate status.

8 Financial Implications

8.1 The budget for investment income in 2022-23 is £2.27m and for 2023-24 is £2.00m, based on prudent assumptions made for the returns on the Council's various treasury investments including the pooled fund portfolio and term deposits, cash rates and forecast level of cash balances. The budget for debt interest payable in 2022-23 is £2.25m, while the budget for 2023-24 is £3.29m (£2.25m plus growth of £1.14m) being agreed as part of the Council's 2023-24 Medium Term Financial Strategy. If actual levels of investments and borrowing, or actual interest rates, differ from that forecast, performance against budget will be correspondingly different.

8.2 The revised budget for MRP in 2022-23 is £13.015m and for 2023-24 £17.235m.

9 Other Options Considered

9.1 The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Financial Officer, having consulted with the treasury advisers Arlingclose, the Cabinet Member for Resources and Corporate Leadership Team believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

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

Appendix A1 – Arlingclose Economic & Interest Rate Forecast December 2022

Underlying assumptions:

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

Forecast:

- The MPC raised Bank Rate by 50bps to 3.5% in December as expected, with signs that some members believe that 3% is restrictive enough. However, a majority of members think further increases in Bank Rate might be required. Arlingclose continues to expect Bank Rate to peak at 4.25%, with further 25bps rises February, March and May 2023.

- The MPC will cut rates in the medium term to stimulate a stuttering UK economy, but will be reluctant to do so until wage growth eases. We see rate cuts in the first half of 2024.

- Arlingclose expects gilt yields to remain broadly steady over the medium term, although with continued volatility across shorter time periods.

- Gilt yields face pressures to both sides from hawkish US/EZ central bank policy on one hand to the weak global economic outlook on the other. BoE bond sales and high government borrowing will provide further underlying support for yields.

	Current	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
Official Bank Rate													
Upside risk	0.00	0.50	0.75	1.00	1.00	1.00	1.25	1.50	1.75	1.50	1.25	1.25	1.25
Arlingclose Central Case	3.50	4.00	4.25	4.25	4.25	4.25	4.00	3.75	3.50	3.25	3.25	3.25	3.25
Downside risk	0.00	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00
3-month money market rate													
Upside risk	0.00	0.50	0.75	1.00	1.00	1.00	1.25	1.50	1.75	1.50	1.25	1.25	1.25
Arlingclose Central Case	3.00	4.40	4.40	4.40	4.35	4.30	4.25	4.00	3.75	3.50	3.40	3.40	3.40
Downside risk	0.00	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00
5yr gilt yield													
Upside risk	0.00	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.43	3.60	3.80	3.80	3.80	3.70	3.60	3.50	3.40	3.30	3.30	3.30	3.30
Downside risk	0.00	0.80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
10yr gilt yield													
Upside risk	0.00	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.47	3.50	3.60	3.60	3.60	3.60	3.50	3.50	3.50	3.50	3.50	3.50	3.50
Downside risk	0.00	0.80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
20yr gilt yield													
Upside risk	0.00	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.86	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85
Downside risk	0.00	0.80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
50yr gilt yield													
Upside risk	0.00	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.46	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60
Downside risk	0.00	0.80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00

PWLB Standard Rate (Maturity Loans) = Gilt yield + 1.00%
PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%
PWLB Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%