AGENDA ITEM:

**Special Executive Overview & Scrutiny:
14 February 2023**

**Council:
22 February 2023**

Report of:	**Head of Finance, Procurement and Commercial Property**
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SUBJECT: CAPITAL FINANCE AND TREASURY MANAGEMENT STRATEGY

Wards affected: Borough Wide

1.0 PURPOSE OF REPORT

1.1 To set the framework for capital financing and treasury management operations for the next financial year.

2.0 RECOMMENDATIONS

Special Executive Overview & Scrutiny
Are asked to recommend the following items to Council for approval:

2.1 That the projected position in respect of the Prudential Indicators for 2022-23 set out in Appendix 1 be noted.

2.2 That the Treasury and Prudential Indicators for the next three years set out in Appendix 1 be agreed.

2.3 That the capital expenditure projections in Appendix 1 be agreed.

2.4 That the CFR projections set out in Appendix 1 be agreed.

2.5 That the MRP policy as set out in section 4.5 be agreed.

Council

2.6 That the projected position in respect of the Prudential Indicators for 2022-23 set out in Appendix 1 be noted.

2.7 That the Treasury and Prudential Indicators for the next three years set out in Appendix 1 be agreed.

2.8 That the capital expenditure projections in Appendix 1 be agreed.

2.9 That the CFR projections set out in Appendix 1 be agreed.

2.10 That the MRP policy as set out in section 4.5 be agreed.

3.0 BACKGROUND

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

The second main function of the treasury management service is the funding of the Authority's capital plans. These capital plans provide a guide to the borrowing need of the Authority, essentially the longer-term cash flow planning, to ensure that it 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 risk or cost objectives.

3.1 Capital Strategy

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
- the implications for future financial sustainability

The aim of the strategy is to ensure that all the Authority's elected members fully understand the overall long-term policy objectives and resulting Capital Strategy requirements, governance procedures and risk appetite. This strategy will be submitted for member consideration separately to this report.

3.2 Treasury Management Strategy for 2023/24

The strategy for 2023/24 covers two main areas Capital Issues, including expenditure plans and associated prudential indicators and Treasury Management Issues, including the current position, treasury indicators which limit risk, prospects for interest rates, borrowing and investment strategy, creditworthiness policy and the use of external service providers

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

3.3 Training

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. Member training was undertaken on the 26th October 2022 and further training will be arranged as required. The training needs of treasury management officers are periodically reviewed.

A formal record of the training received by officers central to the Treasury function will be maintained by the Head of Finance. Similarly, a formal record of the treasury management/capital finance training received by members will also be maintained by Head of Finance.

3.4 Treasury Management Consultants

The Authority uses Link Group, Link Treasury Services Limited as its external treasury management advisors.

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

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

4.0 THE CAPITAL PRUDENTIAL INDICATORS 2023/24 – 2025/26

The Authority'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.

4.1 Capital Expenditure and Financing

This prudential indicator is a summary of the Authority's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts detailed in table 1.1 of Appendix 1.

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

The table 1.1 in Appendix 1 also details how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

4.2 The Authority's Borrowing Need (the Capital Financing Requirement)

The second prudential indicator is the Authority'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 Authority'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.

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.

The CFR includes any other long-term liabilities (e.g., PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Authority's borrowing requirement, these types of schemes include a borrowing facility by the PFI, PPP lease provider and so the Authority is not required to separately borrow for these schemes. The Authority currently has no such schemes within the CFR.

The Authority is asked to approve the CFR projections in table 1.2 of Appendix 1.

4.3 Liability Benchmark

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.

There are four components to the LB: -

1. **Existing loan debt outstanding**: the Authority'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 Authority'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 short-term liquidity allowance.

The Liability Benchmark is detailed in table 1.3 of Appendix 1.

4.4 Core Funds and Expected Investment Balances

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year-end balances for each resource and anticipated day-to-day cash flow balances.

Year End Resources £m	2021/22 Actual	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Fund balances / reserves	17,219	16,107	12,906	12,599	12,931
Capital receipts	2,978	451	22	22	22
Provisions	1,628	1,628	1,628	1,628	1,628
Capital Grants Unapplied	12,400	13,900	11,850	12,800	13,750
Total core funds	**34,225**	**32,086**	**26,406**	**27,049**	**28,331**
Working capital	20,082	6,500	6,500	6,500	6,500
Under/over borrowing	23,480	22,804	22,029	21,128	20,165
Expected investments	**30,827**	**15,782**	**10,877**	**12,421**	**14,666**

4.5 Minimum Revenue Provision (MRP) Policy Statement

Under Regulation 27 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, where the Authority has financed capital expenditure by borrowing it is required to make a provision each year through a revenue charge (MRP).

The Authority is required to calculate a prudent provision of MRP which ensures that the outstanding debt liability is repaid over a period that is reasonably commensurate with that over which the capital expenditure provides benefits. The MRP Guidance (2018) gives four ready-made options for calculating MRP, but the Authority can use any other reasonable basis that it can justify as prudent.

The MRP policy statement requires full council approval (or closest equivalent level) in advance of each financial year.

The Authority is recommended to approve the following MRP Statement

For expenditure incurred before 1 April 2008 which forms part of supported capital expenditure, the MRP policy will be:

- **Asset life method (annuity)** – MRP will be based on an asset life of 50 years

From 1 April 2008 for all unsupported borrowing the MRP policy will be*:*

- **Asset life method (annuity)** – For regeneration and income generating assets MRP will be based on the estimated life of the assets

- **Asset life method (straight line)** – For service delivery assets MRP will be based on the estimated life of the assets

Capital expenditure incurred during 2022/23 will not be subject to an MRP charge until 2023/24, or in the year after the asset becomes operational

The Authority will apply the asset life method for any expenditure capitalised under a Capitalisation Direction.

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.

MRP in respect of assets acquired under Finance Leases or PFI will be charged at an amount equal to the principal element of the annual repayment.

For capital expenditure on loans to third parties where the principal element of the loan is being repaid in annual instalments, the capital receipts arising from the principal loan repayments will be used to reduce the CFR instead of MRP.

Where no principal repayment is made in a given year, MRP will be charged at a rate in line with the life of the assets funded by the loan.

MRP Overpayments – Under the MRP guidance, any charges made in excess of the statutory MRP can be made, known as voluntary revenue provision (VRP).

VRP can be reclaimed in later years if deemed necessary or prudent. In order for these amounts to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year.

Cumulative VRP overpayments made to date are £2.365m.

5.0 BORROWING

The capital expenditure plans set out in Section 2 provide details of the service activity of the Authority. The treasury management function ensures that the Authority's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity and the Authority's Capital Strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions, and the Annual Investment Strategy.

5.1 Current Portfolio Position

The overall treasury management portfolio as at 31.3.22 and for the position as at 31.12.22 are shown below for both borrowing and investments.

TREASURY PORTFOLIO				
	Actual	Actual	Current	Current
	31.03.22	31.03.22	31.12.22	31.12.22
Treasury investments	**£,000**	**%**	**£,000**	**%**
Banks	11,500	39%	8,000	32%
Building societies - unrated	11,500	39%	10,500	42%
Building societies - rated		0%		0%
Local authorities	5,000	17%	5,000	20%
Other (TVD loans)	1,575	5%	1,575	6%
DMADF (H.M.Treasury)		0%		0%
Money Market Funds		0%		0%
Certificates of Deposit		0%		0%
Total managed in house	**29,575**	**100%**	**25,075**	**100%**
Bond Funds	0	0	0	0
Property Funds	0	0	0	0
Total managed externally	**0**	**0**	**0**	**0**
Total treasury investments	**29,575**	**100%**	**25,075**	**100%**
Treasury external borrowing				
Local Authorities	0	0	0	0
PWLB	88,212	100%	88,212	100%
Market Loans		0		0
LOBOs		0		0
Total external borrowing	**88,212**	**100%**	**88,212**	**100%**
Net treasury investments / (borrowing)	**-58,637**		**-63,137**	

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

£m	2021/22 Actual	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
External Debt					
Debt at 1 April	88,212	88,212	105,689	113,985	121,311
Expected change in Debt	0	17,477	8,296	7,326	893
Other long-term liabilities (OLTL)	0	0	0	0	0
Expected change in OLTL	0	0	0	0	0
Actual gross debt at 31 March	**88,212**	**105,689**	**113,985**	**121,311**	**122,204**
The Capital Financing Requirement	**111,692**	**128,493**	**136,014**	**142,439**	**142,369**
Under / (over) borrowing	**23,480**	**22,804**	**22,029**	**21,128**	**20,165**

Within the range of prudential indicators there are several key indicators to ensure that the Authority operates its activities within well-defined limits. One of these is that the Authority 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.

The Head of Finance reports that the Authority complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes account of current commitments, existing plans and the proposals in this budget report.

5.2 Treasury Indicators: Limits to Borrowing Activity

The Operational Boundary. This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources. Details of this indicator are shown in table 1.4 of Appendix 1.

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.

- 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 local authority plans, or those of a specific authority, although this power has not yet been exercised.
- The Authority is asked to approve the following Authorised Limit in table 1.5 of Appendix 1

5.3 Prospects for Interest Rates

The Council has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Link provided the following forecasts on 19.12.22. These are forecasts for certainty rates, gilt yields plus 80 bps.

Link Group Interest Rate View	19.12.22												
	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
BANK RATE	3.50	4.25	4.50	4.50	4.50	4.00	3.75	3.50	3.25	3.00	2.75	2.50	2.50
3 month ave earnings	3.60	4.30	4.50	4.50	4.50	4.00	3.80	3.30	3.00	3.00	2.80	2.50	2.50
6 month ave earnings	4.20	4.50	4.60	4.50	4.20	4.10	3.90	3.40	3.10	3.00	2.90	2.60	2.60
12 month ave earnings	4.70	4.70	4.70	4.50	4.30	4.20	4.00	3.50	3.20	3.10	3.00	2.70	2.70
5 yr PWLB	4.20	4.20	4.20	4.10	4.00	3.90	3.80	3.60	3.50	3.40	3.30	3.20	3.10
10 yr PWLB	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
25 yr PWLB	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
50 yr PWLB	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

Additional notes by Link on this forecast table: -

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

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

The CPI measure of inflation appears to have peaked at 11.1% in Q4 2022 (10.7% in December). Despite the cost-of-living squeeze that is still taking shape, the Bank will want to see evidence that wages are not spiralling upwards in what is evidently a very tight labour market. Wage increases, excluding bonuses, are currently running at 5.7%.

PWLB Rates

Yield curve movements have become less volatile under the Sunak/Hunt government. PWLB 5 to 50 years Certainty Rates are, generally, in the range of 4.10% to 4.80%. The medium to longer part of the yield curve is currently inverted (yields are lower at the longer end of the yield curve compared to the short to medium end).

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

Link's (beyond 10 years) forecast for Bank Rate stands at 2.5%. As all PWLB certainty rates are now 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.

Our interest rate forecast for Bank Rate is in steps of 25 bps, whereas PWLB forecasts have been rounded to the nearest 10 bps and are central forecasts within bands of + / - 25 bps. Naturally, we continue to monitor events and will update our forecasts as and when appropriate.

5.4 Borrowing Strategy

The Authority 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 Authority's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as medium and longer dated borrowing rates are expected to fall from their current levels once prevailing inflation concerns are addressed by tighter near-term monetary policy. That is, Bank Rate increases over the remainder of 2022 and the first half of 2023.

Against this background and the risks within the economic forecast, caution will be adopted with the 2023/24 treasury operations. The Head of Finance 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,* fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

Any decisions will be reported to the appropriate decision-making body at the next available opportunity.

5.5 Policy on Borrowing in Advance of Need

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

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

5.6 Rescheduling

Rescheduling of current borrowing in our debt portfolio is unlikely to occur as there is still a large difference between premature redemption rates and new borrowing rates.

5.7 Approved Sources of Long and Short-term Borrowing

On Balance Sheet	Fixed	Variable
PWLB	●	●
UK Municipal Bond Agency	●	●
Local Authorities	●	●
Banks	●	●
Pension Funds	●	●
Insurance Companies	●	●
UK Infrastructure Bank	●	●
Market (long-term)	●	●
Market (temporary)	●	●
Local Temporary	●	●
Internal (capital receipts & revenue balances)	●	●
Finance Leases	●	●

6.0 ANNUAL INVESTMENT STRATEGY

6.1 Investment Policy – Management of Risk

The Department of Levelling Up, Housing and Communities (DLUHC - this was formerly the Ministry of Housing, Communities and Local Government (MHCLG)) and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with treasury (financial) investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets and service investments, are covered in the Capital Strategy, (a separate report).

The Authority'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")
- CIPFA Treasury Management Guidance Notes 2021

The Authority's investment priorities will be security first, portfolio liquidity second and then yield (return). The Authority will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with regard to the Authority's risk appetite.

In the current economic climate, it is considered appropriate to maintain a degree of liquidity to cover cash flow needs but to also consider "laddering" investments for periods up to 12 months with high credit rated financial institutions, whilst investment rates remain elevated, as well as wider range fund options.

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

1. Minimum acceptable **credit criteria** are applied 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.

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. To achieve this consideration the Authority will engage with its advisors to maintain a monitor on market pricing such as **"credit default swaps"** and overlay that information on top of the credit ratings.

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.

4. This Authority has defined the list of **types of investment instruments** that the treasury management team are authorised to use. The list is outlined in 6.2 below.

Specified investments are those with a high level of credit quality and subject to a maturity limit of one year or have less than a year left to run to maturity, if originally they were classified as being non-specified investments solely due to the maturity period exceeding one year.

Non-specified investments are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.

5. **Non-specified and loan investment limits.** The Authority has determined that it will set a limit to the maximum exposure of the total treasury management investment portfolio to non-specified treasury management investments as set out in 6.2 below.

6. **Lending limits**, (amounts and maturity), for each counterparty will be set through applying the matrix table in paragraph 6.2.

7. **Transaction limits** are set for each type of investment in 6.2.

8. This Authority will set a limit for its investments which are invested for **longer than 365 days**, (see paragraph 6.2).

9. Investments will only be placed with counterparties from the UK.

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

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

12. As a result of the change in accounting standards for 2022/23 under IFRS 9, this Authority 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 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 31.3.23. At the current juncture it has not been determined whether a further extension to the over-ride will be agreed by Government.

However, this Authority will also pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see paragraph 6.5). Regular monitoring of investment performance will be carried out during the year.

Changes in risk management policy from last year.
The above criteria are unchanged from last year.

6.2 Creditworthiness Policy

The primary principle governing the Authority'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 Authority 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 Authority's prudential indicators covering the maximum principal sums invested.

The Head of Finance will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Full 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 Authority may use, rather than defining what types of investment instruments are to be used.

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 at the minimum Authority criteria will be suspended from use, with all others being reviewed in light of market conditions.

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

Type of Counterparty	Maximum loan by Council	Maximum Period
Major British Based Banks and Subsidiaries with at least A- credit rating.	£5m	Up to £5m 364 days Up to £3m 3 years
British Based Building Societies. – Only those with at least A- credit rating as advised by Link.	£5m	Up to £5m 364 days Up to £3m 3 years
Other Local Authorities, where agreed.	£5m	Up to 5 years
Property Funds, Corporate Bonds, Infrastructure Investments	£3m	Up to 3 years for Corporate, and 5 years for Property and Infrastructure
Money Market Funds AAA rated	£3m	N/A Callable deposits

Use of additional information other than credit ratings

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

Creditworthiness

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.

CDS prices

Although bank CDS prices, (these are market indicators of credit risk), spiked upwards during the days of the Truss/Kwarteng government, they have returned to more average levels since then. However, sentiment can easily shift, so it will remain important to undertake continual monitoring of all aspects of risk and return in the current circumstances. Link monitor CDS prices as part of their creditworthiness service to local authorities and the Authority has access to this information via its Link-provided Passport portal.

6.3 Limits

Due care will be taken to consider the exposure of the Authority's total investment portfolio to non-specified investments, countries, groups and sectors.

a. **Non-specified treasury management investment limit.** The Authority has determined that it will limit the maximum total exposure of treasury management investments to non-specified treasury management investments as per paragraph 6.2.

b. **Country limit.** The Authority has determined that it will only use approved counterparties from the UK.

6.4 Investment Strategy

In-house funds. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e., rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. The current shape of the yield curve suggests that is the case at present, but there is the prospect of Bank Rate peaking in the first half of 2023 and possibly reducing as early as the latter part of 2023 so an agile investment strategy would be appropriate to optimise returns.

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

6.5 Investment Performance / Risk Benchmarking

This Authority will use an investment benchmark of 3-month Sterling Overnight Interbank Average Rate (SONIA) to assess the investment performance of its investment portfolio.

6.6 MifiD II Status

The Market in Financial Instruments Directive II (MIFID II) changed the classification of local authority investors. It reclassified local and public authorities as retail investors from 3 January 2018. Authorities could elect for a return to professional status provided they met certain criteria. If the Authority decided against opting up it would have had access to a more limited a range of financial investment instruments. Therefore, the decision has been taken to opt for profession status with all counterparties in which it currently invests and will do the same for any future eligible ones if required.

6.6 End of Year Investment Report

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

7.0 SUSTAINABILITY IMPLICATIONS

7.1 The Capital Financing and Treasury Management Framework ensures that robust financial decisions are made. The strategies in place provide for sound financial management decision making with regards to the Council's assets and their sustainability. This report has no significant impacts on crime and disorder.

8.0 RISK ASSESSMENT

8.1 The Council is signed up to the CIPFA Treasury Management Code of Practice and it reviews the Prudential Indicators on a regular basis. It is, therefore, minimising the risks associated with financing decisions.

9.0 HEALTH AND WELLBEING IMPLICATIONS

9.1 There are no significant health and wellbeing implications arising from this report.

Background Documents

There are no background documents (as defined in Section 100D(5) of the Local Government Act 1972) to this report.

Equality Impact Assessment

The decision does not have any direct impact on members of the public, employees, elected members and/or stakeholders. Therefore, no Equality impact assessment is required.

APPENDICES

1. Prudential and treasury indicators
2. Economic background
3. Treasury management practice 1 – credit and counterparty risk management
4. Treasury management scheme of delegation
5. The treasury management role of the section 151 officer

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

The Authority'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 and Financing

Capital expenditure £,000	2021/22 Actual	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Non-HRA	8,961	12,663	6,506	2,022	630
HRA	16,441	22,370	14,759	15,106	8,531
Total	**25,402**	**35,033**	**21,265**	**17,128**	**9,161**

Financing of capital expenditure £,000	2021/22 Actual	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Capital receipts	1,197	3,326	1,228	798	799
Capital grants	8,119	5,284	1,000	1,535	0
Capital reserves	3,833	3,948	4,066	4,188	4,314
Revenue	4,174	4,998	6,675	3,281	3,155
Net financing need for the year	**8,079**	**17,477**	**8,296**	**7,326**	**893**

1.2 The Authority's Borrowing Need (the Capital Financing Requirement)

£m	2021/22 Actual	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Capital Financing Requirement					
Non-HRA	23,263	28,233	29,339	29,313	29,382
Housing	88,429	100,260	106,675	113,126	112,987
Total CFR	**111,692**	**128,493**	**136,014**	**142,439**	**142,369**
Movement in CFR	**7,422**	**16,801**	**7,521**	**6,425**	**-71**
Movement in CFR represented by					
Net financing need for the year (above)	8,079	17,477	8,296	7,326	893
Less MRP/VRP and other financing movements	-657	-676	-775	-901	-964
Movement in CFR	**7,422**	**16,802**	**7,521**	**6,425**	**-71**

External borrowing £m	2021/22 Actual	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Service spend		16	1,202	1,646	2,090
Housing	88,212	100,405	107,195	114,034	114,297
Regeneration		5,268	5,588	5,631	5,817
Preventative action					
Treasury Management					
Projects for yield					
TOTAL	**88,212**	**105,689**	**113,985**	**121,311**	**122,204**

1.3 Liability Benchmark

West Lancashire Borough Council **Financial Year End**	**£'000 Estimate** 2022/23	**£'000 Estimate** 2023/24	**£'000 Estimate** 2024/25	**£'000 Estimate** 2025/26
PWLB Loans	88,212	88,212	88,212	88,212
Market Loans (excl LOBO loans)				
LOBO Loans				
Short Term inc LA Temporary Borrowing (<1 year)				
Variable rate loans				
Existing Loan Debt Outstanding	*88,212*	*88,212*	*88,212*	*88,212*
Opening Loan Debt				
Less: opening treasury investments				
Plus: planned prudential borrowing	17,477	8,296	7,326	893
Less: MRP & Capital Receipts set aside	-676	-676	-676	-676
+/- other forecast cashflows	13,793	4,905	-1,544	-2,246
Net Loans Requirement (forecast net loan debt)	*89,232*	*101,757*	*106,863*	*104,835*
Opening Loans CFR				
Plus: planned Prudential Borrowing	17,477	8,296	7,326	893
Less: MRP & Capital Receipts set aside	-676	-676	-676	-676
Loans CFR	*128,493*	*136,114*	*142,764*	*142,981*
Liquidity allowance above net debt (liquidity buffer)	1,500	1,500	1,500	1,500
Liability Benchmark (Gross Loans Requirement)	*90,732*	*103,257*	*108,363*	*106,335*
Forecast Investments	1,500	1,500	1,500	1,500
(Over)/Under Liability Benchmark	2,520	15,045	20,151	18,123

1.4 Operational Boundary

Operational Boundary £m	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Debt	128,493	136,014	142,439	142,369
Other long-term liabilities	0	0	0	0
Total	128,493	136,014	142,439	142,369

1.5 Authorised Limit for external debt

Authorised Limit £m	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Debt	138,493	146,014	152,439	152,369
Other long-term liabilities	500	500	500	500
Total	138,993	146,514	152,939	152,869

1.6 Maturity Structure of Borrowing

Maturity analysis of loans	Average Rate %	Interest Payable £'000	2022/2023 £'000
Between 5 and 10 years	3.01	132.76	4,411
Between 10 and 15 years	3.30	145.55	4,411
Between 15 and 20 years	3.44	303.45	8,821
Between 20 and 25 years	3.50	308.74	8,821
Between 25 and 30 years	3.53	621.89	17,642
Between 30 and 35 years	3.52	620.13	17,642
Between 35 and 40 years	3.50	617.48	17,642
Between 40 and 45 years	3.48	306.98	8,822
Total	3.47	3,056.99	88,212

Maturity structure of borrowing	2021/22 Actual %	2022/23 Estimate Limit %	2023/24 Estimate Limit %	2024/25 Estimate Limit %	2025/26 Estimate Limit %
Under 12 months	0	0	0	0	0
12 months and within 24 months	0	0	0	0	0
24 months and within 5 years	0	0	0	0	0
5 years and within 10 years	5%	5%	5%	5%	5%
10 years and above	95%	95%	95%	95%	95%

1.7 Limits for Long Term Treasury Management Investments

Limits for Long Term Treasury Management Investments	2021/22 Actual %	2022/23 Estimate Limit %	2023/24 Estimate Limit %	2024/25 Estimate Limit %	2025/26 Estimate Limit %
Limit for investments > a year	0	Higher of £3m and 20%	Higher of £3m and 20%	Higher of £3m and 20%	Higher of £3m and 20%

1.8 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 Authority's overall finances. The Authority is asked to approve the following indicators: -

1.8.1 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
Non-HRA	1.15%	0.38%	1.05%	1.99%	2.33%
HRA	12.91%	12.37%	12.54%	12.60%	13.24%

Non-HRA £,000	2021/22 Actual	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Interest received on existing investments	-129	-349	-319	-319	-319
Interest cost for new borrowing	0	95	95	147	164
Interest cost existing finance leases/PFI	0	0	0	0	0
Interest cost for new finance leases/PFI	0	0	0	0	0
Gains and losses on the repurchase or early settlement of borrowing	0	0	0	0	0
MRP and VRP	307	314	400	513	562
Total Financing Costs	**178**	**60**	**176**	**341**	**406**
Taxation, precepts	13,928	11,698	12,418	12,936	13,277
Non-specifc grant income	1,550	3,934	4,588	4,233	3,787
Net Revenue Stream	**15,478**	**15,632**	**16,776**	**17,108**	**17,449**
Ratio of Financing Costs	1.15%	0.38%	1.05%	1.99%	2.33%

HRA £,000	2021/22 Actual	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Interest received on existing investments	-5	-49	-119	-119	-119
Interest cost on existing borrowing	3,057	3,057	3,057	3,057	3,057
Interest cost for new borrowing	0	0	427	664	904
Interest cost existing finance leases/PFI	0	0	0	0	0
Interest cost for new finance leases/PFI	0	0	0	0	0
Gains and losses on the repurchase or early settlement of borrowing	0	0	0	0	0
MRP and VRP	350	362	375	388	402
HRA Depreciation	0	0	0	0	0
Total Financing Costs	**3,402**	**3,370**	**3,739**	**3,990**	**4,243**
HRA Rental Income	**26,354**	**27,254**	**29,810**	**31,664**	**32,062**
Ratio of Financing Costs	12.91%	12.37%	12.54%	12.60%	13.24%

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

1.8.2 Ratio of income from commercial and service investments to net revenue stream

%	2021/22 Actual	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Non-HRA	7.73%	8.43%	6.39%	6.36%	6.33%

£,000	2021/22 Actual	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Income from financial investments	0	0	0	0	0
Income from assets held primarily for financial return	2,408	2,253	2,364	2,463	2,480
Investment management costs	0	0	0	0	0
Other direct revenue costs of investments	-1,212	-935	-1,277	-1,370	-1,399
Total Net Commercial & Service Income	**1,196**	**1,318**	**1,087**	**1,092**	**1,081**
Taxation, precepts	13,928	11,698	12,418	12,936	13,277
Non-specifc grant income	1,550	3,934	4,588	4,233	3,787
Net Revenue Stream	**15,478**	**15,632**	**17,006**	**17,169**	**17,064**
Ratio of net income from commercial & service investments	7.73%	8.43%	6.39%	6.36%	6.33%

1.8.3 HRA Ratios

	2021/22 Actual	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
HRA debt £,000	88,212	100,405	107,195	114,832	115,894
HRA revenues £,000	26,354	27,254	29,810	31,664	32,062
Ratio of debt to revenues %	**29.88**	**27.14**	**27.81**	**27.57**	**27.66**

	2021/22 Actual	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
HRA debt £,000	88,212	100,405	107,195	114,832	115,894
Number of HRA dwellings	5,858	5,808	5,758	5,708	5,658
Debt per dwelling £	**15,058**	**17,287**	**18,617**	**20,118**	**20,483**

Assumed RtB sales of 50 per annum without replacement

2. 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.

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.

Throughout Q3 Bank Rate increased, finishing the quarter at 2.25% (an increase of 1%). Q4 has seen rates rise to 3.50% in December and the market expects Bank Rate to hit 4.5% by May 2023.

3. TREASURY MANAGEMENT PRACTICE (TMP1) – CREDIT AND COUNTERPARTY RISK MANAGEMENT

The DLUHC issued Investment Guidance in 2018, and this forms the structure of the Authority's policy below. These guidelines do not apply to either trust funds or pension funds which operate under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for local authorities to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective, the Guidance requires this Authority to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. This Council adopted the Code on 24/02/2022 and will apply its principles to all investment activity. In accordance with the Code, the Head of Finance has produced its treasury management practices (TMPs). This part, TMP 1(1), covering investment counterparty policy requires approval each year.

Annual Investment Strategy - The key requirements of both the Code and the investment guidance are for the Authority to set an Annual Investment Strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of the following:

- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments that the Authority will use. These are high security and high liquidity investments in sterling and with a maturity of no more than a year.

- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

The investment policy proposed for the Authority is:

Strategy guidelines – The main strategy guidelines are contained in the body of the Treasury Management Strategy Statement.

Specified investments – These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Authority has the right to be repaid within 12 months if it wishes. They also include investments which were originally classed as being non-specified investments, but which would have been classified as specified investments apart from originally being for a period longer than 12 months once the remaining period to maturity falls to under 12 months.

These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with: -

- The UK Government (such as the Debt Management Account deposit facility, UK Treasury Bills or a Gilt with less than one year to maturity).
- Supranational Bonds of less than one year's duration.
- A Local Authority, Housing Association, Parish Council or Community Council.
- Pooled investment vehicles (such as Money Market Funds) that have been awarded a high credit rating by a credit rating agency e.g., Standard and Poor's, Moody's and/or Fitch rating agencies.
- A body that is considered of a high credit quality.

In accordance with the Code, the Authority has set out additional criteria to limit the time and the amount of monies which will be invested in these bodies. These criteria are set out in section 4.2 above.

Non-specified investments – are any other type of investment (i.e., not defined as specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are also set out in 4.2.

The monitoring of investment counterparties - The credit rating of counterparties will be monitored regularly. The Authority receives credit rating information (changes, rating watches and rating outlooks) from Link as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Head of Finance, and if required new counterparties which meet the criteria will be added to the list.

4. TREASURY MANAGEMENT SCHEME OF DELEGATION

(i) Full board/council

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

(ii) Boards/committees/council/responsible body

- 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) Body/person(s) with responsibility for scrutiny

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

5. 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 *(say 20+ years – to be determined in accordance with local priorities.)*
- 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 the 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.*