

TREASURY MANAGEMENT POLICY AND STRATEGY 2022/23

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1 INTRODUCTION

1.1 *Background*

The council is required to set a balanced budget, which broadly means that cash raised and received 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. Cash can often be set aside (e.g. reserves) or received ahead of when it is required, for example, government capital grant funding, and therefore cash balances are invested in counterparties or instruments commensurate with the council's risk appetite, and always prioritising adequate liquidity before considering investment return.

The second main function of the treasury management service is the funding of the council's capital plans. These capital plans provide a guide to the borrowing need of the council, essentially the longer-term cash flow planning, to ensure that the council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans, or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn down may be restructured to meet council risk or cost objectives.

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

CIPFA defines treasury management as:

“The management of the local authority’s borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.”

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

1.2 *Reporting Requirements*

1.2.1 *Capital Strategy*

The CIPFA 2017 Prudential and Treasury Management Codes require all local authorities to prepare a capital strategy report, to 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 risks are managed;
- the implications for future financial sustainability.

The aim of the Capital Strategy is to ensure that all members on the full Council understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

This Capital Strategy is reported separately from the Treasury Management Strategy Statement with non-treasury investments being reported through the former. This ensures the separation of the core treasury function under security, liquidity and yield principles, and the policy-driven and commercial investments usually driven by expenditure on an asset.

1.2.2 Treasury Management reporting

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

- a. Prudential and treasury indicators, and treasury strategy** (this report) - The first, and most important report, is forward looking and covers:
 - the capital investment plans, (including prudential indicators);
 - a Minimum Revenue Provision (MRP) policy, (how residual capital expenditure is charged to revenue over time);
 - the Treasury Management Strategy, (how the investments and borrowings are to be organised), including treasury indicators; and
 - an Annual Investment Strategy, (the parameters on how investments are to be managed).
- b. A mid-year treasury management report** – This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision.
- c. An annual treasury management report** – This is a backward looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

This Council delegates responsibility for implementation and monitoring of treasury management to the Policy & Resources Committee (P&R) and responsibility for the execution and administration of treasury management decisions to the Section 151 Officer. P&R therefore receives the mid-year report in December and the annual report in July each year.

The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Policy & Resources Committee.

1.3 Treasury Management Strategy for 2022/23

The strategy for 2022/23 covers two main areas:

1.3.1 Capital issues:

- the capital expenditure plans (section 2) and the associated prudential indicators (Annex C);
- the minimum revenue provision (MRP) policy (Section 3).

1.3.2 Treasury management issues:

- the current treasury position (section 1.5);
- treasury indicators which limit the treasury risk and activities of the council (Annex C);
- prospects for interest rates (Annex B);
- the borrowing strategy (section 2);
- policy on borrowing in advance of need (section 2.3);
- debt rescheduling (section 2.4);
- the investment strategy (section 4);
- creditworthiness policy (section 4.4); and
- the policy on the use of external service providers (section 5.3).

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

1.4 Treasury Management Policy Statement

The policies and objectives of the council's treasury management activities are as follows:

- This council defines its treasury management activities as:

'The management of the authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks'.
- This council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the council, and any financial instruments entered into to manage these risks.
- This council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance management techniques, within the context of effective risk management.

1.5 Current Treasury Portfolio Position

A summary of the council's borrowing & investment portfolios as at 31 December 2021 and forecast at the end of the financial year is shown in **Table 1** below:

Table 1	Actual at 31 December 2021			Forecast to 31 March 2022		
	£'000	% of portfolio	Average Rate*	£'000	% of portfolio	Average Rate
Treasury Investments						
UK Banks	75,002	26%	0.25%	69,900	31%	0.35%
Non-UK Banks	25,000	9%	0.39%	30,000	13%	0.45%
Building Societies	0	0	0	0	0	0
Local Authorities	83,000	28%	0.56%	73,000	33%	0.62%

Money Market Funds (Including VNAV)	98,107	34%	0.04%	40,000	18%	0.13%
Royal London Funds	10,000	3%	1.55%	10,000	4%	1.00%
Total Investments	291,109	100%	0.39%	222,900	100%	0.44%
Borrowing						
PWLB loans	311,554	87%	3.03%	311,554	87%	3.03%
Market loans	45,000	13%	4.45%	45,000	13%	4.45%
Local Authorities	0	0	0	0	0	0
Total external Borrowing	356,554	100%	3.21%	356,554	100%	3.21%

**average rate is taken as a snapshot as at 31 December 2021 except Royal London Funds, which is the average rate of return since the inception of the investments until 30 November 2021.*

2 BORROWING STRATEGY

The capital expenditure plans of the council are set out in the Budget book (Appendix 1 to the budget report). 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 the capital expenditure plans.

Any capital investment that is not funded from new and/or existing resources (e.g. capital grants, receipts from asset sales, revenue contributions or earmarked reserves) increases the council's need to borrow, represented by the council's Capital Financing Requirement (CFR). However, external borrowing does not have to take place immediately to finance its related capital expenditure: the council can utilise cash being held for other purposes (such as earmarked reserves and working capital balances) to temporarily defer the need for external borrowing. This is known as 'internal borrowing' or 'under-borrowing'.

The council's primary objective is to strike an appropriate balance between securing cost certainty and securing low interest rates.

The council operates a two-pool approach for borrowing following the HRA Self Financing regime introduced in March 2012.

On 25 November 2020 the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates; the standard and certainty margins were reduced by 1% but a prohibition was introduced to deny access to PWLB borrowing for any local authority which intended to purchase assets primarily for (commercial) yield in its three year capital programme.

The change prevents the authority from undertaking any new investments where the primary purpose is to create an income stream, such as commercial property, unless the authority sources its borrowing from streams other than PWLB. Whilst there are a number of alternative methods of borrowing available to Local Authorities (such as market lenders, bond issuances), these sources typically have a long lead in time, have high associated costs of arranging and usually require significant borrowing values to access. With the reduction of PWLB rates, it is also likely that other sources will be more expensive than the revised PWLB rates.

This change has therefore resulted in the review of the council's capital programme and the subsequent removal of projects where the primary purpose is to create an income stream.

2.1 General Fund Borrowing Position and Strategy

The General Fund has been carrying an internal borrowing position (i.e. where the General Fund borrows cash from its own reserves) since 2008 as a response to the financial crisis. In response to a combination of the prior expectation of increasing interest rate forecasts, the reduction of certain reserves and historically low PWLB borrowing rates, the General Fund entered into planned borrowing from the PWLB to reduce the internal borrowing position in recent years.

Table 2 below demonstrates that the General Fund has a borrowing need of £33m to support the 2021/22 capital programme. During the year £25m of external borrowing has been undertaken for the General Fund. This external borrowing funds the planned borrowing within the capital programme and maintains the expected General Fund internal borrowing position. This decision was made at a time when interest rates were very low in response to global events but forecast to increase.

Officers must carefully balance the benefits of entering into large volumes of low cost borrowing in advance of needing the cash with the risks of carrying a larger investment portfolio; this increases the credit risk exposure of the council as well creating a cost of carry (that is, the difference between the interest rate of the borrowing and the interest rate earned on investing that cash) which impacts on the revenue budget until the cash is spent.

There isn't expected to be any further borrowing need in 2021/22.

2.1.1 General Fund Borrowing Strategy for 2022/23

The General Fund (GF) capital programme 2022/23 to 2024/25 forecasts a total of £278m capital investment, £130m of which will be met from existing or new resources, and £16m of which financing has not yet been identified. The increase in the GF borrowing need over this period is therefore £132m as shown in **Table 2** below.

2021/22 Projected £m	Table 2 – Borrowing Requirement	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m	Total £m
100	GF Capital Expenditure	128	93	57	278
(67)	Financed by: New & existing resources	(65)	(36)	(29)	(130)
-	Financing not yet identified	-	(8)	(8)	(16)
33	GF Borrowing Need	63	49	20	132

Of the £132m borrowing need shown, £100m is for projects that are awaiting approval or detailed analysis. Therefore, the timing of borrowing is uncertain, and borrowing decisions for these projects will form part of the viability and due diligence process.

For the remaining borrowing need, the strategy will initially focus on meeting this borrowing need from internal borrowing. i.e. avoiding external borrowing by utilising the council's own surplus cash flows.

Officers continually review the level of internal borrowing that the General Fund is able to support in the context of prevailing and forecast interest rates, economic outlook and the expected movement in reserves. Modelling of the movement of

reserves and the council's capital expenditure plans demonstrates that the General Fund's long term reserves and balances can support a level of approximately £75m of internal borrowing in the medium term (initially estimated to 2023/24), reducing to £50m thereafter. This will mitigate the increase in the cost of borrowing and reduce counterparty risk within the council's investment portfolio by reducing the portfolio size.

The internal borrowing position needs to be carefully and continually reviewed to avoid incurring higher borrowing costs in the future at a time when the authority may not be able to avoid new borrowing to finance capital expenditure or refinance maturing debt.

2.2 **Housing Revenue Account (HRA) Borrowing Position and Strategy**

The Housing Revenue Account (HRA) carries a fully funded borrowing position (i.e. the HRA does not borrow from its own reserves, but instead undertakes borrowing for its entire borrowing requirement). Table 3 demonstrates that the HRA has a borrowing need of £25m to support the capital programme in 2021/22. A total of £55m of new borrowing has been undertaken during 2021/22 to support this borrowing need as well as take advantage of low interest rates to replace the £8.0m loan from the General Fund and to fund a proportion of the 2022/23 borrowing requirement.

2.2.1 **HRA Borrowing Strategy for 2022/23**

The HRA Capital Programme 2022/23 to 2024/25 forecasts a total £185m of capital investment over the next three years with £84m met from existing or new resources. The increase in the HRA's borrowing need over this period is therefore £101m as shown in **Table 3** below. It is expected that this borrowing need will be met from a combination of borrowing externally and from the General Fund. The extent to which the HRA can borrow from the General Fund is dependent on the level of liquid resources the General Fund has available to lend to the HRA and additionally will depend on the view of interest rate prospects:

- If it is considered that there is a significant likelihood of reducing long term interest rates, long term borrowing should be postponed;
- If it is considered that there is a significant risk of sharply increasing long term interest rates, long term borrowing should be considered.

2021/22 Projected £m	Table 3 – HRA Borrowing Requirement	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m	Total £m
74	HRA Capital Expenditure	95	50	40	185
(49)	Financed by: New & existing resources	(33)	(25)	(26)	(84)
25	HRA Borrowing Need	62	25	14	101

Table 4 below shows the actual expected external debt compared to the capital financing requirement over the next 3 years for both the General Fund and the HRA. This demonstrates that the HRA CFR is expected to be fully funded to 2024/25, and the General Fund is expected to maintain an underborrowed position:

2021/22 Estimate	Table 4	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
£m		£m	£m	£m
General Fund				
138	GF Debt at 1 April	161	208	247
23	Expected change in Debt	47	39	37
161	GF Debt at 31 March	208	247	281
202	GF CFR* at 1 April	228	283	322
33	Borrowing need (Table 2)	63	49	20
(7)	MRP	(8)	(10)	(11)
228	GF CFR* at 31 March	283	322	331
67	Under / (Over) borrowing	75	75	75
29.4%	% Underborrowed	26.5%	23.3%	15.1%
Housing Revenue Account				
149	HRA Debt at 1 April**	195	235	260
46	Expected change in Debt	40	25	14
195	HRA Debt at 31 March	235	260	274
149	HRA CFR at 1 April	173	235	260
25	Borrowing need (Table 3)	63	25	14
(1)	MRP	0	0	0
173	HRA CFR at 31 March	235	260	274
(22)	Under / (Over) borrowing	-	-	-

* GF CFR in Table 4 is the underlying need to borrow and excludes PFI and lease arrangements, which are included in the CFR figure in the Prudential Indicators in Annex C.

** Includes both external debt and sums borrowed from the General Fund (£8.020m as at 1 April 2021). The sum borrowed from the General Fund was replaced by external debt on 16 December 2021.

2.3 Policy on Borrowing in Advance of Need

The council will not borrow purely in order to profit from investment of sums borrowed in advance of need. Any decision to borrow in advance will be within 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.

2.4 Debt Rescheduling

Officers continue to regularly review opportunities for debt rescheduling but there has been a considerable widening of the difference between new borrowing and repayment rates, which has resulted in far fewer opportunities to realise any savings or benefits from rescheduling PWLB debt.

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil long term treasury strategy aims;
- enhancing the balance of the portfolio (amending the maturity profile and/or the balance of volatility).

The strategy is to continue to seek opportunity to reduce the overall level of the council's debt where prudent to do so, thus providing in future years cost reduction in terms of lower debt repayment costs, and potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt. All rescheduling will be agreed by the S151 Officer.

2.5 Interest Rate Risk & Continual Review

The council's total borrowing need of £233m is identified in **Tables 2 & 4**. This borrowing need, together with the debt at risk of maturity shown in **Table 5**, is the extent to which the council is subject to interest rate risk over the next three years.

Table 5	2022/23	2023/24	2024/25
	£m	£m	£m
Maturing Debt	2	12	15
Debt Subject to early repayments options	20	20	15
Total debt at risk of maturity	22	32	30

Officers continue to review the need to borrow taking into consideration the potential increases in borrowing costs, the need to finance new capital expenditure, the need to refinance maturing debt, and the cost of carry that might incur a revenue loss between borrowing costs and investment returns.

Against this background and the risks within the economic forecast, caution needs to be exercised. The S151 Chief Finance Officer will therefore continue to monitor interest rates in financial markets and adopt a proactive approach to changing circumstances as follows:

- if it was considered that there was a significant risk of a forthcoming sharp fall in long and short term rates (e.g. due to a marked increase in the risk of relapse into recession or increasing risk of deflation), then long term borrowings will be postponed and potential rescheduling from fixed rate funding into short term borrowing will be considered;
- if it was considered that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, for example, arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that borrowing would be undertaken and fixed rate funding drawn on whilst interest rates are still lower than they are expected to be in the next few years.

3 MINIMUM REVENUE PROVISION POLICY STATEMENT

The council is required to pay off an element of the accumulated General Fund capital spend each year (the Capital Financing Requirement - CFR) through a revenue charge (the Minimum Revenue Provision - MRP). Department of Levelling Up, Housing and Communities (DLUHC) regulations require the full Council to approve an MRP Statement in advance of each year. A variety of options are available to councils, so long as the principle of any option selected ensures a prudent provision to redeem its debt liability over a period which is commensurate with that over which the capital expenditure is estimated to provide benefits (i.e. the estimated useful life of the asset being financed).

The Council is recommended to approve the following MRP Statement for 2022/23:

For all debt where the government has provided revenue support (supported capital expenditure), the MRP policy will be:

- Provision on a straight-line basis over 50 years.

For all debt where the government does not provide revenue support:

- Where the debt relates to an asset, the council will set aside a sum equivalent to repaying the debt over the life of the asset either in equal instalments or on an annuity basis over a maximum life of 50 years. The method to be adopted will be determined according to which is the most financially beneficial to the council over the life of the asset.
- Where the debt relates to expenditure which is subject to a capitalisation direction issued by the government, the council will set aside a sum equivalent to repaying the debt over a period consistent with the nature of the expenditure on an annuity basis.
- In the case of assets under construction, MRP will be delayed until the relevant asset becomes operational.

Where the debt relates to capital loans to a third party:

- The repayments of principal will be set aside as capital receipts to finance the initial capital advance in lieu of making a MRP.

Where the debt relates to the Living Wage Joint Venture:

- Where the Living Wage Joint Venture develops housing but disposes of these assets on completion, the council will set aside the capital receipt at the point of transfer in lieu of making an MRP payment.
- Where the Living Wage Joint Venture develops or acquires housing and retains these assets and future rental streams, the council will set aside, in equal instalments, a sum which is equivalent to repaying the debt at the end of year 40 within the 60 year business plan. Set aside will commence, at the latest, in the year in which net surpluses are modelled for each individual tranche of borrowing.

For on-balance sheet PFI schemes and leases, the MRP policy will be:

- Asset Life Method (annuity method) - the MRP will be calculated according to the flow of benefits from the asset, and where the principal repayments increase over the life of the asset. Any related MRP will be equivalent to the “capital repayment element” of the annual charge payable.

There is the option to charge more than the prudential provision of MRP each year through a Voluntary Revenue Provision (VRP).

4 ANNUAL INVESTMENT STRATEGY

The DLUHC and CIPFA have extended the meaning of ‘investments’ to include both financial and non-financial investments. This report deals with financial investments. Non-financial investments are covered in the Capital Strategy (Appendix 2).

The council’s investment policy has regard to the following:

- DLUHC’s Guidance on Local Government Investments (the “Guidance”);
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 (the “Code”);
- CIPFA Treasury Management Guidance Notes 2018.

The council’s investment priorities will be the security of capital first, portfolio liquidity second and then yield (return).

4.1 Annual Investment Strategy for 2022/23

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 predicted that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments on short term or variable terms.
- Conversely, if it is predicted that Bank Rate is likely to fall within that time period, consideration will be given to locking in the higher rates currently obtainable, for longer periods.

Currently, Bank Rate is forecast gradually increase over the next few years. Bank Rate forecasts for financial year ends (March) are:

Year	2021/22	2022/23	2023/24	2024/25
Bank Rate	0.25%	0.75%	1.00%	1.25%

Link Asset Service’s (LAS) view on the prospect for interest rates, including their forecast for short term investment rates is appended at Annex B.

The primary principle governing the council’s investment criteria is the security of its investments, but return on investment is also important. After this main principle, the council will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in and the criteria for choosing investment counterparties with adequate security, and monitoring their security;
- It has sufficient liquidity in its investments.

4.1.1 Approach for 2022/23

Investment balances have increased further during 2021/22 due to a combination of an increase in PWLB borrowing, the short-term retention of certain COVID business grants received from the government, and an increase in cash balances managed on behalf of other organisations. Increase in balances has put pressure on the

council's counterparty limits, and as a result the strategy recommends that counterparty limits are increased.

Whilst the council's cash balances have been increasing on a longer-term basis over a number of years, a proportion of the increase in cash balances is still expected to be temporary, so a larger amount of liquidity than usual is still required.

The environment for investment in the last 2 years has seen historically low levels of returns as a result of the reduction of the Bank Rate by the Bank of England in March 2020 in response to the pandemic. The interest rate was increased back to 0.25% in December 2021. Officers have already seen an increase in investment returns offered by both Money Market Funds and individual counterparties since the rate rise. As such, the average investment rate of the portfolio is expected to gradually increase over 2022/23 as maturing investments are rolled into new investments offering a more attractive investment return. Maturities of investments will be maintained at regular intervals during 2022/23 with all active counterparties to ensure the council can take advantage of the rising interest rate environment.

In February 2021, £10.0m was invested across two short term bond funds managed by Royal London Asset Management. Up to November 2021 the average rate of total return (that is inclusive of both income and capital changes to the investment) on these funds was 1.55%. We are expecting to see a fall in the capital value in December 2021 as a result of the increase in the bank rate. There is no impact on the council's income from these funds, and the current statutory override means that there is no impact on the council's budget as a result of this change in value. The investment time horizon is expected to be at least 3 years, and therefore we are expecting the capital value to recover before divesting from the funds.

4.1.2 Changes from 2021/22 Strategy

It is recommended that counterparty limits in the 2022/23 strategy are increased. The counterparty limits were last reviewed and amended in March 2016 when the council's average investment balances were £83.4m. The average investment balances in 2021/22 to date is £254.2m. Investment balances have increased for a number of reasons, including the increase in cash balances that the council is looking after on behalf of other organisations (the South Downs National Park Authority and the Coast to Capital LEP), as well as increases in the council's own cash balances.

This large increase in balances has meant that the counterparty limits are no longer appropriate for the size of the council's portfolio. Increasing the limits which we can lend to individual counterparties or funds will allow officers to manage the council's cash more efficiently, which should also have the impact of increasing the council's return on investments.

Tables 6 and 7 within section 4.4 of this appendix set out the 2021/22 limit and revised limit for 2022/23 proposed for approval. The full counterparty list at Annex A has also been amended to reflect the updated limits.

There have been no other changes proposed to the 2021/22 Annual Investment Strategy.

4.2 Investment Policy – Management of risk

Treasury management risks and how these risks are managed and mitigated are identified in the council's Treasury Management Practices and related procedures,

details of which are held within the council's Treasury Management Team. The main risks to the council's treasury activities are:

- liquidity risk (inadequate cash resources);
- market or interest rate risk (fluctuations in interest rate levels and thereby in the value of investments);
- inflation risks (exposure to inflation);
- credit and counterparty risk (security of investments);
- re-financing risks (impact of debt maturing in future years); and
- legal and regulatory risk (i.e. non-compliance with statutory and regulatory requirements, risk of fraud).

The guidance from 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:

- i) Minimum acceptable credit criteria are applied in order to generate a list of high creditworthy counterparties. This also enables diversification and thus avoids a concentration of risk. The key ratings used to monitor counterparties are the short term and long-term ratings.
- ii) 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 monitor market pricing such as "credit default swaps" (CDS) and overlay that information on credit ratings.
- iii) Other information sources used will include the financial press, share prices and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.
- iv) Where there is a significant or sudden deterioration in one or more indicators (such as CDS prices), officers will undertake a review and, where necessary take action. This action may take the form of temporary suspension of a counterparty from the council's approved lending list, or a restriction of the maximum period and investment limits.
- v) This authority has defined the list of types of investment instruments that the treasury management team are authorised to use.
 - a. **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year. The limits and permitted instruments for specified investments are listed within Table 6.
 - b. **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. The limits and permitted instruments for non-specified investments are listed within Table 7.

- vi) Lending limits (amounts and maturity) for each counterparty will be set through applying the credit criteria matrix (within Table 7).
- vii) This authority will set limits for the amount of its investments:
 - a. which are invested for longer than 365 days, detailed in the Treasury Indicators in Annex C;
 - b. which are invested in any one sector (paragraph 4.5);
 - c. which are invested in any one counterparty within its relevant sector (paragraph 4.5).
- viii) Investments in Non-UK Banks will only be placed with counterparties from countries with a specified minimum sovereign rating of AA (paragraph 4.3).
- ix) Investments in UK banks will only be placed with counterparties with a minimum credit rating of BBB.
- x) This authority has engaged external consultants, (see paragraph 5.3), 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.
- xi) All investments will be denominated in sterling.
- xii) As a result of the change in accounting standards in 2018/19 under International Financial Reporting Standard 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 DLUHC concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for 5 years commencing from 1/4/18).

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 4.7). Regular monitoring of investment performance will be carried out during the year.

4.3 Sovereign Credit Ratings

For 2022/23 it is recommended to maintain the policy of lending to sovereign nations and their banks which hold at least an AA- credit rating. The list of countries that qualify using this credit criteria (as at the date of this report) are shown below:

- AAA** Australia, Denmark, Germany, Netherlands, Singapore, Sweden & Switzerland
- AA+** Finland, Canada & United States,
- AA** France & United Arab Emirates

4.4 Creditworthiness Policy

Each counterparty included on the council's approved lending list must meet the criteria set out below. Without the prior approval of the Council, no investment will be made in an instrument that falls outside the list below.

Table 6 below summarises the types of specified investment counterparties available to the council, and the maximum amount and maturity periods placed on

each of these. A full list of the council's counterparties and the current limits for 2022/23 are appended at Annex A.

When assessing credit ratings to ascertain limits for each counterparty, the lowest short and long term ratings from each of the three ratings agencies is applied. For simplicity, the ratings for Standard & Poor's are used in the tables below.

4.4.1 Criteria for Specified Investments

All specified investments will be sterling denominated, with maturities up to a maximum of 1 year, meeting the minimum 'high' rating criteria where applicable:

Table 6	Country/ Domicile	Minimum Capital Require- ments	Min. Credit Criteria (L/term / S/term)	Max. Amount 2021/22	Proposed Max Amount 2022/23	Max. maturity period
Debt Management and Deposit Facilities (DMADF)	UK	N/A	N/A	unlimited	unlimited	6 months
UK Local Authorities	UK	N/A	UK Sovereign Rating	£10m per LA	£20m per LA	12 months
UK Banks – part nationalised*	UK	UK government must own majority shareholding	N/A	£25m	£30m	12 months
UK Banks & credit rated Building Societies	UK	Must meet minimum credit criteria	AA- / A-1+	£25m	£30m	12 months
			A / A-1	£15m	£20m	12 months
			BBB / A-2	£10m	£15m	6 months
Banks – Non-UK	Those with sovereign rating of at least AA*	Must meet minimum credit criteria	AA- / A-1+	£25m	£30m	12 months
Non-rated Building Societies	UK	Must have an asset base of at least £5bn at the time of investment	N/A	£5m	£5m	6 months
Money Market Funds (CNAV and LVNAV)	UK / Ireland / EU domiciled	Must meet minimum credit criteria	AAA	£15m per fund	£20m per fund	Liquid
Ultra Short Dated Bond Funds	UK / Ireland / EU domiciled	Must meet minimum credit criteria	AA	£15m per fund	£20m per fund	Liquid

*See Paragraph 4.3 for full list of countries that meet these criteria

4.4.2 *Lending to the council's operational banking service provider*

An additional operating limit of £2m and an additional investment limit of £5m will be provided for the council's provider of transactional banking services (currently Lloyds Bank plc). It is unavoidable that the £2m operational limit will be breached from time to time however, officers will endeavour to keep this to an absolute minimum.

4.4.3 *UK banks – ring fencing*

The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), were required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as “ring-fencing”. Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.

Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler activities offered from within a ring-fenced bank (RFB) will be focused on lower risk, day-to-day core transactions, whilst more complex and “riskier” activities are required to be housed in a separate entity, a non-ring-fenced bank (NRFB). This is intended to ensure that an entity's core activities are not adversely affected by the acts or omissions of other members of its group.

While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings (and any other metrics considered) will be considered for investment purposes. The list of approved counterparties in Annex A differentiates the limits for both ring fenced and non-ring fenced banks.

4.4.4 *Part-Nationalised Banks*

The council can lend up to £30m for up to 12 months to any bank in which the UK Government holds a majority shareholding regardless of the credit rating due to the implied government support of those entities. The Royal Bank of Scotland PLC & National Westminster Bank PLC are the two entities currently treated as part nationalised.

4.4.5 *Non-Specified investments*

These are any other types of investment that are not defined as specified.

Table 7	Instrument Type	Minimum credit criteria (L/term / S/term)	Max. Amount 2021/22	Proposed Max. Amount 2022/23	Period
UK Local Authorities	N/A	N/A	£10m per LA	£20m per LA	5 years
UK Banks &	Fixed Deposits	AA+ / A-1+	£25m	£30m	3 years

Non UK Banks		AA- / A-1+	£25m	£30m	2 years
	Negotiable Instruments	AA- / A-1+	£25m	£30m	5 years
Short Dated Bond Funds	UK/Ireland/EU domiciled	Short Dated bond funds are not rated. A selection process will evaluate relative risks & returns. Security of the council's money and fund volatility will be key measures of suitability	£15m per fund	£15m per fund	Liquid

A full list of counterparties that meet the council's criteria for both specified and non-specified investments are listed in Annex A.

4.5 Other Limits

In order to mitigate concentration risk, there are a number of other limits imposed within the investment strategy. **Table 8** sets out the maximum permitted investment for each sector at the time of investment:

Table 8 – Other Limits	
Sector	Max total of portfolio
Banking sector	100%
Building Society Sector	75%
Local Authority Sector	100%
Money Market Funds (MMF)	100%
Short Dated & Ultra Short Dated Bond Funds	50%
Debt Management Account Deposit Facility (DMADF)	100%

In addition to these limits:

- no more than 25% of the portfolio can be invested for more than 1 year; and
- with the exception of MMF & the DMADF, no one counterparty may have more than 25% of the relevant sector maximum at the time the investment is made.

4.6 Approved Methodology for adding and removing counterparties

A counterparty shall be removed from the council's list where a change in their credit rating results in a failure to meet the criteria set out above.

A new counterparty may only be added to the list with the written prior approval of the Chief Finance Officer and only where the counterparty meets the minimum criteria set out above.

A counterparty's exposure limit will be reviewed (and changed where necessary) following notification of a change in that counterparty's credit rating or a view expressed by the credit rating agency warrants a change.

A counterparty's exposure limit will also be reviewed where information contained in the financial press or other similar publications indicates a possible worsening in credit worth of a counterparty. The review may lead to the suspension of any counterparty where it is considered appropriate to do so by the Chief Finance Officer.

4.7 *Investment Risk Benchmarking*

The weighted average benchmark risk factor for 2022/23 is recommended to be 0.05%. This is unchanged from 2021/22. This is a measure of the percentage of the portfolio deemed to be at risk of loss by reference to the maturity date, value of investment, and credit rating of the individual investments within the portfolio compared to the historic default data for those credit ratings.

This benchmark is a simple target (not limit) to measure investment risk and so may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that the in-house treasury team can monitor the current and trend position and amend the operational strategy depending on any changes. Any breach of the benchmarks will be reported with supporting reasons in the mid-year or end of year reviews.

This matrix will only cover internally managed investments, excluding externally managed cash that has been subject to an individual selection process. It also excludes funds lent to other Local Authorities, consistent with the CIPFA Accounting Code.

For any investment where there is a direct and legal offset against an existing financial liability, the investment will be assumed to have a benchmark risk of 0.00%.

5 OTHER TREASURY MATTERS

5.1 *Banking Services*

Lloyds Bank plc currently provides banking services for the council.

5.2 *Training*

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. Training was last provided for members of the Audit & Standards Committee and Policy & Resources Committee on 4 October 2021 and further training will be arranged as required.

The training needs of treasury management officers are periodically reviewed and training arranged as required.

5.3 *Policy on the use of External Service Providers*

The council uses Link Asset Services as its external treasury management advisors.

The council recognises that responsibility for treasury management decisions remains with the council at all times and will ensure that undue reliance is not placed upon our external service providers. 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 subject to regular review.

5.4 Lending to Third Parties

The council has the power to lend monies to third parties subject to a number of criteria. These are not treasury type investments, rather they are policy investments. Any activity will only take place after relevant due diligence has been undertaken, as described in the Capital Strategy (Appendix 2 to the budget report).

5.5 Updates to Accounting Requirements

5.5.1 IFRS 9 – local authority override – English local authorities

The DLUHC enacted a statutory over-ride from 1 April 2018 for a five year period until 31 March 2023 following the introduction of IFRS 9 and the requirement for any capital gains or losses on marketable funds to be chargeable in year. This has the effect of allowing any capital losses on funds to be held on the balance sheet until 31 March 2023, allowing councils to initiate an orderly withdrawal of funds if required.

5.5.2 IFRS 16 – Leasing

The CIPFA Code of Practice and Guidance notes for 2022/23 will incorporate the requirement to account for all leases onto the council's balance sheet. This has the following impact to this paper:

- The council's Capital Financing Requirement authorised limit and operational boundary for 2022/23 onwards has been increased to reflect the estimated effect of this change. These limits can be amended during 2022/23, and brought to full Council to amend with the TMSS Mid Year report if the limits need to be increased following some more detailed work on the leases to be brought onto the balance sheet.
- The MRP policy statement incorporates the policy for the provision for the principal element of lease payments in preparation for accounting for leases under IFRS16.

5.6 Updates to Treasury and Prudential Codes

Following consultation with Local Authorities, CIPFA published the revised Treasury and Prudential codes on 20 December 2021. To ensure Local Authorities can implement the code changes in a smooth and orderly fashion, formal adoption is not required until 2023/24.

The revised codes will have the following implications:

- The requirement for authorities to classify all investments and the relevant investment income into one of the three categories of treasury management, service delivery or commercial investments;
- A prohibition for Local Authorities to borrow to invest primarily for financial return (to include commercial investments);

- a requirement for the Authority to adopt a new debt liability benchmark treasury indicator to support the financing risk management of the capital financing requirement;
- clarify on what CIPFA expects a local authority to borrow for and what they do not view as appropriate. This will include the requirement to set a proportionate approach to commercial and service capital investment;
- requirement to address Environmental, Social and Governance (ESG) issues within the Capital Strategy;
- required implementation of a policy to review commercial investments (including property) on an annual basis, with a view to divest where appropriate;
- creation of new Investment Practices to manage risks associated with non-treasury investment (similar to the current Treasury Management Practices);
- ensures that any long term treasury investment is supported by a business model;
- a requirement to effectively manage liquidity and longer term cash flow requirements;
- amendment to Treasury Management Practice 1 (TMP1) to address ESG policy within the treasury management risk framework;
- amendment to the knowledge and skills register for individuals involved in the treasury management function - to be proportionate to the size and complexity of the treasury management conducted by each authority;
- a new requirement to clarify reporting requirements for service and commercial investment, (especially where supported by borrowing/leverage).

Members will be updated on how all these changes will impact our current approach and any changes required will be formally adopted within the 2023/24 TMSS report.

ANNEX A - Approved List of Counterparties 2022/23

Counterparty	Specified /Non-specified	Short-term			Long-term			Lending Limit	Fixed deposit duration limit (months)
		F=Fitch M=Moody's SP=Standard & Poor's							
		F	M	SP	F	M	SP		
(1) UK Banks									
Lloyds Banking Group:									
Bank of Scotland PLC (RFB)	Specified	F1	P-1	A-1	A+	A1	A+	£25m	12
Lloyds Bank PLC (RFB)	Specified	F1	P-1	A-1	A+	A1	A+	£25m	12
Lloyds Bank Corporate Markets PLC (NRFB)	Specified	F1	P-1	A-1	A+	A1	A	£25m	12
Total Max. exposure to Lloyds Banking Group								£25m	12
Barclays Banking Group:									
Barclays Bank PLC (NRFB)	Specified	F1	P-1	A-1	A+	A1	A	£20m	12
Barclays Bank UK PLC (RFB)	Specified	F1	P-1	A-1	A+	A1	A	£20m	12
Total Max. exposure to Barclays Banking Group**								£20m	12
HSBC Group:									
HSBC Bank PLC (NRFB)	Specified	F1+	P-1	A-1	AA-	A1	A+	£20m	12
HSBC UK Bank PLC (RFB)	Specified	F1+	P-1	A-1	AA-	A1	A+	£20m	12
Total Max. exposure to HSBC Group**								£20m	12
RBS/Natwest Group:									
Natwest Markets PLC (NRFB)	Specified	F1	P-1	A-2	A+	A2	A-	£15m	6
National Westminster Bank PLC (RFB)	Specified	F1	P-1	A-1	A+	A1	A	£30m	12
The Royal Bank of Scotland PLC (RFB)	Specified	F1	P-1	A-1	A+	A1	A	£30m	12
Total Max. exposure to RBS/Natwest Group**								£30m	12
Close Brothers Ltd	Specified	F2	P-1		A-	Aa3		£15m	6
Clydesdale Bank PLC	Specified	F2	P-2	A-2	A-	Baa1	A-	£15m	6
Goldman Sachs International Bank	Specified	F1	P-1	A-1	A+	A1	A+	£20m	12
Handelsbanken PLC	Both	F1+		A-1+	AA		AA-	£30m	24
Santander UK PLC	Specified	F1	P-1	A-1	A+	A1	A	£20m	12
Standard Chartered Bank	Specified	F1	P-1	A-1	A+	A1	A	£20m	12
SMBC Bank International Plc	Specified	F1	P-1	A-1	A	A1	A	£20m	12
(2) Building Societies⁺									
Coventry (2)	Specified	F1	P-1		A-	A2		£15m	6
Leeds (5)	Specified	F1	P-2		A-	A3		£15m	6
Nationwide (1)	Specified	F1	P-1	A-1	A	A1	A+	£20m	12
Principality (6)	Specified	F2	P-2		BBB+	Baa2		£15m	6
Skipton (4)	Specified	F1	P-1		A-	A2		£15m	6
Yorkshire (3)	Specified	F1	P-2		A-	A3		£15m	6

Appendix 3

Counterparty	Specified /Non-specified	Short-term			Long-term			Lending Limit	Fixed deposit duration limit (months)
		<i>F=Fitch M=Moody's SP=Standard & Poor's</i>							
		F	M	SP	F	M	SP		
(3) Non-UK Banks									
Toronto Dominion (Canada)	Both	F1+	P-1	A-1+	AA-	Aa1	AA-	£30m	24
Nordea Bank Abp (Finland)	Both	F1+	P-1	A-1+	AA-	Aa3	AA-	£30m	24
Landwirtschaftliche Renenbank (Germany)	Both	F1+	P-1	A-1+	AAA	Aaa	AAA	£30m	36
NRW.BANK (Germany)	Both	F1+	P-1	A-1+	AAA	Aa1	AA	£30m	24
Bank Nederlandse Gemeenten (The Netherlands)	Both	F1+	P-1	A-1+	AAA	Aaa	AAA	£30m	36
Nederlandse Waterschapsbank N. V. (The Netherlands)	Both		P-1	A-1+		Aaa	AAA	£30m	36
DBS Bank Ltd (Singapore)	Both	F1+	P-1	A-1+	AA-	Aa1	AA-	£30m	24
Overseas Chinese Banking Corporation Limits (Singapore)	Both	F1+	P-1	A-1+	AA-	Aa1	AA-	£30m	24
United Overseas Bank Limited (Singapore)	Both	F1+	P-1	A-1+	AA-	Aa1	AA-	£30m	24
Svenska HandelsBanken AB (Sweden)	Both	F1+	P-1	A-1+	AA	Aa2	AA-	£30m	24
First Abu Dhabi Bank PJSC	Both	F1+	P-1	A-1+	AA-	Aa3	AA-	£30m	24
Bank of New York Mellon (USA)	Both	F1+	P-1	A-1+	AA	Aa1	AA-	£30m	24

Ratings as advised by Link Asset Services 25 January 2022

+ UK Building Societies ranking based on Total Asset size – Source: Building Societies Association Jan 2022

** Where there are multiple counterparties within a banking group, exposure to the overall group will be the largest limit, but exposure to individual counterparties within the group will be based on the individual counterparty limit. Eg, exposure to Lloyds Banking Group can be up to £20m, but max exposure to Lloyds Bank Corporate Markets PLC will be £15m.

ANNEX B - ECONOMIC OVERVIEW & INTEREST RATE VIEW

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 20 December 2021. These are forecasts for certainty rates, gilt yields plus 80 bps.

Link Group Interest Rate View 20.12.21															
	Dec-21	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	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25	
3 month ave earnings	0.20	0.30	0.50	0.50	0.60	0.70	0.80	0.90	0.90	1.00	1.00	1.00	1.00	1.00	
6 month ave earnings	0.40	0.50	0.60	0.60	0.70	0.80	0.90	1.00	1.00	1.10	1.10	1.10	1.10	1.10	
12 month ave earnings	0.70	0.70	0.70	0.70	0.80	0.90	1.00	1.10	1.10	1.20	1.20	1.20	1.20	1.20	
5 yr PWLB	1.40	1.50	1.50	1.60	1.60	1.70	1.80	1.80	1.80	1.90	1.90	1.90	2.00	2.00	
10 yr PWLB	1.60	1.70	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10	2.20	2.30	
25 yr PWLB	1.80	1.90	2.00	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.40	2.40	2.50	2.50	
50 yr PWLB	1.50	1.70	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.20	2.20	2.30	2.30	

Over the last two years, the coronavirus outbreak has caused 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.

As shown in the forecast table above, the forecast for Bank Rate now includes four increases, one in December 2021 to 0.25%, then quarter 2 of 2022 to 0.50%, quarter 1 of 2023 to 0.75%, quarter 1 of 2024 to 1.00% and, finally, one in quarter 1 of 2025 to 1.25%.

The UK - The Bank of England MPC surprised market expectations for a second consecutive meeting in December, raising Bank Rate by 0.15% to 0.25%. In doing so, it became the first major central bank to raise official policy rates since the onset of the pandemic.

The Committee voted 8-1 for the change in the policy rate with only well-established "dove", Silvana Tenreyro, dissenting. Meanwhile, the Committee voted unanimously to keep the current QE programme unchanged. The minutes showed that the Bank now expects inflation to peak at 6% in April, and while Omicron was already having an impact on some sectors, the Committee felt it had to act now because it saw "some signs of greater persistence in domestic costs and price pressures". It also stressed how it had stated at its November meeting that it would raise rates if the economy evolved as expected and that "these conditions had been met".

Looking ahead, unlike in November, there was no reference to inflation being expected to be below the 2% target over its forecast period, which may suggest that the Committee is contemplating raising rates further than it had been at its previous meeting.

While this may underpin market expectations that Bank Rate will rise to 1% in the second half of 2022, the minutes also retained the comment that a "modest tightening" in policy will be required over its 3yr forecast period. Further, it did caveat that inflation could yet

prove weaker or stronger than expected. Market expectations for future hikes have increased in the aftermath of the result, with the potential for the next hike in Q1 2022, with a move to 0.75% by May and the 1% level being hit in August / September, compared to November ahead of the meeting. By the close of 2022, markets are now edging nearer to a 1.25% level, with this expectation having picked up since the start of trading this year.

Link has formally reviewed its own forecast in light of the December meeting but has made no change to its Bank Rate forecast, with just modest changes to expectations for longer term yields which are reflected in the table below. Typically, a rate hike would fully flow through market pricing, especially at the short end of the curve.

Link Asset Services forward view January 2022

It is not expected that Bank Rate will go up fast after the initial rate rise as the supply potential of the economy is not likely to have taken a major hit during the pandemic: it should, therefore, be able to cope well with meeting demand after supply shortages subside over the next year, without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the MPC's 2% target after the spike up to around 5%. The forecast includes four increases in Bank Rate over the three-year forecast period to March 2025, ending at 1.25%. However, it is likely that these forecasts will need changing within a relatively short timeframe for the following reasons: -

- We do not know how severe an impact Omicron could have on the economy and whether there will be another lockdown or similar and, if there is, whether there would be significant fiscal support from the Government for businesses and jobs.
- There were already increasing grounds for viewing the economic recovery as running out of steam during the autumn and now into the winter. And then along came Omicron to pose a significant downside threat to economic activity. This could lead into stagflation, or even into recession, which would then pose a dilemma for the MPC as to whether to focus on combating inflation or supporting economic growth through keeping interest rates low.
- Will some current key supply shortages spill over into causing economic activity in some sectors to take a significant hit.
- Rising gas and electricity prices in October and next April and increases in other prices caused by supply shortages and increases in taxation next April, are already going to deflate consumer spending power without the MPC having to take any action on Bank Rate to cool inflation.
- On the other hand, consumers are sitting on over £160bn of excess savings left over from the pandemic so when will they spend this sum, in part or in total.
- It looks as if the economy coped well with the end of furlough on 30th September. It is estimated that there were around 1 million people who came off furlough then and there was not a huge spike in unemployment. The other side of the coin is that vacancies have been hitting record levels so there is a continuing acute shortage of workers. This is a potential danger area if this shortage drives up wages which then feed through into producer prices and the prices of services i.e., a second-round effect that the MPC would have to act against if it looked like gaining significant momentum.

- If the UK invokes article 16 of the Brexit deal over the dislocation in trading arrangements with Northern Ireland, this has 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. As the interest forecast table for PWLB certainty rates above shows, there is forecast to be a steady, but slow, rise in both Bank Rate and gilt yields during the forecast period to March 2025, though there will doubtless be a lot of unpredictable volatility during this forecast period.

While monetary policy in the UK will have a major impact on gilt yields, there is also a need to consider the potential impact that rising treasury yields in America could have on our gilt yields. As an average since 2011, there has been a 75% correlation between movements in US 10-year treasury yields and UK 10-year gilt yields. This is a significant upward RISK exposure to our forecasts for longer term PWLB rates. However, gilt yields and treasury yields do not always move in unison.

There are also possible downside risks from the huge sums of cash that the UK populace have saved during the pandemic; when savings accounts earn little interest, it is likely that some of this cash mountain could end up being invested in bonds and so push up demand for bonds and support their prices i.e., this would help to keep their yields down. How this will interplay with the Bank of England eventually getting round to not reinvesting maturing gilts and then later selling gilts, will be interesting to monitor.

There is likely to be exceptional volatility and unpredictability in respect of gilt yields and PWLB rates due to the following factors: -

- How strongly will changes in gilt yields be correlated to changes in US treasury yields (see below). Over 10 years since 2011 there has been an average 75% correlation between movements in US treasury yields and gilt yields. However, from time to time these two yields can diverge. Lack of spare economic capacity and rising inflationary pressures are viewed as being much greater dangers in the US than in the UK. This could mean that central bank rates will end up rising earlier and higher in the US than in the UK if inflationary pressures were to escalate; the consequent increases in treasury yields could well spill over to cause (lesser) increases in gilt yields. There is, therefore, an upside risk to forecasts for gilt yields due to this correlation. The Link Group forecasts have included a risk of a 75% correlation between the two yields.
- Will the Fed take action to counter increasing treasury yields if they rise beyond a yet unspecified level.
- Would the MPC act to counter increasing gilt yields if they rise beyond a yet unspecified level.
- How strong will inflationary pressures actually turn out to be in both the US and the UK and so put upward pressure on treasury and gilt yields.
- How will central banks implement their new average or sustainable level inflation monetary policies.

- How well will central banks manage the withdrawal of QE purchases of their national bonds i.e., without causing a panic reaction in financial markets as happened in the “taper tantrums” in the US in 2013.
- Will exceptional volatility be focused on the short or long-end of the yield curve, or both.

The forecasts are also predicated on an assumption that there is no break-up of the Eurozone or EU within the forecasting period, despite the major challenges that are looming up, and that there are no major ructions in international relations, especially between the US and China / North Korea and Iran, which have a major impact on international trade and world GDP growth.

The balance of risks to medium to long term PWLB rates: -

There is a balance of upside risks to forecasts for medium to long term PWLB rates. A new era – a fundamental shift in central bank monetary policy

- One of the key results of the pandemic has been a fundamental rethinking and shift in monetary policy by major central banks like the Fed, the Bank of England and the ECB, to tolerate a higher level of inflation than in the previous two decades when inflation was the prime target to bear down on so as to stop it going above a target rate. There is now also a greater emphasis on other targets for monetary policy than just inflation, especially on ‘achieving broad and inclusive “maximum” employment in its entirety’ in the US, before consideration would be given to increasing rates.
- The Fed in America has gone furthest in adopting a monetary policy based on a clear goal of allowing the inflation target to be symmetrical, (rather than a ceiling to keep under), so that inflation averages out the dips down and surges above the target rate, over an unspecified period.
- The Bank of England has also amended its target for monetary policy so that inflation should be ‘sustainably over 2%’ before starting on raising Bank Rate and the ECB now has a similar policy.
- For local authorities, this means that investment interest rates and very short term PWLB rates will not be rising as quickly or as high as in previous decades when the economy recovers from a downturn and the recovery eventually runs out of spare capacity to fuel continuing expansion.
- Labour market liberalisation since the 1970s has helped to break the wage-price spirals that fuelled high levels of inflation and has now set inflation on a lower path which makes this shift in monetary policy practicable. In addition, recent changes in flexible employment practices, the rise of the gig economy and technological changes, will all help to lower inflationary pressures.
- Governments will also be concerned to see interest rates stay lower as every rise in central rates will add to the cost of vastly expanded levels of national debt; (in the UK this is £21bn for each 1% rise in rates)

Investment and borrowing rates

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

- Borrowing interest rates fell to historically very low rates as a result of the COVID crisis and the quantitative easing operations of the Bank of England and still remain at historically low levels. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years.
- There will remain a significant cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

ANNEX C - PRUDENTIAL AND TREASURY INDICATORS 2022/23 to 2024/25

The council's capital expenditure plans are a key driver of treasury management activities. The output of the capital expenditure plans are reflected in prudential indicators. Local authorities are required to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the council's capital investment plans are affordable, prudent and sustainable. The Code sets out the indicators that must be used but does not suggest limits or ratios as these are for the authority to set itself.

The Prudential Indicators for 2022/23 to 2024/25 are set out in **Table A** below:

Table A	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
General Fund (GF) Prudential Indicators			
GF Capital Expenditure £m (gross) General Fund capital expenditure plans	£128m	£93m	£57m
GF Capital Financing Requirement £m* Measures the underlying need to borrow for capital purposes (including PFI & Leases)	£334m	£370m	£376m
GF Ratio of financing costs to net revenue stream** Identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against net revenue stream	5.39%	6.46%	7.42%
Housing Revenue Account (HRA) Prudential Indicators			
HRA Capital Expenditure £m (gross) HRA capital expenditure plans	£95m	£50m	£40m
HRA Capital Financing Requirement £m* Measures the underlying need to borrow for capital purposes	£235m	£260m	£275m
HRA Ratio of financing costs to net revenue stream** Identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against net revenue stream	9.61%	9.69%	9.60%

* From 2022/23, the CFR includes an estimate for leases that will be bought onto the balance sheet under a change in leasing accounting regulations.

** the ratio of financing costs to net revenue stream illustrates the percentage of the Council's net revenue budget being used to finance the council's borrowing. This includes interest costs relating to the council's borrowing portfolio and MRP, net of the investment income from the council's investment portfolio.

The Treasury Management Code requires that Local Authorities set a number of indicators for treasury performance in addition to the Prudential Indicators which fall under the Prudential Code. The Treasury Indicators for 2022/23 to 2024/25 are set out in **Tables B**

& C below. These have been calculated and determined by Officers in compliance with the Treasury Management Code of Practice:

Table B	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Authorised Limit for External Debt £m* The council is expected to set a maximum authorised limit for external debt. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by Full Council.	£590m	£651m	£670m
Operational boundary for external debt £m* The council is required to set an operational boundary for external debt. This is the limit which external debt is not normally expected to exceed. This indicator may be breached temporarily for operational reasons.	£580m	£641m	£660m
Principal Sums invested for longer than 365 days	£40m	£40m	£40m

**From 2022/23 The Authorised Limit and Operational Boundary includes an estimate for leases that will be bought onto the balance sheet under a change in leasing accounting regulations.*

Table C		
Maturity Structure of fixed interest rate borrowing*		
The council needs to set upper and lower limits with respect to the maturity structure of its borrowing.		
	Lower	Upper
Under 12 months	0%	40%
12 months to 2 years	0%	40%
2 years to 5 years	0%	50%
5 years to 10 years	0%	75%
Over 10 years	40%	100%

ANNEX D - SCHEME OF DELEGATION

1. Full Council

- Approval of Annual Investment Strategy, Treasury Management Strategy Statement, Capital Strategy, Treasury Management Policy Statement;
- Approval of the Minimum Revenue Provision Policy;
- Approval of the Prudential and Treasury indicators, including the Affordable borrowing limits;
- Approval of the annual revenue budget for financing costs.

The requirements are all contained within this appendix (TMSS incorporating the AIS) and Appendix 2 (Capital Strategy) of the budget report.

- Any changes to the Annual Investment Strategy during the year require approval by full Council.
- Full Council are able to delegate the implementation and monitoring of the treasury management function. This function is delegated to the Policy & Resources Committee.

2. Policy & Resources Committee

- Approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- Budget development, consideration and approval;
- Approval of the division of responsibilities;
- Receiving and reviewing regular monitoring reports and acting on recommendations.

P&R receive the following reports in order to fulfil these requirements:

- A **Mid-Year Review Report** – an update on progress of the treasury and investment strategy against budget and the treasury & prudential indicators for the first six months of the year. Any amendments to the indicators or investment strategy require P&R committee to recommend that full Council approve the changes.
- **End of Year Review report** – an update regarding the actual outturn of the treasury position provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.
- **Regular TBM reports** - includes the revenue impact of the financing cost budget.

P&R Committee is the body held responsible for the scrutiny of the actual performance of the treasury activities against the strategy.

3. Role of the Section 151 Officer

The council's appointed Section 151 Chief Financial Officer is responsible for:

- 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.

There are further responsibilities for the S151 Officer identified within the 2017 Code in respect of non-financial investments. They are identified and listed in the Capital Strategy where relevant.

