Treasury Management Strategy and Prudential Indicators for 2022/23

1. Treasury Management Strategy for 2022/23

The strategy covers two main areas:

Capital Issues

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

Treasury Management Issues

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

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

2. Training

The CIPFA Code requires that the responsible officer ensures that Members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. Further training will be arranged as required. The training needs of treasury management officers are also periodically reviewed.

3. Treasury Management Consultants

The Council uses Link Group, Treasury Solutions 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 our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisors.

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.

The scope of investments within the Council's operations now includes both conventional treasury investments, (the placing of residual cash from the Council's functions), and more commercial type investments. The commercial (known as non-financial) investments require specialist advisers. These investments will be governed by the Commercial Investment Strategy.

4. The Capital Prudential Indicators 2022/23 to 2024/25

The Council's capital expenditure plans are the key drivers 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.

5. Capital Expenditure and Financing

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

Capital Expenditure	**2020/21 Actual £000**	**2021/22 Estimate £000**	**2022/23 Estimate £000**	**2023/24 Estimate £000**	**2024/25 Estimate £000**
Total	**2,132**	**5,343**	**6,763**	**5,260**	**5,210**

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

Financing of Capital Expenditure	**2020/21 Actual £000**	**2021/22 Estimate £000**	**2022/23 Estimate £000**	**2023/24 Estimate £000**	**2024/25 Estimate £000**
Capital Receipts	0	703	3,926	500	450
Capital Grants	372	1,354	576	1,520	2,670
Capital Reserves	920	2,120	1,050	300	658
Revenue	0	256	636	106	6
Net Financing Need for the Year	**840**	**910**	**575**	**2,834**	**1,426**

6. The Council's Borrowing Need (Capital Financing Requirement (CFR)

The second prudential indicator is the Council's Capital Financing Requirements (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 need to borrow. 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 such as finance leases which have been brought onto the balance sheet. Whilst this increases the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has no finance lease liabilities within the CFR.

The Council is asked to approve the CFR projections below:

	2020/21 Actual £000	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000
Capital Financing Requirement					
CFR	10,508	11,041	11,110	13,403	14,088
Movement in CFR	27	533	69	2,293	685
Movement in CFR Represented By:					
Net financing need for the year (above)	840	910	575	2,834	1,426
Less MRP and other financing movements	(813)	(377)	(506)	(541)	(741)
Movement in CFR	27	533	69	2,293	685

7. 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.).

8. Minimum Revenue Provision (MRP) Policy Statement

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

DLUHC regulations have been issued which require the Council to approve an **MRP Statement** in advance of each year. A variety of options are available to Councils so long as there is a prudent provision. 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 policy will be:

> Existing practice - MRP will follow the existing practice outlined in former DLUHC regulations (option 1).

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

From 1 April 2008 for all unsupported borrowing (including 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 (option 3).

This option will be calculated using the annuity method using the weighted average rate of the Council's external borrowing (WABR) and will start the year after project completion.

This is a change from previous years and was approved by Council in December 2021 to be effective from 2021/22. Previously MRP was calculated on a straight-line basis by dividing the borrowing over the asset life of the capital scheme. The revised method will result in lower payments in the initial years of the borrowing.

These options provide for a reduction in the borrowing need over approximately the asset's life.

Where the Council is investing in assets solely with the intention of generating a capital receipt on completion it will defer the charging of MRP until the loan is repaid through receipt of capital receipts. This will be evidenced through explicit setting aside of future Capital Receipts for this purpose at project inception.

9. Affordability Prudential Indicators

The previous sections cover the overall capital expenditure 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. The estimates of financing costs include current commitments and the proposals in the budget report.

	2020/21 Estimate %	**2021/22 Estimate %**	**2022/23 Estimate %**	**2023/24 Estimate %**	**2024/25 Estimate %**
Ratio	8.63%	2.44%	1.16%	3.18%	3.36%

10. Borrowing

The capital expenditure plans set out in paragraph 5 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.

11. The Current Portfolio Position

The overall treasury management portfolio position as at 31 March 2021 and the position as at 31 December 2021 are shown below for both borrowing and investments. The investment balance reflects the timing of collection fund payments and receipts, as the pattern of collection is mostly over the first 10 months of the year, balances will reduce towards 31 March.

Treasury Portfolio				
Treasury Investments	**Actual 31.03.21 £000**	**Actual 31.03.21 %**	**Current 31.12.21 £000**	**Current 31.12.21 %**
Banks	7,835	32%	17,635	37%
Building Societies - rated	8,000	32%	20,000	42%
Building Societies - unrated	3,000	12%	4,000	8%
Money Market Funds	4,500	18%	4,500	9%
Total Managed in House	23,335	94%	46,135	97%
Property Funds	1,500	6%	1,500	3%
Total Managed Externally	1,500	6%	1,500	3%
Total Treasury Investments	24,835	100%	47,635	100%
Treasury External Borrowing				
PWLB	1,490	100%	1,490	100%
Total External Borrowing	1,490	100%	1,490	100%
Net Treasury Investments/(Borrowing)	23,345		46,145	

The Council'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.

	2020/21 Actual £000	**2021/22 Estimate £000**	**2022/23 Estimate £000**	**2023/24 Estimate £000**	**2024/25 Estimate £000**
External Debt					
Debt at 1 April	1,490	1,490	2,400	2,975	5,809
Expected change in debt	0	910	575	2,834	1,426
Actual Gross Debt at 31 March	**1,490**	**2,400**	**2,975**	**5,809**	**7,235**
Capital Financing Requirement	**10,508**	**11,041**	**11,110**	**13,403**	**14,088**
Under/(over) borrowing	**9,018**	**8,641**	**8,135**	**7,594**	**6,853**

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

The Director of Finance and Assets 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 the 2022/23 budget report.

12. Treasury Indicators – Limits to Borrowing Activities

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.

Operational boundary	**2021/22 Estimate £000**	**2022/23 Estimate £000**	**2023/24 Estimate £000**	**2024/25 Estimate £000**
Debt	12,000	12,000	14,000	15,000
Other long-term liabilities	500	500	500	500
Total	12,500	12,500	14,500	15,500

The Authorised Limit for External Debt - A further key prudential indicator 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 councils' plans, or those of a specific Council, although this power has not yet been exercised.

- The Council is asked to approve the following Authorised Limits:

Authorised limit	**2021/22 Estimate £000**	**2022/23 Estimate £000**	**2023/24 Estimate £000**	**2024/25 Estimate £000**
Debt	17,000	17,000	19,000	20,000
Other long-term liabilities	1,000	1,000	1,000	1,000
Total	18,000	18,000	20,000	21,000

13. 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, and their view is further detailed in **Appendix 7.3**.

Link Group Interest Rate View	7.2.22												
	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
BANK RATE	0.75	1.00	1.00	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25
3 month av. earnings	0.80	1.00	1.00	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20
6 month av. earnings	1.00	1.10	1.20	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30
12 month av. earnings	1.40	1.50	1.60	1.70	1.70	1.60	1.60	1.50	1.40	1.40	1.40	1.40	1.40
5 yr PWLB	2.20	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30	2.30
10 yr PWLB	2.30	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40
25 yr PWLB	2.40	2.50	2.50	2.60	2.60	2.60	2.60	2.60	2.60	2.60	2.60	2.60	2.60
50 yr PWLB	2.20	2.30	2.30	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40	2.40

Over the last two years, the coronavirus outbreak has done huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings until raising it to 0.25% at its meeting on 16th December 2021 and then to 0.50% at its meeting of 4th February 2022.

As shown in the forecast table above, the forecast for Bank Rate now includes a further three increases of 0.25% in March, May and November 2022 to end at 1.25%

Significant risks to the forecasts

- Mutations of the virus render current vaccines ineffective, and tweaked vaccines to combat these mutations are delayed, or cannot be administered fast enough to prevent further lockdowns.

- Labour and supply shortages prove more enduring and disruptive and depress economic activity.

- The Monetary Policy Committee acts too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.

- The Monetary Policy Committee tightens monetary policy too late to ward off building inflationary pressures.

- The Government acts too quickly to cut expenditure to balance the national budget.

- 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.

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

- Major stock markets e.g., in the US, become increasingly judged as being over-valued and susceptible to major price corrections. Central banks become increasingly exposed to the "moral hazard" risks of having to buy shares and corporate bonds to reduce the impact of major financial market selloffs on the general economy.

- Geopolitical risks, for example in Ukraine, Iran, North Korea, but also in Europe and Middle Eastern countries; on-going global power influence struggles between Russia/China/US. These could lead to increasing safe-haven flows.

The balance of risks to the UK economy: -

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

Forecasts for Bank Rate

The Monetary Policy Committee is now very concerned at the way that forecasts for inflation have had to be repeatedly increased within a matter of just a few months. Combating this rising tide of inflation is now its number one priority and the 5-4 vote marginally approving only a 0.25% increase on 4th February rather than a 0.50% increase, indicates it is now determined to push up Bank Rate quickly. A further increase of 0.25% is therefore probable for March, and again in May, followed possibly by a final one in November. However, data between now and November could shift these timings or add to or subtract from the number of increases.

However, it is likely that these forecasts will need changing within a relatively short timeframe for the following reasons: -

- We do not know whether there will be further mutations of Covid and how severe they may be, nor how rapidly scientific advances may be made in combating them.

- The economy was running out of steam during the second half of 2021 and Omicron will mean that economic growth in quarter 1 of 2022 is likely to be flat, though on the rise towards the end of the quarter as the economy recovers. However, 54% energy cap cost increases from April, together with 1.25% extra employee national insurance, food inflation around 5% and council tax likely to rise in the region of 5% too - these increases are going to hit lower income families hard despite some limited assistance from the Chancellor to postpone the full impact of rising energy costs.

- Consumers are 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 increases. But most of those holdings are held by more affluent people whereas poorer people already spend nearly all their income before these increases hit and have few financial reserves.

- These increases are already highly disinflationary; inflation will also be on a gradual path down after April so that raises a question as to whether the MPC may shift into protecting economic growth by November, i.e., it is more debatable as to whether they will deliver another increase then.

- The big issue – will the current spike in inflation lead to a second-round effect in terms of labour demanding higher wages, (and/or lots of people getting higher wages by changing job)?

- If the labour market remains very tight during 2022, then wage inflation poses a greater threat to overall inflation being higher for longer, and the MPC may then feel it needs to take more action.

- If the UK were to invoke article 16 of the Brexit deal over the dislocation in trading arrangements with Northern Ireland, this would have the potential to end up in a no-deal Brexit.

In summary, with the high level of uncertainty prevailing on several different fronts, we expect to have to revise our forecasts again - in line with whatever the new news is.

Forecasts for PWLB rates and gilt and treasury yields
Since the start of 2021, we have seen a lot of volatility in gilt yields, and hence PWLB rates. Our forecasts show little overall increase in gilt yields during the forecast period to March 2025 but there will doubtless be a lot of unpredictable volatility during this forecast period.

Investment and borrowing rates

- Investment returns have started improving in the second half of 21/22 and are expected to improve further during 22/23 as the MPC progressively increases Bank Rate.
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- Borrowing interest rates fell to historically very low rates as a result of the COVID crisis and the quantitative easing operations of the Bank of England and still remain at historically low levels. The policy for avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years.

- The current margins over gilt yields are as follows:-

  - PWLB Standard Rate is gilt plus 100 basis points (G+100bps)
  - PWLB Certainty Rate is gilt plus 80 basis points (G+80bps)
  - Local Infrastructure Rate is gilt plus 60bps (G+60bps)

- Borrowing for capital expenditure. Our long-term (beyond 10 years) forecast for Bank Rate is 2.00%. As nearly all PWLB certainty rates are now above this level, borrowing strategy will need to be reviewed, especially as the maturity curve has flattened out considerably. Better value can be obtained at the very short and at the longer end of the curve and longer-term rates are still at historically low levels. Temporary borrowing rates are likely, however, to remain near Bank Rate and may also prove attractive as part of a balanced debt portfolio. In addition, there are also some cheap alternative sources of long-term borrowing if an authority is seeking to avoid a "cost of carry" but also wishes to mitigate future re-financing risk.

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

Further analysis is set out at **Appendix 7.4.**

14. Borrowing Strategy

The total debt portfolio is funded by the Public Works Loans Board (PWLB). The details of the portfolio are set out in **Appendix 7.5**. During 2021/22 no annuity principals will have been repaid, as all of the current loans are repayable at maturity. The average maturity profile of the loan portfolio is 29.6 years.

The Council is currently maintaining an under borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.

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

- *if it was felt that there was a significant risk of a sharp fall in borrowing rates* then borrowing will be postponed.

- *if it was felt that there was a significant risk of a much sharper rise in borrowing rates than that currently forecast,* perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position would 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.

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

15. Treasury Indicators for Debt

Maturity structure of borrowing - these gross limits are set to reduce the Council's exposure to large, fixed rate sums falling due for refinancing and are required for upper and lower limits.

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

Maturity structure of fixed interest rate borrowing 2022/23		
	Lower	**Upper**
Under 12 months	0%	10%
12 months to 2 years	0%	10%
2 years to 5 years	0%	20%
5 years to 10 years	0%	30%
Over 10 years	0%	100%
Maturity structure of variable interest rate borrowing 2022/23		
	Lower	**Upper**
Under 12 months	0%	10%
12 months to 2 years	0%	10%
2 years to 5 years	0%	20%
5 years to 10 years	0%	30%
Over 10 years	0%	100%

16. Policy on Borrowing in Advance of Need

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

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.

17. Debt Rescheduling

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

All rescheduling will be reported to the Council at the earliest meeting following its action.

18. New Financial Institutions as a Source of Borrowing and Types of Borrowing

Currently the PWLB Certainty Rate is set at gilts + 80 basis points for 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 will still be 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" or to achieve refinancing certainty).

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

19. Annual Investment Strategy

Investment Policy – management of risk. DLUHC 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, will be covered in the Capital Strategy, (a separate report).

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 2017 ("the Code")
- CIPFA Treasury Management Guidance Notes 2018

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

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

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.

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 Council will engage with its advisors to maintain a monitor on market pricing such as “credit default swaps” and overlay that information on top of the credit ratings.

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 Council has defined the list of types of investment instruments that the treasury management team are authorised to use. There are two lists in **Appendix 7.2** under the categories of ‘specified’ and ‘non-specified’ investments.

•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 originally 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. Counterparty limits will be as set out through the Council’s treasury management practices (TMPs) which were last reviewed and agreed by Council on 26 February 2018.

6. Transaction limits are set for each type of investment in the TMPs.

7. The authority will set a limit for its investments which are invested for longer than 365 days.

8. Investments will only be placed with counterparties within the UK.

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

10. All investments will be denominated in sterling.

11. As a result of the change in accounting standards for 2022/23 under IFRS 9, this Council will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and

resultant charges at the end of the year to the General Fund. (In November 2018, the Ministry of Housing, Communities and Local Government, (MHCLG), concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years ending 31 March 2023.)

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

The above criteria are unchanged from the previous year, apart from the use of multi-asset vehicles have been added to the defined list of investment instruments in TMP1 detailed in **Appendix 7.2.** These are to be considered as part of the investment review detailed in paragraph 24.

20. Creditworthiness Policy

This Council applies the creditworthiness service provided by the Link Group. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies – Fitch, Moody's, and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- "Watches" and "Outlooks" from credit rating agencies.
- Credit Default Swap (CDS) spreads to give early warning of likely changes in credit ratings.
- Sovereign ratings to select counterparties from only the most creditworthy countries.

This modelling approach combines credit ratings and any assigned Watches and Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads. The end product of this is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:

- Yellow 5 years
- Dark Pink 5 Years
- Light Pink 5 Years
- Purple 2 years
- Blue 1 year (nationalised/or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 100 days
- No Colour not to be used (NB: except Building Societies)

In respect of building societies, the Council will use those societies that have assets in excess of £1 billion, subject to them having either a minimum credit rating of P-2 (Moody's) if rated or being unrated. In addition, the Council proposes to use the locally based Market Harborough Building Society, subject to a monetary limit of £2m to support the Corporate Priority of "an enterprising and vibrant place" by being able to invest in a local institution.

The Link Asset Services' creditworthiness service uses a wider array of information than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not place undue emphasis on just one agency's ratings.

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

All credit ratings will be monitored on an ongoing basis. The Council is alerted to changes to ratings of all three agencies through its use of the Link creditworthiness service.

- If a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- In addition to the use of credit ratings the Council will be advised of information regarding movements in credit default swaps against the iTraxx European Financials benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link. Extreme market movements may result in downgrade of an institution or removal from the Councils lending list.

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

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, as economies are beginning to reopen, there have been some instances of previous lowering of Outlooks being reversed.

CDS prices

Although bank CDS prices, (these are market indicators of credit risk), spiked upwards at the end of March / early April 2020 due to the heightened market uncertainty and ensuing liquidity crisis that affected financial markets, 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 Council has access to this information via its Link-provided Passport portal.

21. Other Limits

Due care will be taken to consider the exposure of the Council's total investment portfolio to non-specified investments, countries, groups and sectors. The Council has considered the use of non-UK based banks, but given the current economic situation, has discounted their use for the foreseeable future, in the interests of prudence. Due care will be taken to consider the group and sector exposure of the Council's investments. The limits referred to above will apply to group companies, and sector limits will be monitored regularly for appropriateness.

22. 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. 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.

- 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.

The criteria to be used in determining whether the Council may invest with a counterparty is set out in **Appendix 7.2**.

The Council's proposed Counterparty List appears at **Appendix 7.6**.

Investment Returns Expectations

The current forecast shown in paragraph 13, includes a forecast for Bank Rate to reach 1.25% in November 2022.

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:

Average earnings in each year	
2022/23	1.00%
2023/24	1.25%
2024/25	1.25%
2025/26	1.25%
Years 6 to 10	1.50%
Years 10+	2.00%

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

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.

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

Maximum principal sums invested for more than 365 days	**2022/23**	**2023/24**	**2024/25**
Principal sums invested > 365 days	£000s 10,000	£000s 10,000	£000s 10,000

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

23 <u>Investment Performance / Risk Benchmarking</u>

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

24 <u>Investment Review</u>

The Director of Finance and Assets has commissioned a review of the Councils investments by its treasury advisors, Link Group, with a view to diversifying, in particular making some longer-term investments in multi-asset vehicles to gain improved returns. Review of the long term cashflow has revealed up to £6 million is available to invest in a risk managed way.

25 Flexible Use of Capital Receipts

Delegation was given to the Director of Finance and Assets to use potential non right to buy receipts to provide additional flexibility, this delegation will be extended to 2022/23.

The current freedoms expire on 31 March 2022, but DLUHC have confirmed that the freedoms will be extended past this date.

This freedom will allow the Council to finance its Transformation programme, and this is shown in the Draft 2022/23 Capital Programme. In case the freedom is not renewed, then the Council is also maintaining a Transformation Earmarked Reserve.

Further details are provided in **Appendix 7.9**.

26 End of Year Investment Report

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