Cabinet
07 March 2023

Treasury Management Strategy Statement

Minimum Revenue Provision Policy Statement and Annual Investment Strategy 2023/24

Cabinet Member:	Cllr Barry Warren, Leader and Cabinet Member for Finance & Environment
Responsible Officer:	Andrew Jarrett, S151 (Deputy Chief Executive)

Reason for Report: To agree the proposed Treasury Management Strategy and Annual Investment Strategy for 2023/24.

RECOMMENDATION(S):

> **That Cabinet recommends to Full Council that the proposed Treasury Management Strategy and Annual Investment Strategy for 2023/24, including the prudential indicators for the next 3 years and the Minimum Revenue Provision Statement (Appendix 1), be approved.**

Relationship to the Corporate Plan: Maximising our return from all associated treasury activities enables the Council to support current levels of spending in accordance with our Corporate Plan.

Financial Implications: Good financial management and administration underpins the entire strategy.

Legal Implications: Authorities are required by regulation to have regard to the Prudential Code when carrying out their duties under Part 1 of the Local Government Act 2003.

Risk Assessment: The S151 Officer is responsible for the administration of the financial affairs of the Council. Implementing this strategy and the CIPFA Code of Practice on Treasury Management helps manage the risk associated with the Council's treasury management activity.

Equality Impact Assessment: There are no Equalities Impact implications relating to the content of this report.

Impact on Climate Change: There are no Climate Change implications relating to the content of this report.

1.0 Background

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

1.2 The second main function of the treasury management 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.

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

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

1.5 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."

1.6 In the recent Devon Audit Partnership audit (December 2022), a Substantial Assurance opinion was given, meaning the Council has "a sound system of governance, risk management and control exists, with internal controls operating effectively and being consistently applied to support the achievement of objectives in the area audited".

2.0 Reporting requirements

2.1 Treasury Strategy

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

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

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

2.2 Treasury Management reporting

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

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

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy (how the investments and borrowings are to be organised), including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

b. A mid-year treasury management report – This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision. In addition, members will receive quarterly treasury updates as part of the financial monitoring.

c. An annual treasury report – This is a backward looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

2.2.2 **Scrutiny.** The above reports are required to be adequately scrutinised before being recommended to the Council. The Cabinet undertakes this role.

2.3 Treasury Management Strategy for 2023/24

2.3.1 The strategy for 2023/24 covers two main areas:

2.3.2 **Capital issues**

- The capital expenditure plans and the associated prudential indicators; and
- The minimum revenue provision (MRP) policy.

2.3.3 **Treasury management issues**

- The current treasury position;
- Treasury indicators which limit the treasury risk and activities of the Council;
- Prospects for interest rates;
- The borrowing strategy;
- Policy on borrowing in advance of need;
- Debt rescheduling;
- The investment strategy;
- Creditworthiness policy; and
- The policy on the use of external service providers.

2.3.4 These elements cover the requirements of the Local Government Act 2003, the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code, Department for Levelling Up, Housing and Communities (DLUHC – this was formerly the Ministry of Housing, Communities and Local Government [MHCLG]) MRP Guidance, the CIPFA Treasury Management Code and DLUHC Investment Guidance.

2.4 Training

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

2.4.2 Furthermore, the Code states that all organisations are expected to have a formal and comprehensive knowledge and skills or training policy for the effective acquisition and retention of treasury management knowledge and skills for those responsible for management, delivery, governance and decision making.

2.4.3 The scale and nature of this will depend on the size and complexity of the organisation's treasury management needs. Organisations should consider how to assess whether treasury management staff and council members have the required knowledge and skills to undertake their roles and whether they have been able to maintain those skills and keep them up to date.

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

- Record attendance at training and ensure action is taken where poor attendance is identified;
- Prepare tailored learning plans for treasury management officers and board/council members;
- Require treasury management officers and board/council members to undertake self-assessment against the required competencies (as set out in the schedule that may be adopted by the organisation); and
- Have regular communication with officers and board/council members, encouraging them to highlight training needs on an ongoing basis.

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

2.4.6 Training requirements of members will be reviewed in 2023/24 following the district election in May and training will be arranged as required.

2.4.7 The training needs of treasury management officers are periodically reviewed.

2.4.8 A formal record of the training received by officers central to the Treasury function will be maintained by the S151 (Deputy Chief Executive). Similarly, a formal record of the treasury management/capital finance training received by members will be maintained by the Member Services Manager.

2.5 Treasury management consultants

2.5.1 The Council uses Link Group as its external treasury management advisors. The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon the services of our external service providers.

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

3.0 The Capital Prudential Indicators 2023/24 – 2025/26

3.1.1 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.

3.2 Capital expenditure and financing

3.2.1 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. The below table shows planned expenditure in the 2023/24 Capital Programme of £64,826k, (£58,625k new projects plus the projected slippage from prior years £6,201k).

Prudential Indicator: Estimates of Capital Expenditure

Capital Expenditure £000	2021/22 Actual	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
General Fund	3,836	5,224	17,084	23,992	2,855
HRA	4,196	7,446	21,634	32,574	26,705
Loans to Subsidiary Company *	3,591	9,282	26,108	11,162	14,138
Total	**11,623**	**21,952**	**64,826**	**67,728**	**43,698**

* *Loans to Subsidiary Company are non-treasury investments and so not covered in detail in this report. Refer to the Capital Strategy for further information.*

For Members clarity, the NHS Hub loan is treated as General Fund.

3.2.2 Other long-term liabilities – The above financing need excludes other long-term liabilities, such as PFI and leasing arrangements that already include borrowing instruments.

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

Financing of capital expenditure £000	2021/22 Actual	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Capital Receipts	1,484	1,190	1,575	2,426	1,587
Capital Grants	1,367	4,934	15,023	29,652	11,016
Capital Reserves	0	0	0	0	0
Revenue	2,889	4,733	4,934	5,661	2,927
Net financing need for the year	**5,883**	**11,095**	**43,294**	**29,989**	**28,168**

3.2.4 The net financing need for Loans to Subsidiary Company included in the above table against expenditure is shown below:

Loans to Subsidiary Company £000	2021/22 Actual	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Capital Expenditure	3,591	9,282	26,108	11,162	14,138
Financing Costs	0	0	0	0	0
Net financing need for the year	**3,591**	**9,282**	**26,108**	**11,162**	**14,138**
Percentage of total net financing need %	61.0%	83.7%	60.3%	37.2%	50.2%

The financing costs are zero as, to date, all lending has been funded through internal borrowing. This is forecast to be possible in the years 2023/24 – 2025/26.

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

3.3.1 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.

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

3.3.3 The CFR includes any other long-term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility by the PFI, PPP lease provider and so the Council is not required to separately borrow for these schemes. The Council currently has £2.314m of such schemes within the CFR.

3.3.4 **The Council is asked to approve the CFR projections below:**

Prudential Indicator: Estimates of Capital Financing Requirement

Capital Financing Requirement £000	2021/22 Actual	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
CFR – General Fund	10,162	9,877	14,223	19,411	18,856
CFR – Housing	39,603	40,580	51,934	64,400	76,626
CFR – Loans to Subsidiary Company	11,363	20,522	30,636	15,622	14,138
Total CFR	**61,128**	**70,979**	**96,793**	**99,433**	**109,620**
Movement in CFR*	**3,282**	**9,851**	**25,814**	**2,640**	**10,187**

**The movement in CFR will not directly match the Net Financing Need (see 3.2.3) due to the annual MRP charge reducing the balance in line with each asset's expected life. The CFR is cumulative, so increases and decreases for scheduled loans to, and repayments from, 3 Rivers Developments Ltd.*

3.4 Liability Benchmark

3.4.1 A third and new Prudential Indicator for 2023/24 is the Liability Benchmark (LB). The Authority is required to estimate and measure the LB for the forthcoming financial year and the following two financial years, as a minimum.

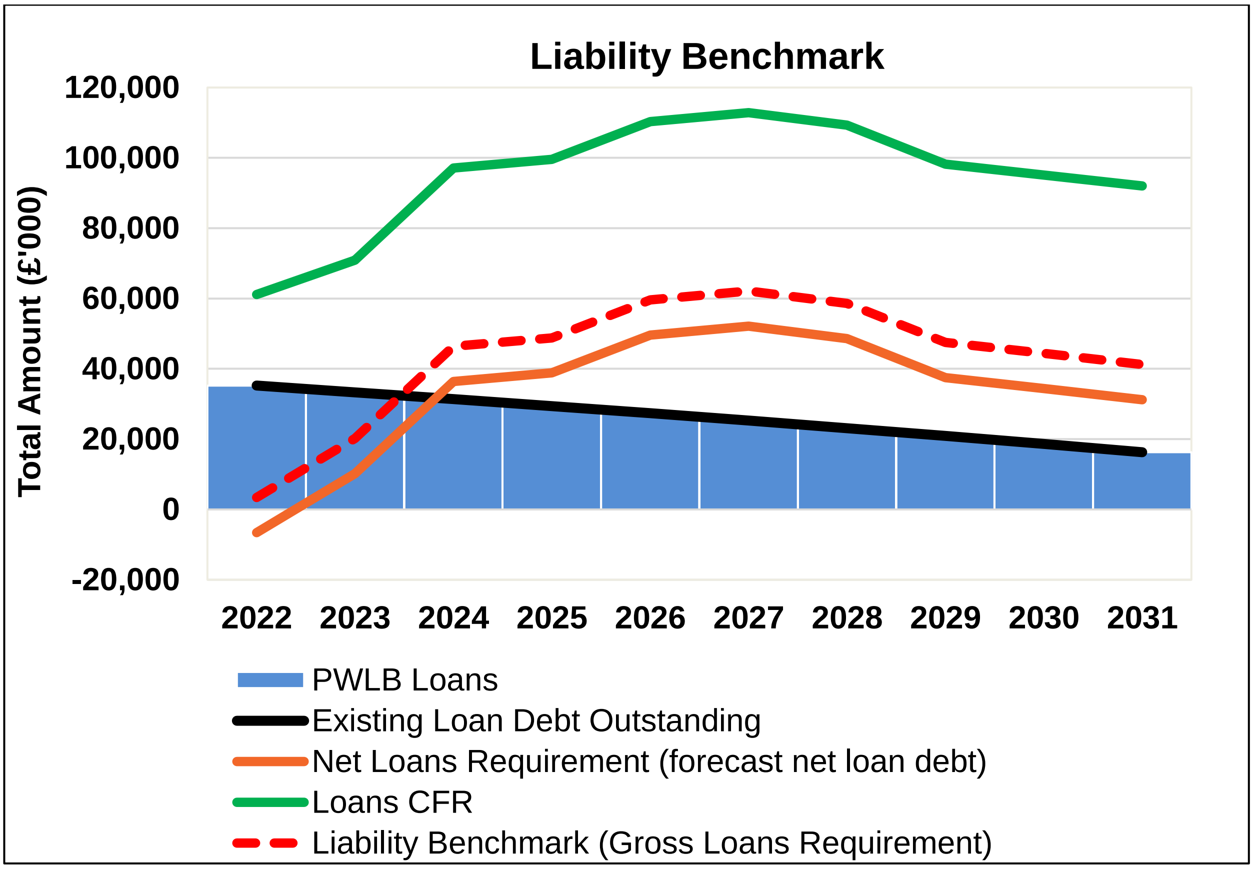
3.4.2 There are four compenents to the LB:

1. **Existing loan debt outstanding**: the Council's existing loans that are still outstanding in future years.
2. **Loans CFR**: this is calculated in accordance with the loans CFR definition in the Prudential Code and projected into the future based on approved prudential borrowing and planned MRP.

3 **Net loans requirement**: this will show the Council's gross loan debt less treasury management investments at the last financial year-end, projected into the future and based on its approved prudential borrowing, planned MRP and any other major cash flows forecast.

4 **Liability benchmark** (or gross loans requirement): this equals net loans requirement plus a short-term liquidity allowance.

3.4.3 The Council's Liability Benchmark for years ending March 2022 to March 2031 is shown below:



3.4.4 The chart can be interpreted as follows:

- The liability benchmark (red dashed line) is the Council's need for external borrowing.
- Where the liability benchmark exceeds the existing loans (black line) then there is a need for new borrowing. Where the liability benchmark is below the existing loans then the Council is holding surplus cash that will be put into short-term investments.
- The area between the liability benchmark and net loans requirement (orange line) shows the cash required to manage the Council's day-to-day cash flow need, which is estimated to be £10m.
- The area between the loans CFR (green line) and liability benchmark shows the potential for internal borrowing, which currently stands at circa £50m.

4.0 Borrowing

4.1 The capital expenditure plans set out in Section 3 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity and the Council's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. This strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

4.2 Current portfolio position

4.2.1 The overall treasury management portfolio as at 31 March 2022 and the position as at 31 December 2022 are shown below for both borrowing and investments.

TREASURY PORTFOLIO				
	Actual	**Actual**	**Current**	**Current**
	31/03/2022	**31/03/2022**	**31/12/2022**	**31/12/2022**
Treasury Investments	**£000**	**%**	**£000**	**%**
Banks	17,832	43%	17,479	45%
Building Societies	4,000	10%	0	0%
Local Authorities	15,000	36%	11,000	28%
DMADF (H.M.Treasury)	0	0%	5,500	14%
Other Public Bodies	0	0%	0	0%
Total Managed In-House	**36,832**	**88%**	**33,979**	**87%**
Property Funds	5,000	12%	5,000	13%
Total Managed Externally	**5,000**	**12%**	**5,000**	**13%**
Total Treasury Investments	**41,832**	**100%**	**38,979**	**100%**
Treasury External Borrowing				
Local Authorities	0	0%	0	0%
PWLB	35,234	100%	34,279	100%
Total External Borrowing	**35,234**	**100%**	**34,279**	**100%**
Net Treasury Investments / (Borrowing)	**6,598**		**4,700**	

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

External Debt £000	2021/22 Actual	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Debt at 1 April	37,104	35,234	33,310	43,873	47,898
Expected Change in Debt	-1,870	-1,924	10,563	4,025	9,967
Other Long-Term Liabilities (OLTL)	2,436	2,190	2,314	2,037	2,323
Expected Change in OLTL	-247	125	-277	287	-532
Actual Gross Debt at 31 March	**37,423**	**35,625**	**45,910**	**50,222**	**59,656**
Capital Financing Requirement	**61,128**	**70,979**	**96,793**	**99,433**	**109,620**
Under / (Over) Borrowing	**23,705**	**35,354**	**50,883**	**49,211**	**49,964**

4.2.3 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 2023/24 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes.

4.2.4 The S151 (Deputy Chief Executive) reports that the Council complied with this Prudential Indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

4.3 Treasury Indicators: limits to borrowing activity

4.3.1 **The operational boundary.** This is the limit which external debt is not normally expected to exceed. This is the CFR, split between debt and other long term liabilities (leases) and rounded up to the nearest million.

Prudential Indicator: Operational Boundary

Operational boundary £000	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Debt	69,000	95,000	98,000	108,000
Other long term liabilities	3,000	3,000	3,000	2,000
Total	**72,000**	**98,000**	**101,000**	**110,000**

4.3.2 **The Authorised Limit for external debt.** 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 the 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.

4.3.3 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. The authorised limit is set at the CFR plus £5m for debt and £4m for other long term liabilities, to cover exceptional circumstances and borrowing ahead of need to secure interest rates.

4.3.4 **The Council is asked to approve the following authorised limit:**

Prudential Indicator: Authorised Limit

Authorised Limit £000	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Debt	74,000	100,000	103,000	113,000
Other long term liabilities	7,000	7,000	7,000	6,000
Total	**81,000**	**107,000**	**110,000**	**119,000**

4.4 Prospects for interest rates

4.4.1 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 future interest rates. The following table gives their view as at 19 December 2022.

Interest Rates	Dec 22	Mar 23	Jun 23	Sep 23	Dec 23	Mar 24	Jun 24	Sep 24	Dec 24	Mar 25	Jun 25	Sep 25	Dec 25
Bank Rate View	3.50%	4.25%	4.50%	4.50%	4.50%	4.00%	3.75%	3.50%	3.25%	3.00%	2.75%	2.50%	2.50%
5yr PWLB Rate	4.20%	4.20%	4.20%	4.10%	4.00%	3.90%	3.80%	3.60%	3.50%	3.40%	3.30%	3.20%	3.10%
10yr PWLB Rate	4.30%	4.40%	4.40%	4.30%	4.10%	4.00%	3.90%	3.80%	3.60%	3.50%	3.40%	3.30%	3.30%
25yr PWLB Rate	4.60%	4.60%	4.60%	4.50%	4.40%	4.20%	4.10%	4.00%	3.90%	3.70%	3.60%	3.50%	3.50%
50yr PWLB Rate	4.30%	4.30%	4.30%	4.20%	4.10%	3.90%	3.80%	3.70%	3.60%	3.50%	3.30%	3.20%	3.20%

4.4.2 Over the last 12 months, the Bank of England has made a series of increases to Bank Rate in an attempt to tame inflation. CPI looks to have peaked at 11.1% in Q4 2022 and currently sits at 10.5%, yet further increases to Bank Rate are expected in the coming months to help bring this down further. The current Bank Rate is 3.5% and most forecasts, including that of Link Group, expect this to reach a peak of 4.5% around May of this year before falling again once inflationary pressures reach an acceptable level, perhaps as early as Q1 2024.

4.4.3 A more thorough economic outlook provided by our Treasury Advisors is detailed in **Appendices 2 and 3.**

4.5 Borrowing strategy

4.5.1 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. With significant levels of capital expenditure expected during 2023/24, it is recommended that the Council maximises its use of internal borrowing rather than seeking to fund projects through new external borrowing. This strategy is prudent as investment returns are lower than the cost of borrowing and counterparty risk is still an issue that needs to be considered.

4.5.2 Against this background and the risks within the economic forecast, caution will be adopted with the 2023/24 treasury operations. The S151 (Deputy Chief Executive) will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- If it was felt that there was a significant risk of a sharp FALL in borrowing rates, then borrowing will be postponed;
- If it was felt that there was a significant risk of a much sharper RISE in borrowing rates than that currently forecast, 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.
- The Council will consider all external loan options available in the market including Public Works Loans Board, Banks, Other Local Authorities and the Municipal Bond Agency. The term and repayment profile of any loans will be determined by the periods financing is required. The level of borrowing will stay within the above limits.

4.5.3 Any decisions will be reported to the Cabinet at the next available opportunity.

4.6 Policy on borrowing in advance of need

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

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

4.7 Debt rescheduling

4.7.1 Rescheduling of current borrowing in our debt portfolio is unlikely to occur as the penalties currently being applied to premature repayments are prohibitive. If rescheduling is done, it will be reported to the Cabinet at the earliest meeting following its action.

4.8 New financial institutions as a source of borrowing and / or types of borrowing

4.8.1 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 reasons:

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

- Municipal Bonds Agency (possibly still a viable alternative depending on market circumstances prevailing at the time)

4.8.2 The degree to which any of these options proves cheaper than PWLB Certainty Rate is constantly evolving but our advisors will keep us informed.

4.9 Approved Sources of Long and Short Term Borrowing

On Balance Sheet	Fixed	Variable
PWLB	●	●
Municipal Bond Agency	●	●
Local Authorities	●	
Banks	●	●
Finance Leases	●	●

5.0 Annual Investment Strategy

5.1 Investment policy – management of risk

5.1.1 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 (a separate report).

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

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

5.1.3 The Council’s investment priorities will be Security first, portfolio Liquidity second and then Yield (return) – known as the SLY Principle.

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

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

5.1.4.2 **Other information:** ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets, which the Council will achieve through engaging with its advisors to maintain a monitor on market pricing.

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

5.1.4.4 The Council has defined the list of **types of investment instruments** that the treasury management team are authorised to use. See **Appendix 4** for a list.

5.1.4.5 **Lending and transaction limits** (amounts and maturity) for each counterparty will be set through applying the matrix table in paragraph 5.2.6.

5.1.4.6 The Council will set a limit for the amount of its investments which are invested for **longer than 365 days** (see paragraph 5.4.9).

5.1.4.7 Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating** (see paragraph 5.3.2).

5.1.5 The Council has engaged external consultants (see paragraph 2.5.1), to provide expert advice on how to optimise an appropriate balance of Security, Liquidity and Yield, given the risk appetite of the Council in the context of the expected level of cash balances and need for liquidity throughout the year.

5.1.6 All investments will be denominated in sterling.

5.1.7 As a result of the change in accounting standards for 2019/20 under IFRS 9, the 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 then MHCLG concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years ending 31 March 2023.) It has not yet been determined whether a further extension to the override will be agreed by Government.

5.1.8 However, the Council will also pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance (see section 5.5). Regular monitoring of investment performance will be carried out during the year.

5.1.9 The above criteria are unchanged from last year.

5.2 Creditworthiness policy

5.2.1 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:

- 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
- 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.

5.2.2 The S151 (Deputy Chief Executive) 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 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.

5.2.3 Credit rating information is supplied by 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 the 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 with the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.

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

- 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 Fitch rating of AAA; and
  iii. have, as a minimum, a credit rating of F1 (Fitch), with regard for Moody's and Standard & Poor's credit ratings (where rated).
- Banks 2 – 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.
- Building Societies – The Council will use all societies which:
  i. Meet the Fitch rating for banks outlined above; and
  ii. Have assets in excess of £1bn;
- Money Market Funds Fitch CNAV AAAmmf/AAA
- Money Market Funds LNVAV AAAmmf/AAA
- Money Market Funds VNAV AAAmmf/AAA
- UK Government (including gilts, Treasury Bills and the DMADF)
- Local authorities, Police, Fire, parish councils and other public bodies

5.2.5 **Use of additional information other than credit ratings.** 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 will be applied to compare the relative security of differing investment opportunities.

5.2.6 **Time and monetary limits applying to investments.** 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):

Details	Fitch Short term Rating	Money and/or % Limit	Transaction Limit	Time Limit
The Council's bank* (currently NatWest)	F1	£5m + balance of grant funds	n/a	n/a
Banks 1 (good credit quality)	F1	£5m	£5m	2yr
Banks 2 (Council's banker if not meeting Banks 1)	F2/F3	£5m (call account)	£5m (call account)	1 day
DMADF	UK sovereign rating	unlimited	unlimited	unlimited
Local authorities & other public bodies	N/A	unlimited	unlimited	unlimited
Building Societies	F1	£5m	£5m	2yr
Money Market Funds - CNAV	AAAmmf/AAA	£2m	£2m	liquid
Money Market Funds - LVNAV	AAAmmf/AAA	£2m	£2m	liquid
Money Market Funds - VNAV	AAAmmf/AAA	£2m	£2m	liquid

**This limit was approved in the TMSS for 2021/22 to allow the continued administration of business grant funds.*

The above table relates to financial investments only – non-financial investments, such as commercial loans or purchases of income yielding assets are covered in the Capital Strategy.

5.2.7 The proposed criteria for specified and non-specified investments are shown in **Appendix 4** for approval.

5.2.8 **Creditworthiness**

5.2.9 Significant levels of downgrades to short- and long-term credit ratings have not materialised since the crisis in March 2020. In the main, where they did change, any alterations were limited to Outlooks. However, more recently the UK sovereign debt rating has been placed on Negative Outlook by the three major rating agencies in the wake of the Truss/Kwarteng unfunded tax-cuts policy. Although the Sunak/Hunt government has calmed markets, the outcome of the rating agency reviews is unknown at present, but it is possible the UK sovereign debt rating will be downgraded. Accordingly, when setting minimum sovereign debt ratings, this Authority will not set a minimum rating for the UK.

5.3 Other limits

5.3.1 Due care will be taken to consider the country, group and sector exposure of the Council's investments.

5.3.2 **Country limit.** The Council has determined that it will only use approved counterparties from the UK and from countries with a minimum sovereign credit rating of AAA. The list of countries that qualify using this credit criteria as at the date of this report are shown in **Appendix 5**. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

5.3.3 **Other limits.** In addition:

- no more than 30% of overall investment balances will be placed with any non-UK country at any time;
- limits in place above will apply to a group of companies; and
- the Council will not hold more than £5m with any banking group.

5.4 Investment strategy

5.4.1 In-house funds

5.4.2 Over recent years, the Council has typically held upwards of £20m in short term investments with the objective of managing cash flows whilst earning a return at the same time. These returns remained historically low for two years after interest rates plummeted at the start of the Covid-19 pandemic in Q4 2019/20, however increases to interest rates over the last 12 months have seen returns on short term investments rebound from £54k in 2021/22 to a forecast £534k in 2022/23.

5.4.3 Retaining cash balances (short term investments + current account [excluding Covid-19 grant funds]) of £10m would be enough to ensure a regular turnover in short term investments to manage the fluctuations in cash flows. Therefore, internal borrowing will be used to finance capital expenditure where cash balances remain above £10m, with external borrowing only sought to keep balances above this limit where necessary. Interest rates currently available from PWLB are around 50 basis points (0.50%) higher than rates available for short term investments, and so maximising internal borrowing could result in net savings of around £50k per annum versus maintaining cash balances at current levels.

5.4.4 As cash balances reduce through 2023/24, there will be a need to reduce the average maturity on investments to ensure a regular turnover of maturities, which will be matched with the Council's large cash outflows. This will mean the primary consideration for investments will be the core balance and cash flow requirements, with the outlook for short-term interest rates only considered where significant changes are expected. Greater returns are usually obtainable by investing for longer periods, however this needs to be balanced with the Council's cash requirements.

- 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 most investments as being short term or variable.
- 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.

5.4.5 **Investment returns expectations**

5.4.6 The current forecast shown in paragraph 4.4.1, includes a forecast for Bank Rate to reach 4.5% in Q2 2023.

5.4.7 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:

Year	%
2023/24	4.40%
2024/25	3.30%
2025/26	2.60%
2026/27	2.50%
Later years	2.80%

5.4.8 **Investment treasury indicator and limit -** total principal funds invested for greater than 365 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

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

Upper limit for principal sums invested for longer than 365 days	2023/24 (£m)	2024/25 (£m)	2025/26 (£m)
Principal sum invested for longer than 365 days but not exceeding 2 years.	5	5	5

5.4.10 For its cash flow generated balances, the Council will seek to utilise money market funds and short-dated deposits (overnight to 365 days) in order to benefit from the compounding of interest.

5.5 Investment performance / risk benchmarking

5.5.1 The Council will use an investment benchmark to assess the performance of its investment portfolio of 7 day SONIA (Sterling Overnight Index Average).

5.6 End of year investment report

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

5.7 Commercial and Non-Financial Investments

5.7.1 **Property Investments.** A limit of £5m will be applied to the use of non-specified investments. This principally relates to property funds, which is within the Local Authorities' Property Fund via CCLA.

5.7.2 **Non-Financial Investments.** On the 30th March 2017, Cabinet approved the establishment of a Special Purpose Vehicle – 3 Rivers Developments Limited and that the Council could lend to 3 Rivers Developments Ltd. This company is a subsidiary of Mid Devon District Council and has the sole purpose of property development.

5.7.3 There is no cap on the amount of money that can be loaned to 3 Rivers Developments Ltd. However, for each new project the company takes on, there is an individual loan agreement signed by the S151 Officer prior to any lending. All project spending / borrowing requirements are approved annually by Cabinet as part of the company's Annual Report/Business Plan, with individual Business Cases reviewed and approved by Cabinet on any development over £1m.

5.7.4 Please refer to the Capital Strategy for a more detailed programme and borrowing streams.

6.0 Conclusion

6.1 Treasury management is a highly complex and specialist subject. It is tightly controlled by regulation and procedures that the Council must abide by. In addition to the skilled staff in house, the Council has access to advice from its Treasury Advisors (Link Group) where we need it to ensure that we comply with these rules.

6.2 Cabinet will consider the Treasury Management Strategy before recommending Full Council approve it at its budget meeting on 22 February.

APPENDICES

1. Prudential and treasury indicators and MRP statement
2. Interest rate forecasts
3. Economic background
4. Treasury management practice 1 – credit and counterparty risk management
5. Approved countries for investments
6. Treasury management scheme of delegation
7. The treasury management role of the Section 151 Officer

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APPENDIX 1

1.0 THE CAPITAL PRUDENTIAL AND TREASURY INDICATORS 2023/24 – 2025/26

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.

1.1 Capital expenditure

See section 3.2 for the breakdown of capital expenditure.

1.2 Affordability prudential indicators

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

Ratio of financing costs to net revenue stream

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

%	2021/22 Actual	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
General Fund	0.95%	-3.55%	-4.89%	-3.14%	-3.45%
HRA	15.06%	12.56%	12.59%	15.63%	17.16%

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

1.3 Minimum Revenue Provision (MRP) Policy Statement

Where the Council finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the Council to have regard to the Department of Levelling Up, Housing & Communities' *Statutory Guidance on Minimum Revenue Provision* (the DLUHC Guidance).

The broad aim of the DLUHC Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

The DLUHC Guidance requires the Council to approve an Annual MRP Statement each year, and recommends a number of options for calculating a prudent amount of MRP.

The Council is recommended to approve the following MRP Statement*:*

For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:

- **Based on CFR** – MRP will be based on the CFR.

This option provides for an approximate 4% reduction in the borrowing need (CFR) each year.

From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be*:*

- **Asset life method** – MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction)

This option provides for a reduction in the borrowing need over approximately the asset's life.

Finance leases will have their capital financing applied on a straight-line basis over the life of the lease contract.

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.

The MRP requirement for a finance lease or PFI contract is deemed to be equal to the element of the charge/rent that goes to write down the balance sheet liability.

For capital expenditure loans to third parties that are expected to be repaid in full, the Council will make nil MRP, but will instead apply the capital receipts arising from principal repayments to reduce the capital financing requirement. Where it becomes probable that a loan will not be repaid in full, MRP will be charged in accordance with the Expected Credit Loss (ECL) model outlined in IFRS 9.

MRP will not be charged against capital expenditure in the year it is incurred, but will instead commence the following year. Capital expenditure incurred during 2022/23 will not be subject to a MRP charge until 2023/24.

1.4 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 March 2022, the total VRP overpayments were £0m.

APPENDIX 2 – Provided by Link Group (MDDC's Treasury Advisor)

2.0 INTEREST RATE FORECASTS 2023-2025

Link Group Interest Rate View

Interest Rates	Dec 22	Mar 23	Jun 23	Sep 23	Dec 23	Mar 24	Jun 24	Sep 24	Dec 24	Mar 25	Jun 25	Sep 25	Dec 25
Bank Rate View	3.50%	4.25%	4.50%	4.50%	4.50%	4.00%	3.75%	3.50%	3.25%	3.00%	2.75%	2.50%	2.50%
5yr PWLB Rate	4.20%	4.20%	4.20%	4.10%	4.00%	3.90%	3.80%	3.60%	3.50%	3.40%	3.30%	3.20%	3.10%
10yr PWLB Rate	4.30%	4.40%	4.40%	4.30%	4.10%	4.00%	3.90%	3.80%	3.60%	3.50%	3.40%	3.30%	3.30%
25yr PWLB Rate	4.60%	4.60%	4.60%	4.50%	4.40%	4.20%	4.10%	4.00%	3.90%	3.70%	3.60%	3.50%	3.50%
50yr PWLB Rate	4.30%	4.30%	4.30%	4.20%	4.10%	3.90%	3.80%	3.70%	3.60%	3.50%	3.30%	3.20%	3.20%

The central forecast for interest rates was updated on 19 December and reflected a view that the MPC would be keen to further demonstrate its anti-inflation credentials by delivering a succession of rate increases. Bank Rate stands at 3.5% currently but is expected to reach a peak of 4.5% in H1 2023.

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

The CPI measure of inflation looks to have peaked at 11.1% in Q4 2022 (currently 10.7%). Despite the cost-of-living squeeze that is still taking shape, the Bank will want to see evidence that wages are not spiralling upwards in what is evidently a very tight labour market.

Regarding the plan to sell £10bn of gilts back into the market each quarter (Quantitative Tightening), this has started and will focus on the short, medium and longer end of the curve in equal measure, now that the short-lived effects of the Truss/Kwarteng unfunded dash for growth policy are firmly in the rear-view mirror.

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

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

PWLB RATES

- The yield curve movements have become less volatile of late and PWLB 5 to 50 years Certainty Rates are, generally, in the range of 4.10% to 4.80%.
- The markets are seen as having built in, already, nearly all the effects on gilt yields of the likely increases in Bank Rate and the elevated inflation outlook.

The balance of risks to the UK economy: -

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

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

- **Labour and supply shortages** prove more enduring and disruptive and depress economic activity (accepting that in the near-term this is also an upside risk to inflation and, thus, rising gilt yields).

- **The Bank of England** acts too quickly, or too far, over the next year to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.

- **UK / EU trade arrangements** – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.

- **Geopolitical risks,** for example in Ukraine/Russia, China/Taiwan/US, Iran, North Korea and Middle Eastern countries, which could lead to increasing safe-haven flows.

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

- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly and for a longer period within the UK economy, which then necessitates Bank Rate staying higher for longer than we currently project or even necessitates a further series of increases in Bank Rate.

- **The Government** acts too quickly to cut taxes and/or increases expenditure in light of the cost-of-living squeeze.

- **The pound weakens** because of a lack of confidence in the UK Government's fiscal policies, resulting in investors pricing in a risk premium for holding UK sovereign debt.

- Longer term **US treasury yields** rise strongly and pull gilt yields up higher than currently forecast.

- Projected **gilt issuance, inclusive of natural maturities and QT,** could be too much for the markets to comfortably digest without higher yields consequently.

Borrowing advice: The long-term (beyond 10 years) forecast for Bank Rate stands at 2.5%. As all PWLB certainty rates are currently above this level, borrowing strategies will need to be reviewed in that context. Better value can generally be obtained at the shorter end of the curve and short-dated fixed LA to LA monies should be considered. Temporary borrowing rates are likely, however, to remain near Bank Rate and may also prove attractive whilst the market waits for inflation, and therein gilt yields, to drop back later in 2023.

APPENDIX 3 – Provided by Link Group (MDDC's Treasury Advisor)

3.0 ECONOMIC BACKGROUND

Against a backdrop of stubborn inflationary pressures, the easing of Covid restrictions in most developed economies, the Russian invasion of Ukraine, and a range of different UK Government policies, it is no surprise that UK interest rates have been volatile right across the curve, from Bank Rate through to 50-year gilt yields, for all of 2022.

Market commentators' misplaced optimism around inflation has been the root cause of the rout in the bond markets with, for example, UK, EZ and US 10-year yields all rising by over 200bps since the turn of the year. The table below provides a snapshot of the conundrum facing central banks: inflation is elevated but labour markets are extra-ordinarily tight, making it an issue of fine judgment as to how far monetary policy needs to tighten.

	UK	Eurozone	US
Bank Rate	3.5%	2.0%	4.25%-4.50%
GDP	-0.2%q/q Q3 (2.4%y/y)	+0.2%q/q Q3 (2.1%y/y)	2.6% Q3 Annualised
Inflation	10.7%y/y (Nov)	10.1%y/y (Nov)	7.1%y/y (Nov)
Unemployment Rate	3.7% (Oct)	6.5% (Oct)	3.7% (Nov)

Q2 of 2022 saw UK GDP revised upwards to +0.2% q/q, but this was quickly reversed in the third quarter, albeit some of the fall in GDP can be placed at the foot of the extra Bank Holiday in the wake of the Queen's passing. Nevertheless, CPI inflation has picked up to what should be a peak reading of 11.1% in October, although with further increases in the gas and electricity price caps pencilled in for April 2023, and the cap potentially rising from an average of £2,500 to £3,000 per household, there is still a possibility that inflation will spike higher again before dropping back slowly through 2023.

The UK unemployment rate fell to a 48-year low of 3.6%, and this despite a net migration increase of c500k. The fact is that with many economic participants registered as long-term sick, the UK labour force actually shrunk by c500k in the year to June. Without an increase in the labour force participation rate, it is hard to see how the UK economy will be able to grow its way to prosperity, and with average wage increases running at over 6% the MPC will be concerned that wage inflation will prove just as sticky as major supply-side shocks to food and energy that have endured since Russia's invasion of Ukraine on 22nd February 2022.

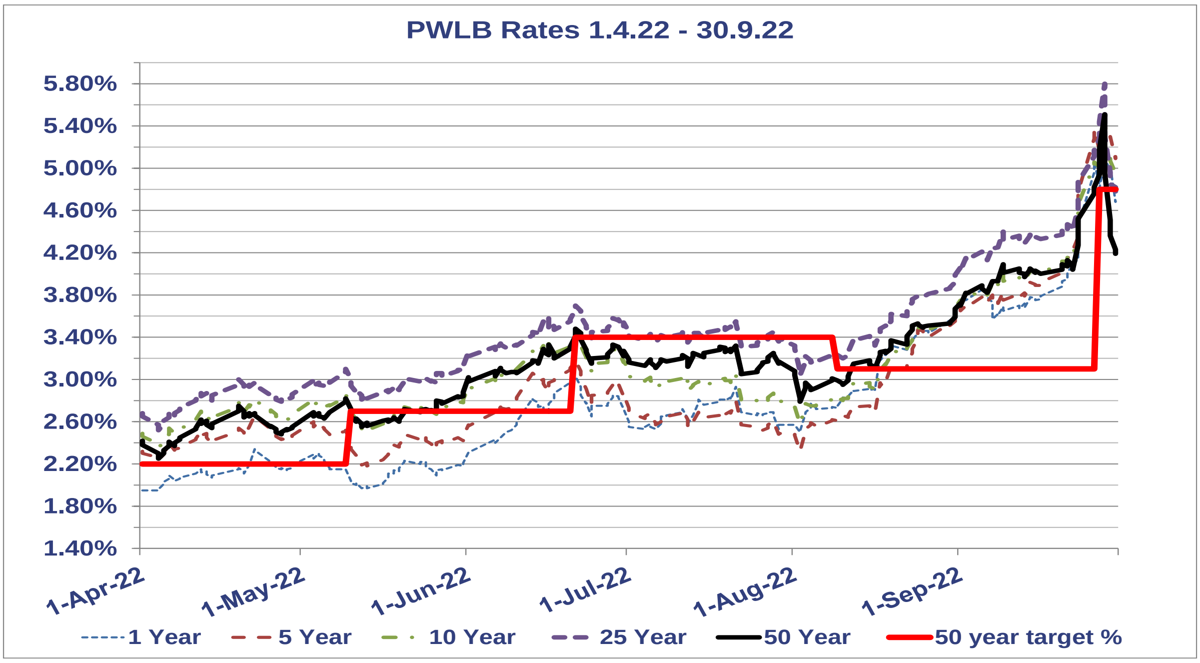
Throughout Q3 Bank Rate increased, finishing the quarter at 2.25% (an increase of 1%). Q4 has seen rates rise to 3.5% in December and the market expects Bank Rate to hit 4.5% by May 2023.

Following a Conservative Party leadership contest, Liz Truss became Prime Minister for a tumultuous seven weeks that ran through September and October. Put simply, the markets did not like the unfunded tax-cutting and heavy spending policies put forward by her Chancellor, Kwasi Kwarteng, and their reign lasted barely seven weeks before being replaced by Prime Minister Rishi Sunak and Chancellor Jeremy Hunt. Their Autumn Statement of 17th November gave rise to a net £55bn fiscal tightening, although much of the "heavy lifting" has been left for the next Parliament to deliver. However, the markets liked what they heard, and UK gilt yields have almost completely reversed the increases seen under the previous tenants of No10/11 Downing Street.

Globally, though, all the major economies are expected to struggle in the near term. The fall below 50 in the composite Purchasing Manager Indices for the UK, US, EZ and China all point to at least one, if not more, quarters of GDP contraction. In November, the MPC projected eight quarters of negative growth for the UK lasting throughout 2023 and 2024, but with Bank Rate set to peak at lower levels than previously priced in by the markets and the fiscal tightening deferred to some extent, it is not clear that things will be as bad as first anticipated by the Bank.

The £ has strengthened of late, recovering from a record low of $1.035, on the Monday following the Truss government's "fiscal event", to $1.22. Notwithstanding the £'s better run of late, 2023 is likely to see a housing correction of some magnitude as fixed-rate mortgages have moved above 5% and affordability has been squeezed despite proposed Stamp Duty cuts remaining in place.

In the table below, the rise in gilt yields, and therein PWLB rates, through the first half of 2022/23 is clear to see.



However, the peak in rates on 28th September as illustrated in the table covering April to September 2022 below, has been followed by the whole curve shifting lower. PWLB rates at the front end of the curve are generally over 1% lower now whilst the 50 years is over 1.75% lower.

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.95%	2.18%	2.36%	2.52%	2.25%
Date	01/04/2022	13/05/2022	04/04/2022	04/04/2022	04/04/2022
High	5.11%	5.44%	5.35%	5.80%	5.51%
Date	28/09/2022	28/09/2022	28/09/2022	28/09/2022	28/09/2022
Average	2.81%	2.92%	3.13%	3.44%	3.17%
Spread	3.16%	3.26%	2.99%	3.28%	3.26%

After a shaky start to the year, the S&P 500 and FTSE 100 have climbed in recent weeks, albeit the former is still 17% down and the FTSE 2% up. The German DAX is 9% down for the year.

CENTRAL BANK CONCERNS – DECEMBER 2022

In December, the Fed decided to push up US rates by 0.5% to a range of 4.25% to 4.5%, whilst the MPC followed by raising Bank Rate from 3% to 3.5%, in line with market expectations. EZ rates have also increased to 2% with further tightening in the pipeline.

Having said that, the sentiment expressed in the press conferences in the US and the UK were very different. In the US, Fed Chair, Jerome Powell, stated that rates will be elevated and stay higher for longer than markets had expected. Governor Bailey, here in the UK, said the opposite and explained that the two economies are positioned very differently so you should not, therefore, expect the same policy or messaging.

Regarding UK market expectations, although they now expect Bank Rate to peak within a lower range of 4.5% - 4.75%, caution is advised as the Bank of England Quarterly Monetary Policy Reports have carried a dovish message over the course of the last year, only for the Bank to have to play catch-up as the inflationary data has proven stronger than expected.

In addition, the Bank's central message that GDP will fall for eight quarters starting with Q3 2022 may prove to be a little pessimistic. Will the £160bn excess savings accumulated by households through the Covid lockdowns provide a spending buffer for the economy – at least to a degree? Ultimately, however, it will not only be inflation data but also employment data that will mostly impact the decision-making process, although any softening in the interest rate outlook in the US may also have an effect (just as, conversely, greater tightening may also).

APPENDIX 4

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

Specified Investments: All investments with a high level of credit quality subject to a maturity limit of one year.

Non-Specified Investments: Any investments that do not meet the specified investment criteria. These may be of a lower credit quality, for periods in excess of one year, or are more complex instruments which require a greater consideration by members and officers before being authorised for use. A maximum of £5m will be held in aggregate in non-specified investment.

A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made, it will fall into one of the above categories.

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

	Minimum credit criteria	Max % of total investments / £ limit per institution	Max. maturity period
DMADF – UK Government	N/A	100%	Any
UK Government gilts	UK sovereign rating	100%	Any
UK Government Treasury bills	UK sovereign rating	100%	Any
Money Market Funds CNAV	AAAmmf/AAA	£2m	Liquid
Money Market Funds LNVAV	AAAmmf/AAA	£2m	Liquid
Money Market Funds VNAV	AAAmmf/AAA	£2m	Liquid
Local authorities	N/A	100%	Any
Term deposits with banks and building societies	F1 (Fitch) / £1bn asset base for building societies	£5m	2 Years
Term deposits with Non-UK banks and building societies	Sovereign Fitch rating of AAA	£3m	1 Year
Gilt funds	UK sovereign rating	100%	Any
Property funds	LA Property Fund	£5m	Ongoing

In addition to the minimum credit criteria outlined in the above table, all term deposits with banks and building societies will be subject to the maximum recommended duration set out by Link Group.

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

Environmental, Social and Governance (ESG) factors. Following changes to the CIPFA Treasury Management Code 2021, the Council is required to consider ESG factors as part of its investment policy. This is a new and evolving area within the short-term financial markets, so the impact on investment decisions will be limited for the coming year.

Governance is by far the most important part of ESG when considering treasury investments, as this is most likely to impact on the financial performance of an entity and its ability to repay deposits. Governance issues already play a role in the selection of acceptable investment counterparties, as any banks or building societies with significant governance concerns are unlikely to achieve the high credit ratings required for the Council to deposit funds.

Environmental and Social factors have less of an impact when considering short-term investments. This is because investments specifically for environmental or social gain are typically longer term and inherently more risky, which isn't aligned with the Security, Liquidity and Yield (SLY) principle the Council currently follows. Only the larger banks and building societies are able to achieve the credit ratings required by the Council, all of which are likely to have environmental and social aims broadly aligned with that of the Council, so further consideration of these factors are currently unlikely to influence the Council's investment decisions.

Further work on ESG is required by the financial markets before the Council can incorporate this into its investment policy. Trying to do this too early could result in artificially limiting potential counterparty options, thus decreasing diversification and increasing financial risk. This could then lead to the need to widen credit criteria to find more counterparties, again increasing financial risk beyond what is considered prudent and acceptable. Members will be updated on any significant advances by the financial markets that could allow the formulation of ESG criteria to include in the Council's investment policy.

APPENDIX 5

5.0 APPROVED COUNTRIES FOR INVESTMENTS

AAA

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

The sovereign ratings shown above are at 19 December 2022 from Link Group.

APPENDIX 6

6.0 TREASURY MANAGEMENT SCHEME OF DELEGATION

(i) Full Council

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.

(ii) Cabinet

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;
- approving the selection of external service providers and agreeing terms of appointment.

(iii) Cabinet

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

(iv) Delegation from the S151 (Deputy Chief Executive) to the nominated post(s) for the taking of the investment decisions:

- Corporate Manager for Finance and Procurement (Deputy S151)

APPENDIX 7

7.0 THE TREASURY MANAGEMENT ROLE OF THE SECTION 151 OFFICER

The S151 (responsible) officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers;
- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe for example 25+ years;
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money;
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority;
- ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing;
- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources;
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities;
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees;
- ensuring that members are adequately informed and understand the risk exposures taken on by an authority;
- ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above;
- creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed, to include the following
    - *Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;*
    - *Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;*

- *Decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;*

- *Reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken;*

- *Training and qualifications (TMP10 and schedules), including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.*