**COUNCIL**

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| **DATE OF MEETING:** | **23 February 2023** |
| **TITLE OF REPORT:** | **TREASURY MANAGEMENT STRATEGY STATEMENT, ANNUAL INVESTMENT STRATEGY AND CAPITAL STRATEGY** |
| **Report of:** | **Director of Corporate Services and S151 Officer** |
| **Cabinet member:** | **Councillor James Radley, Deputy Leader and Finance** |

## 1 PURPOSE OF REPORT

1.1 To present the draft Treasury Management Strategy Statement for 2023/24 which incorporates the Annual Investment Strategy, revised Minimum Revenue Provision (MRP) Policy and Prudential and Treasury Indicators. Setting a Capital Strategy, which is also presented for consideration, is also a statutory requirement and this sets the overall strategic context for the treasury activity.

## 2 RECOMMENDATION

2.1 Cabinet recommends that Council:

I. approve the Treasury Management Strategy Statement 2023/24 and the revised Minimum Revenue Provision policy contained within it,
II. approve the Annual Investment Strategy for 2023/24 noting the changes to the counterparty financial limits and ESG criteria and approach, and;
III. approve and draft Capital Strategy 2023/24.

## 3 BACKGROUND

3.1 The Local Government Act 2003 (“the Act”) and supporting regulations require the council 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.

3.2 The Act therefore requires the council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act); these set out the council’s policies for managing its investments and for giving priority to the security and liquidity of those investments.

3.3 The Treasury Management Strategy Statement is attached as Appendix 1. This incorporates the Annual Investment Strategy 2023/24 at section 4 and the proposed revision of Hart’s MRP policy at section 2.5. The template for this strategy statement was provided by Hart’s treasury advisors Link who provide treasury services to many councils. Using Link’s template ensures that all statutory requirements are met, including the latest revisions to the Code of Practice which were referred to in the report to Council in February 2022. Link also provided specific advice in relation to the MRP policy and this is set out in section 5.5. The S151 Officer has discussed this with Hart's external auditor. The Capital Strategy is included as Appendix 2.

3.4 The Overview and Scrutiny Committee considered the draft report at its meeting on 17 January 2023. The meeting was informed following of the necessary changes to the Investment Strategy including, reducing the Council's ability to borrow for commercial ventures, a revised Minimum Revenue Provision Policy, reflecting ESG factors into investment criteria and revisions to counterparty limits. With regard to the ESG criteria, it was felt that the proposed approach would help the Council to make acceptable financial investments, combining ESG with the other core investment priorities of security, liquidity and yield. It was noted that this will be reported in the quarterly updates to O&S committee in 2023/24.

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**APPENDICES**

**Appendix 1 – Treasury Management Strategy Statement, Minimum Revenue Provision Policy Statement and Annual Investment Strategy**

**Appendix 2 – Capital Strategy**

**Appendix 3 - Interest rate forecasts and economic background from treasury advisors Link**

# TREASURY MANAGEMENT STRATEGY STATEMENT 2023/24

## 1.0 Introduction and Key Considerations

### 2021 revised CIPFA Treasury Management Code and Prudential Code – changes which will impact on future TMSS/AIS reports and the risk management framework

CIPFA published the revised Codes on 20th December 2021 and has stated that revisions need to be included in the reporting framework from the 2023/24 financial year. This Council, therefore, must have regard to these Codes of Practice when it prepares the Treasury Management Strategy Statement and Annual Investment Strategy, and also related reports during the financial year, which are taken to Full Council for approval.

**The revised Treasury Management Code requires all investments and investment income to be attributed to one of the following three purposes:**

**Treasury management**
Arising from the organisation's cash flows or treasury risk management activity, this type of investment represents balances which are only held until the cash is required for use. Treasury investments may also arise from other treasury risk management activity which seeks to prudently manage the risks, costs or income relating to existing or forecast debt or treasury investments.

**Service delivery**
Investments held primarily and directly for the delivery of public services including housing, regeneration and local infrastructure. Returns on this category of investment which are funded by borrowing are permitted only in cases where the income is "either related to the financial viability of the project in question or otherwise incidental to the primary purpose".

**Commercial return**
Investments held primarily for financial return with no treasury management or direct service provision purpose. Risks on such investments should be proportionate to a council's financial capacity – i.e., that 'plausible losses' could be absorbed in budgets or reserves without unmanageable detriment to local services. A council must not borrow to invest primarily for financial return.

**The revised Treasury Management Code requires a council to implement the following:**

- **Adopt a new liability benchmark treasury indicator** to support the financing risk management of the capital financing requirement; this is to be shown in chart form for a minimum of ten years, with material differences between the liability benchmark and actual loans to be explained;

- **Long-term treasury investments**, (including pooled funds), are to be classed as commercial investments unless justified by a cash flow business case;

- **Pooled funds** are to be included in the indicator for principal sums maturing in years beyond the initial budget year;

- Amendment to the **knowledge and skills register** for officers and members involved in the treasury management function - to be proportionate to the size and complexity of the treasury management conducted by each council;

- **Reporting to members is to be done quarterly.** Specifically, the Chief Finance Officer (CFO) is required to establish procedures to monitor and report performance against all forward-looking prudential indicators at least quarterly. The CFO is expected to establish a measurement and reporting process that highlights significant actual or forecast deviations from the approved indicators. However, monitoring of prudential indicators, including forecast debt and investments, is not required to be taken to Full Council and should be reported as part of the council's integrated revenue, capital and balance sheet monitoring;

- **Environmental, social and governance (ESG)** issues to be addressed within an council's treasury management policies and practices. This is covered in the Annual Investment Strategy in section 4.3.

**The main requirements of the Prudential Code relating to service and commercial investments are:**

- The risks associated with service and commercial investments should be proportionate to their financial capacity – i.e. that plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services;
- A council must not borrow to invest for the primary purpose of commercial return;
- It is not prudent for local authorities to make any investment or spending decision that will increase the CFR, and so may lead to new borrowing, unless directly and primarily related to the functions of the council, and where any commercial returns are either related to the financial viability of the project in question or otherwise incidental to the primary purpose;
- An annual review should be conducted to evaluate whether commercial investments should be sold to release funds to finance new capital expenditure or refinance maturing debt;
- A prudential indicator is required for the net income from commercial and service investments as a proportion of the net revenue stream;
- Create new Investment Management Practices to manage risks associated with non-treasury investments, (similar to the current Treasury Management Practices).

**A council's Capital Strategy or Annual Investment Strategy should include:**

- The council's approach to investments for service or commercial purposes (together referred to as non-treasury investments), including defining the council's objectives, risk appetite and risk management in respect of these investments, and processes ensuring effective due diligence;

- An assessment of affordability, prudence and proportionality in respect of the council's overall financial capacity (i.e. whether plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services);

- Details of financial and other risks of undertaking investments for service or commercial purposes and how these are managed;

- Limits on total investments for service purposes and for commercial purposes respectively (consistent with any limits required by other statutory guidance on investments);

- Requirements for independent and expert advice and scrutiny arrangements (while business cases may provide some of this material, the information contained in them will need to be periodically re-evaluated to inform the council's overall strategy);

- State compliance with paragraph 51 of the Prudential Code in relation to investments for commercial purposes, in particular the requirement that an council must not borrow to invest primarily for financial return;

## 1.1 Background

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

The second main function of the treasury management service is the funding of the 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 it can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet risk or cost objectives.

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

"The management of the local council's borrowing, investments and cash flows, including 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 2021 Prudential and Treasury Management Codes require all local authorities to prepare a Capital Strategy report which will provide the following: -

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

The aim of the strategy is to ensure that all the council's elected members fully understand the overall long-term policy objectives and resulting Capital Strategy requirements, governance procedures and risk appetite. The draft Capital Strategy is included at Appendix 2.

### 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.

1. **Prudential and treasury indicators and treasury strategy** (this report) - The first, and most important report is forward looking and covers:
    - the capital plans, (including prudential indicators)
    - a minimum revenue provision (MRP) policy, (how residual capital expenditure is charged to revenue over time)
    - the Treasury Management Strategy, (how the investments and borrowings are to be organised), including treasury indicators; and
    - an Annual Investment Strategy, (the parameters on how investments are to be managed)

2. **A mid-year treasury management report** – This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision. In addition, this Council will receive quarterly update reports.

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

### Scrutiny

The above reports are required to be adequately scrutinised before being recommended to the Full Council. This role is undertaken by the Overview and Scrutiny Committee.

### Quarterly reports

In addition to the three major reports detailed above, from 2023/24 quarterly reporting (end of June/end of December) is also required. However, these additional reports do not have to be reported to Full Council/Board but do require to be adequately scrutinised. This role is undertaken by the Overview and Scrutiny Committee. (The reports, specifically, should comprise updated Treasury/Prudential Indicators.)

## 1.3 Treasury Management Strategy for 2023/2024

The strategy for 2023/24 covers two main areas:

### Capital issues

- the capital expenditure plans and the associated prudential indicators
- 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
- the policy on use of external service providers

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

## 1.4 Training

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

Furthermore, pages 47 and 48 of the Code state that they expect "all organisations to have a formal and comprehensive knowledge and skills or training policy for the effective acquisition and retention of treasury management knowledge and skills for those responsible for management, delivery, governance, and decision making.

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

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

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

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

In the light of the new requirements, training will be arranged for the members that have oversight of Hart's treasury activity, including scrutiny, and further training will be arranged as required.

The training needs of treasury management officers are periodically reviewed.

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

## 1.5 Treasury Management Consultants

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

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

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

## 2. The Capital Prudential Indicators 2023/24 – 2025/26

The council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

### 2.1 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:

Table 1

| Capital Expenditure by Service | 2021/22 Actual £'000 | 2022/23 Estimate £'000 | 2023/24 Estimate £'000 | 2024/25 Estimate £'000 | 2025/26 Estimate £'000 |
|---|---|---|---|---|---|
| Community Services | 875 | 1,817 | 1,147 | 868 | 867 |
| Corporate Services | 183 | 367 | 140 | 0 | 0 |
| Place | 1,526 | 2,370 | 0 | 0 | 0 |
| **Total** | **2,584** | **4,554** | **1,287** | **868** | **867** |
| Commercial activities/ non-financial investments * | 19,105 | 0 | 0 | 0 | 0 |
| **Total capital expenditure** | **21,689** | **4,554** | **1,287** | **868** | **867** |

* Commercial activities / non-financial investments relate to areas such as capital expenditure on investment properties, loans to third parties etc.

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

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

Table 2

| **Financing of capital expenditure** | **2021/22 Actual £'000** | **2022/23 Estimate £'000** | **2023/24 Estimate £'000** | **2024/25 Estimate £'000** | **2025/26 Estimate £'000** |
|---|---|---|---|---|---|
| **Total capital expenditure** | **21,689** | **4,554** | **1,287** | **868** | **867** |
| Financed by: | | | | | |
| Capital receipts | 1 | 241 | 0 | 0 | 0 |
| Capital grants | 2,583 | 3,362 | 867 | 868 | 867 |
| Earmarked Reserves | 0 | 0 | 420 | 0 | 0 |
| Revenue | 0 | 951 | 0 | 0 | 0 |
| **Total financing need for year** | **2,584** | **4,554** | **1,287** | **868** | **867** |
| **Borrowing requirement** | **19,105** | **0** | **0** | **0** | **0** |

## 2.2 The council's Borrowing Need (the Capital Financing Requirement)

The second prudential indicator is the council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the council's indebtedness and so its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

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 council is asked to approve the CFR projections below:

Table 3

| **Capital Financing Requirement (CFR)** | **2021/22 Actual £'000** | **2022/23 Est £'000** | **2023/24 Est £'000** | **2024/25 Est £'000** | **2025/26 Est £'000** |
|---|---|---|---|---|---|
| Brought Forward | 22,889 | 41,463 | 40,909 | 40,345 | 39,770 |
| Borrowing requirement | 19,105 | 0 | 0 | 0 | 0 |
| Less MRP and other financing movements | 531 | 554 | 564 | 575 | 579 |
| **Net movement in CFR** | **18,574** | **(554)** | **(564)** | **(575)** | **(579)** |
| **CFR Carried Forward** | **41,463** | **40,909** | **40,345** | **39,770** | **39,191** |

Table 4

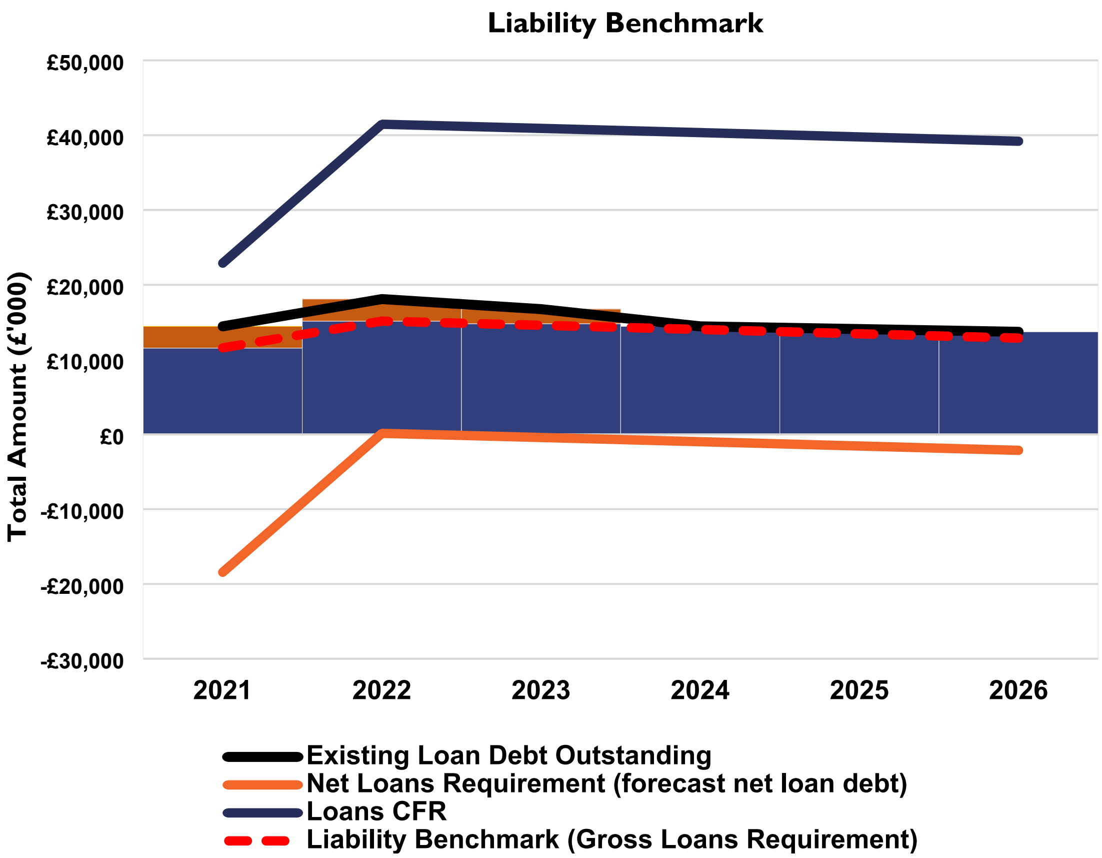
| **External borrowing** | **2021/22 Actual £'000** | **2022/23 Estimate £'000** | **2023/24 Estimate £'000** | **2024/25 Estimate £'000** | **2025/26 Estimate £'000** |
|---|---|---|---|---|---|
| Housing | 6,800 | 0 | 0 | 0 | 0 |
| **TOTAL** | **6,800** | **0** | **0** | **0** | **0** |

## 2.3 Liability Benchmark

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

There are four components to the LB: -

1. **Existing loan debt outstanding**: the council's existing loans that are still outstanding in future years.
2. **Loans CFR**: this is calculated in accordance with the loans CFR definition in the Prudential Code and projected into the future based on approved prudential borrowing and planned MRP.
3. **Net loans requirement**: this will show the council's gross loan debt less treasury management investments at the last financial year-end, projected into the future and based on its approved prudential borrowing, planned MRP and any other major cash flows forecast.
4. **Liability benchmark** (or gross loans requirement): this equals net loans requirement plus short-term liquidity allowance.



### 2.4 Core Funds and Expected Investment Balances

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

Table 5

| Year End Resources | 2021/22 Actual £'000 | 2022/23 Estimate £'000 | 2023/24 Estimate £'000 | 2024/25 Estimate £'000 | 2025/26 Estimate £'000 |
|---|---|---|---|---|---|
| Fund balances/reserves | 43,074 | 43,074 | 43,074 | 43,074 | 43,074 |
| Capital receipts | 387 | 387 | 387 | 387 | 387 |
| Provisions | 687 | 687 | 687 | 687 | 687 |
| Other | 0 | 0 | 0 | 0 | 0 |
| **Total core funds** | **44,148** | **44,148** | **44,148** | **44,148** | **44,148** |
| Working capital* | 8,906 | 8,906 | 8,906 | 8,906 | 8,906 |
| Under/(over) borrowing** | 23,375 | 24,167 | 25,905 | 25,691 | 25,480 |
| **Expected investments** | **29,679** | **28,887** | **27,149** | **27,363** | **27,574** |

### 2.5 Minimum revenue provision (MRP) policy statement

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

Regulation 28 of the Local Authorities (Capital Finance and Accounting) (England) (Amendment) regulations 2008 require the Authority to calculate a prudent provision of MRP whilst having regard to the current MRP Guidance (2018). The broad aim of prudent provision is to ensure that the outstanding debt liability is repaid over a period that is reasonably commensurate with that over which the capital expenditure provides benefits. The Guidance gives four ready-made options for calculating MRP but the Authority can use any other reasonable basis that it can justify as prudent.

The MRP policy statement requires full Council approval in advance of each financial year.

It is recommended that Council approves the following MRP Policy Statement.

- Unsupported borrowing will be subject to MRP using the Asset Life Method, which will be charged over a period which is reasonably commensurate with the estimated useful life of the assets. An annuity method will be applied for the MRP calculation.

- MRP will commence in the financial year following the one in which the expenditure was incurred, or in the year after the asset becomes operational.
- The interest rate applied to the annuity calculations will reflect the market conditions at the time. For the current financial year the interest rate used will be the Authority's weighted average borrowing rate.
- MRP in respect of unsupported borrowing taken to meet expenditure, which is treated as capital expenditure by virtue of either a capitalisation direction or regulations, will be determined in accordance with the asset life method as recommended by the MRP guidance.
- MRP in respect of assets acquired under PFI or Finance Leases will be charged at a rate equal to the principal element of the annual lease rental for the year in question.
- MRP Overpayments - The MRP Guidance allows that any charges made in excess of the statutory MRP, i.e. voluntary revenue provision (VRP) or overpayments, can be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year. The VRP overpayments up to 31st March 2022 are zero.
- On an annual basis the Section 151 officer shall review the level of MRP to be charged, to determine if this is at a level which is considered prudent based on the Authority's circumstances at that time, taking into account medium / long term financial plans, current budgetary pressures, current and future capital expenditure plans. Dependant on this review the Section 151 officer will adjust the annual MRP charge by making VRP or reclaiming previous VRP. The amount of MRP charged shall not be less than zero in any financial year.

## 3. Borrowing

The capital expenditure plans set out in Section 2 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. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions, and the Annual Investment Strategy.

### 3.1 Current Portfolio Position

The overall treasury management portfolio as at 31.3.22 and for the position as at 20.12.2022. are shown below for both borrowing and investments.

Table 6

| TREASURY PORTFOLIO | | | | |
|---|---|---|---|---|
| | £'000 | % | £'000 | % |
| | **31.03.22** | **31.03.22** | **20.12.22** | **20.12.22** |
| **Treasury investments** | | | | |
| Banks | 15,747 | 53% | 33,837 | 80% |
| Money Market Funds | 13,900 | 47% | 8,500 | 20% |
| **Total treasury investments** | **29,647** | **100%** | **42,337** | **100%** |
| **Treasury external borrowing** | | | | |
| Local Authorities | 2,950 | 16% | 1,950 | 12% |
| PWLB | 15,137 | 84% | 14,967 | 88% |
| **Total external borrowing** | **18,087** | **100%** | **16,917** | **100%** |
| | | | | |
| **Net treasury investments / (borrowing)** | **11,560** | | **25,420** | |

Table 7

| **Treasury portfolio per Counterparty** | **Amount Invested £'000** | **Amount Invested £'000** | **Counterparty Limit** |
|---|---|---|---|
| | **31.03.22** | **20.12.22** | **20.12.22** |
| Barclays - Call account | 747 | 833 | |
| Barclays - Green Account | 5,000 | 5,000 | |
| **Barclays total** | **5,747** | **5,833** | **10mil** |
| Bank of New York Mellon - Federated Fund | 4,900 | 3,500 | 5mil |
| Aberdeen Liquidity Fund | 5,000 | 5,000 | 5mil |
| Insight Liquidity Funds | 4,000 | | 5mil |
| Santander | - | 3,004 | 5mil |
| Qatar National Bank | 5,000 | | 5mil |
| First Abu Dhabi | - | 5,000 | 5mil |
| Sumitomo Mitsui Banking Corp. | - | 5,000 | 5mil |
| Bayerische Landesbank | - | 5,000 | 5mil |
| Goldman Sachs | - | 5,000 | 5mil |
| Standard Chartered sustainable | 5,000 | 5,000 | 5mil |
| **Total** | **29,647** | **42,337** | |

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.

Table 8

| **Borrowing** | **2021/22 Actual £'000** | **2022/23 Estimate £'000** | **2023/24 Estimate £'000** | **2024/25 Estimate £'000** | **2025/26 Estimate £'000** |
|---|---|---|---|---|---|
| Borrowing | 18,088 | 16,742 | 14,440 | 14,079 | 13,711 |
| **Total debt at 31 March** | **18,088** | **16,742** | **14,440** | **14,079** | **13,711** |
| CFR | 41,463 | 40,909 | 40,345 | 39,770 | 39,191 |
| **Under / (over) borrowing** | **23,375** | **24,167** | **25,905** | **25,691** | **25,480** |

Within the range of prudential indicators there are several key indicators to ensure that the council operates its activities within well-defined limits. One of these is that the council needs to ensure that its gross debt does not, except in the short-term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2023/24 and the following two financial years. This allows some flexibility for limited early borrowing for future years but ensures that borrowing is not undertaken for revenue or speculative purposes.

The S151 Officer reports that the council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes account of current commitments, existing plans and the proposals in this budget report.

### 3.2 Treasury Indicators: limits to borrowing activity

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

Table 9

| **Operational Boundary** | **2021/22 Actual £'000** | **2022/23 Estimate £'000** | **2023/24 Estimate £'000** | **2024/25 Estimate £'000** | **2025/26 Estimate £'000** |
|---|---|---|---|---|---|
| Debt | 25,000 | 25,000 | 25,000 | 25,000 | 25,000 |
| **Total debt** | **25,000** | **25,000** | **25,000** | **25,000** | **25,000** |

**The Authorised Limit for external debt.** This is a key prudential indicator and represents a control on the maximum level of borrowing. This represents a legal limit beyond which external debt is prohibited, and this limit needs to be set or revised by the Full Council. It reflects the level of external debt which, while not desired, could be afforded in the short-term, but is not sustainable in the longer-term.

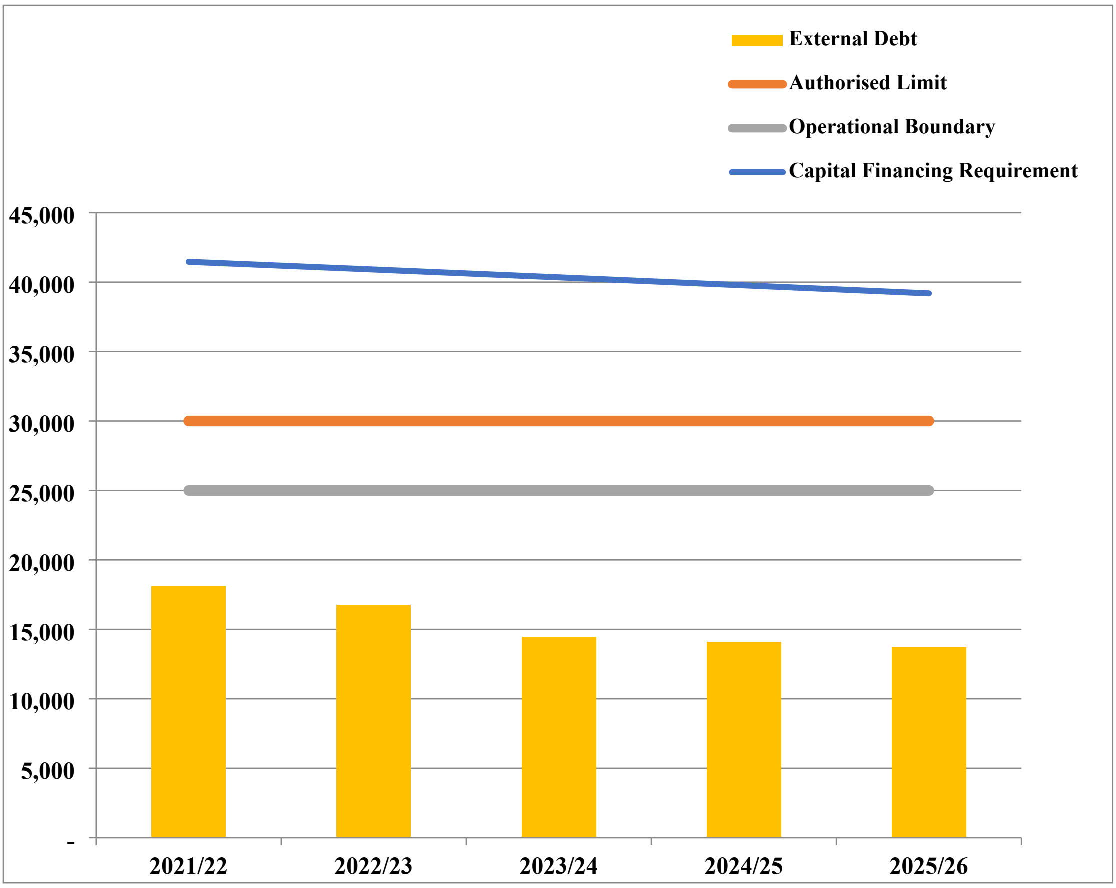
- This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all local council plans, or those of a specific council, although this power has not yet been exercised.
- The council is asked to approve the following Authorised Limit:

**Table 10**

| Authorised Limit | 2021/22 Actual £'000 | 2022/23 Estimate £'000 | 2023/24 Estimate £'000 | 2024/25 Estimate £'000 | 2025/26 Estimate £'000 |
|---|---|---|---|---|---|
| Debt | 30,000 | 30,000 | 30,000 | 30,000 | 30,000 |
| **Total** | **30,000** | **30,000** | **30,000** | **30,000** | **30,000** |

**Table 11**

| Capital Financing Requirement | 2021/22 Actual £'000 | 2022/23 Estimate £'000 | 2023/24 Estimate £'000 | 2024/25 Estimate £'000 | 2025/26 Estimate £'000 |
|---|---|---|---|---|---|
| Authorised Limit | 30,000 | 30,000 | 30,000 | 30,000 | 30,000 |
| Operational Boundary | 25,000 | 25,000 | 25,000 | 25,000 | 25,000 |
| Capital Financing Requirement | 41,463 | 40,909 | 40,345 | 39,770 | 39,191 |
| External Debt | 18,088 | 16,742 | 14,440 | 14,079 | 13,711 |
| | | | | | |
| Under / (over) borrowing | 23,375 | 24,167 | 25,905 | 25,691 | 25,480 |
| Change in External Debt | 6,554 | (1,346) | (2,302) | (361) | (368) |




### 3.3 Prospects for Interest Rates

The council has appointed Link Group as its treasury advisor and part of their service is to assist the council to formulate a view on interest rates. Link provided the following forecasts on 08.11.22. These are forecasts for certainty rates, gilt yields plus 80 bps.

| Link Group Interest Rate View | 08.11.22 | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Dec-22 | Mar-23 | Jun-23 | Sep-23 | Dec-23 | Mar-24 | Jun-24 | Sep-24 | Dec-24 | Mar-25 | Jun-25 | Sep-25 | Dec-25 |
| BANK RATE | 3.50 | 4.25 | 4.50 | 4.50 | 4.50 | 4.00 | 3.75 | 3.50 | 3.25 | 3.00 | 2.75 | 2.50 | 2.50 |
| 3 month ave earnings | 3.60 | 4.30 | 4.50 | 4.50 | 4.50 | 4.00 | 3.80 | 3.30 | 3.00 | 3.00 | 2.80 | 2.50 | 2.50 |
| 6 month ave earnings | 4.20 | 4.50 | 4.60 | 4.50 | 4.20 | 4.10 | 3.90 | 3.40 | 3.10 | 3.00 | 2.90 | 2.60 | 2.60 |
| 12 month ave earnings | 4.70 | 4.70 | 4.70 | 4.50 | 4.30 | 4.20 | 4.00 | 3.50 | 3.20 | 3.10 | 3.00 | 2.70 | 2.70 |
| 5 yr PWLB | 4.30 | 4.30 | 4.20 | 4.10 | 4.00 | 3.90 | 3.80 | 3.60 | 3.50 | 3.40 | 3.30 | 3.20 | 3.10 |
| 10 yr PWLB | 4.50 | 4.50 | 4.40 | 4.30 | 4.20 | 4.00 | 3.90 | 3.70 | 3.60 | 3.50 | 3.40 | 3.30 | 3.20 |
| 25 yr PWLB | 4.70 | 4.70 | 4.60 | 4.50 | 4.40 | 4.30 | 4.10 | 4.00 | 3.90 | 3.70 | 3.60 | 3.50 | 3.50 |
| 50 yr PWLB | 4.30 | 4.40 | 4.30 | 4.20 | 4.10 | 4.00 | 3.80 | 3.70 | 3.60 | 3.40 | 3.30 | 3.20 | 3.20 |

*Additional notes by Link on this forecast table: -*

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

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

The CPI measure of inflation will peak at close to 11% in Q4 2022. Despite the cost-of-living squeeze that is still taking shape, the Bank will want to see evidence that wages are not spiralling upwards in what is evidently a very tight labour market. Wage increases, excluding bonuses, are currently running at 5.7%.

Regarding the plan to sell £10bn of gilts back into the market each quarter (Quantitative Tightening), this has started but will focus on the short to medium end of the curve for the present. This approach will prevent any further disruption to the longer end of the curve following on from the short-lived effects of the Truss/Kwarteng unfunded dash for growth policy.

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

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

## PWLB RATES

Yield curve movements have become less volatile under the Sunak/Hunt government. PWLB 5 to 50 years Certainty Rates are, generally, in the range of 3.75% to 4.50%. The medium to longer part of the yield curve is currently inverted (yields are lower at the longer end of the yield curve compared to the short to medium end).

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

### The balance of risks to the UK economy:

- The overall balance of risks to economic growth in the UK is to the downside. Indeed, the Bank of England projected two years of negative growth in their November Quarterly Monetary Policy Report.

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

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

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

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

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

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

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

- **The Government** acts too slowly to increase taxes and/or cut expenditure to balance the public finances, in the light of the cost-of-living squeeze.

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

- Longer term **US treasury yields** rise strongly, if inflation numbers disappoint on the upside, and pull gilt yields up higher than currently forecast.

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

Our suggested budgeted earnings rates for investments up to about three months' duration in each financial year are as follows:

Table 12

| Average earnings in each year | |
|---|---|
| 2022/23 (remainder) | 3.95% |
| 2023/24 | 4.40% |
| 2024/25 | 3.30% |

| | |
|---|---|
| 2025/26 | 2.60% |
| 2026/27 | 2.50% |
| Years 6 to 10 | 2.80% |
| Years 10+ | 2.80% |

As there are so many variables at this time, caution must be exercised in respect of all interest rate forecasts.

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

### 3.4 Borrowing Strategy

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 medium and longer dated borrowing rates are expected to fall from their current levels once prevailing inflation concerns are addressed by tighter near-term monetary policy. That is, Bank Rate increases over the remainder of 2022 and the first half of 2023.

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

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

- *if it was felt that there was a significant risk of a much sharper RISE in borrowing rates than that currently forecast,* fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

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

### 3.5 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.

### 3.6 Debt rescheduling

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

If rescheduling is to be undertaken, it will be reported to the council, at the earliest meeting following its action.

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

Currently the PWLB Certainty Rate is set at gilts + 80 basis points. 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 – generally still cheaper than the Certainty Rate).
- Financial institutions (primarily insurance companies and pension funds but also some banks, out of forward dates where the objective is to avoid a “cost of carry” or to achieve refinancing certainty over the next few years).
- Municipal Bonds Agency

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

### 3.8 Approved Sources of Long and Short term Borrowing

| On Balance Sheet | Fixed | Variable |
|---|---|---|
| PWLB | ● | ● |
| UK Municipal Bond Agency | ● | ● |
| Local Authorities | ● | ● |
| Banks | ● | ● |
| Pension Funds | ● | ● |
| Insurance Companies | ● | ● |
| UK Infrastructure Bank | ● | ● |
| | | |
| Market (long-term) | ● | ● |
| Market (temporary) | ● | ● |
| Market (LOBOs) | ● | ● |

| | | |
|---|---|---|
| Stock Issues | ● | ● |
| | | |
| Local Temporary | ● | ● |
| Local Bonds | ● | |
| Local Council Bills | ● | ● |
| Overdraft | | ● |
| Negotiable Bonds | ● | ● |
| | | |
| Internal (capital receipts & revenue balances) | ● | ● |
| Commercial Paper | ● | |
| Medium Term Notes | ● | |
| Finance Leases | ● | ● |

## 4 Annual Investment Strategy

### 4.1 Investment policy – management of risk

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

The council's investment policy has regard to the following: -

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

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 regard to the Council's risk appetite and the Environmental, Social and Governance (ESG) credentials, see section 4.3.

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

The above guidance from the DLUHC and CIPFA places a high priority on the management of risk. This 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 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 section 5.2 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 classified as being non-specified investments solely due to the maturity period exceeding one year.

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

5. **Non-specified and loan investment limits.** The council has determined that it will set a limit to the maximum exposure of the total treasury management investment portfolio to non-specified treasury management investments of 50%.

6. **Lending limits**, (amounts and maturity), for each counterparty will be set through applying the matrix table in paragraph 4.2.

7. **Transaction limits** are set for each type of investment in 4.2.

8. This Council will set a limit for its investments which are invested for **longer than 365 days**, (see paragraph 4.4).

9. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating**, (see paragraph 4.3).

10. This Council has engaged **external consultants**, (see paragraph 1.5), to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this Council in the context of the expected level of cash balances and need for liquidity throughout the year.

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

12. As a result of the change in accounting standards for 2022/23 under IFRS 9, the Council will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, the MHCLG, concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years ending 31.3.23. In December 2022 the Government confirmed that a further extension to the over-ride to 31.3.25 has been agreed.

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, (see paragraph 4.5). Regular monitoring of investment performance will be carried out during the year.

### Changes in risk management policy from last year

The above criteria are unchanged from last year, however, there are proposed changes to some financial limits, and these are set out in the following sections of the report, and it is proposed to formally introduce an ESG assessment of counterparties into investment decisions wherever possible.

### 4.2 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 & Poor's. The credit ratings of counterparties are supplemented with the following overlays:

1. "watches" and "outlooks" from credit rating agencies;
2. CDS spreads that may give early warning of changes in credit ratings;
3. 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 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 for Ultra-Short Dated Bond Funds with a credit score of 1.25
- Light pink 5 years for Ultra-Short Dated Bond Funds with a credit score of 1.5
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 100 days
- No colour not to be used

The Link creditworthiness service uses a wider array of information other than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings.

Typically, the minimum credit ratings criteria the council uses will be a short-term rating (Fitch or equivalents) of F1 and 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 weekly. 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 in movements in Credit Default Swap spreads against the iTraxx European Senior 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 council's lending list.

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

| Y | Pi1 | Pi2 | P | B | O | R | G | N/C |
|---|---|---|---|---|---|---|---|---|
| 1 | 1.25 | 1.5 | 2 | 3 | 4 | 5 | 6 | 7 |
| Up to 5yrs | Up to 5yrs | Up to 5yrs | Up to 2yrs | Up to 1yr | Up to 1yr | Up to 6mths | Up to 100days | No Colour |

| | Colour (and long-term rating where applicable) | Money Limit* | Time limit |
|---|---|---|---|
| Banks | Yellow | £7.5m | 5 yrs |
| Banks | Purple | £7.5m | 2 yrs |
| Banks | Orange | £7.5m | 1 yr |

| | | | |
|---|---|---|---|
| Banks – part nationalised | Blue | £7.5m | 1 yr |
| Banks | Red | £7.5m | 6 mths |
| Banks | Green | £7.5m | 100 days |
| Limit 3 category – Authority's banker (where "No Colour") | XXX | | 1 day |
| Other institutions limit | - | £7.5m | 1yr |
| DMADF | UK sovereign rating | unlimited | 6 months |
| Local authorities | n/a | £7.5m | 1yr |
| Housing associations | Colour bands | £7.5m | As per colour band |

| | **Fund rating** | **Money Limit*** | **Time Limit** |
|---|---|---|---|
| Money Market Funds CNAV | AAA | £7.5m | liquid |
| Money Market Funds LVNAV | AAA | £7.5m | liquid |
| Money Market Funds VNAV | AAA | £7.5m | liquid |
| Ultra-Short Dated Bond Funds with a credit score of 1.25 | Dark Pink / AAA | £7.5m | liquid |
| Ultra-Short Dated Bond Funds with a credit score of 1.50 | Light Pink / AAA | £7.5m | liquid |

This Money Limit relates to principal amounts invested and could be exceeded with interest received but consideration will be given to keep this to a minimum and allowable under this Strategy.
*The current money limits are £5m which have been in place for over 10 years. In order to reflect much higher investment cash balances, a more limited number of counterparties meeting the Council's high assessment levels including ESG criteria, and the need to generate yield to support the budget, it is proposed to increase the money limits to £7.5m or 20% of total investments at the time of the transaction, whichever is the lower. This adds the additional safeguard of proportionality.

### CDS prices

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

### 4.3 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.

- **Non-specified treasury management investment limit.**
- **Country limit.** The council has determined that it will only use approved counterparties from the UK and from countries with a **minimum sovereign credit rating of AA-** from Fitch. The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 5.6. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

**Other limits.** In addition:

- limits in place above will apply to a group of companies/institutions;
- sector limits will be monitored regularly for appropriateness.
- Barclays Bank (Hart's own bank) currently have a counterparty limit of £10m due to the working capital that is held within Barclays for events such as payment runs while still providing the council with an investment return.

The security and liquidity will be assessed at the time of the transaction, as described within this Annual Investment Strategy. The Environmental, Social and Governance (ESG) assessment needs to be reliable, relevant and practical to administer when making investment decisions. Whilst it is a relatively new area, there are resources available that will help inform officers and enable them to apply the Council's ESG criteria. It is proposed, wherever possible, to use this information and include within the investment transaction record. Officers have trialled the use of an online ESG info hub which gives an ESG score for potential counterparties. It is proposed that this becomes a formal stage in the investment procedure. The ESG assessment produces a score on a scale of 1-100 based on four areas; Environment, Employees, Governance, Community. It is proposed that the minimum ESG score threshold is set at 60, below which we wouldn't place an investment. Range 60-79 we would only proceed if the other criteria were met strongly. Range 80-100 would be given equal weight to yield in the overall evaluation.

### 4.4 Investment Strategy

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

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

**Investment returns expectations**
The current forecast shown in paragraph 3.3, includes a forecast for Bank Rate to reach 4.5% in Q2 2023.

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 (remainder) | 3.95% |
| 2023/24 | 4.40% |
| 2024/25 | 3.30% |
| 2025/26 | 2.60% |
| 2026/27 | 2.50% |
| Years 6 to 10 | 2.80% |
| Years 10+ | 2.80% |

As there are so many variables at this time, caution must be exercised in respect of all interest rate forecasts.

For its cash flow generated balances, the council will seek to utilise its 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.

**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 following treasury indicator and limit: -

Table 13

| Upper limit for principal sums invested for longer than 365 days |
|---|

| £m | 2023/24 | 2024/25 | 2025/26 |
|---|---|---|---|
| Principal sums invested for longer than 365 days | £10m | £10m | £10m |
| Current investments as at 20/12/2022 in excess of 1 year maturing in each year | £0m | £0m | £0m |

For its cash flow generated balances, the council will seek to utilise its business reserve instant access, money market funds and short-dated deposits (overnight to 100 days), in order to benefit from the compounding of interest. The current limit is £5m which has been in place for over 10 years. To reflect much higher investment cash balances, a more limited number of counterparties meeting the Council's high assessment levels including ESG criteria, and the need to generate yield to support the budget, it is proposed to increase the money limits to £10m. This will enable officers to secure high rated investment opportunities and achieve a higher interest rate fixed over a longer period, say 2 years.

### 4.5 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.

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

The council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

### 5.1.1 Capital Expenditure

Please see table in Section 2.1

### 5.1.2 Affordability prudential indicators

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

**Ratio of Financing Costs to Net Revenue Stream**

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

Table 14

| | 2021/22 Actual | 2022/23 Estimate | 2023/24 Estimate | 2024/25 Estimate | 2024/25 Estimate |
|---|---|---|---|---|---|
| Ratio of financing costs to revenue stream (%) | 6.15 | 2.40 | 1.04 | 1.11 | 2.39 |

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

### 5.1.3 Maturity structure of borrowing

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 2023/24** | | |
|---|---|---|
| | **Lower** | **Upper** |
| Under 12 months | 0% | 100% |
| 12 months to 2 years | 0% | 100% |
| 2 years to 5 years | 0% | 100% |
| 5 years to 10 years | 0% | 100% |
| 10 years to 20 years | 0% | 100% |
| 20 years to 30 years | 0% | 100% |
| 30 years to 40 years | 0% | 100% |
| 40 years to 50 years | 0% | 100% |

| **Maturity structure of variable interest rate borrowing 2023/24** | | |
|---|---|---|
| | Lower | Upper |
| Under 12 months | 0% | 100% |
| 12 months to 2 years | 0% | 100% |
| 2 years to 5 years | 0% | 100% |
| 5 years to 10 years | 0% | 100% |
| 10 years to 20 years | 0% | 100% |
| 20 years to 30 years | 0% | 100% |
| 30 years to 40 years | 0% | 100% |
| 40 years to 50 years | 0% | 100% |

### 5.1.4. Control of interest rate exposure

Please see paragraphs 3.3, 3.4 and 4.4.

## 5.2 TREASURY MANAGEMENT PRACTICE (TMP) – CREDIT AND COUNTERPARTY RISK MANAGEMENT

**SPECIFIED INVESTMENTS:** All such investments will be sterling denominated, with **maturities up to a maximum of 1 year**, meeting the minimum 'high' quality criteria where applicable. (Non-specified investments which would be specified investments apart from originally being for a period longer than 12 months, will be classified as being specified once the remaining period to maturity falls to under twelve months.)

**NON-SPECIFIED INVESTMENTS**: These are any investments which do not meet the specified investment criteria. If they do not meet the criteria solely because they have an initial period of more than one year, the Council will consider them.

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

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

| | Minimum credit criteria / colour band | Max % of total investments / £ limit per institution | Max. maturity period |
|---|---|---|---|
| DMADF – UK Government | Yellow | 100% | 6 months (max. is set by the DMO*) |
| UK Gilts | Yellow | 100% | 5 years |
| UK Treasury Bills | Yellow | 100% | 364 days (max. is set by the DMO*) |
| Bonds issued by multilateral development banks | Yellow | £5m | 5 years |
| Money Market Funds CNAV | AAA | 100% | Liquid |
| Money Market Funds LNVAV | AAA | £5m | Liquid |
| Money Market Funds VNAV | AAA | £5m | Liquid |
| Ultra-Short Dated Bond Funds with a credit score of 1.25 | AAA | 100% | Liquid |
| Ultra-Short Dated Bond Funds with a credit score of 1.5 | AAA | 100% | Liquid |
| Local Authorities | Yellow | 100% | 5 years |
| Term Deposits with Housing Associations | Blue<br>Orange<br>Red<br>Green<br>No Colour | £7.5m** | 12 months<br>12 months<br>6 months<br>100 days<br>Not for use |

| | | | |
|---|---|---|---|
| Term Deposits with Banks and Building Societies | Blue<br>Orange<br>Red<br>Green<br>No Colour | £7.5m** | 24 months<br>12 months<br>6 months<br>100 days<br>Not for use |
| CDs or Corporate Bonds with Banks and Building Societies | Blue<br>Orange<br>Red<br>Green<br>No Colour | £7.5m** | 12 months<br>12 months<br>6 months<br>100 days<br>Not for use |
| Gilt Funds | UK sovereign rating | £5m | |

* DMO – is the Debt Management Office of HM Treasury
**Or 20% of total investment balance at the time of the transaction, whichever is the lower

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

### 5.5 Link list of approved countries for investments (as at 02.12.2022)

This list is based on those countries which have sovereign ratings of AA- or higher, (we show the lowest rating from Fitch, Moody's and S&P) and also, (except - at the time of writing - for Hong Kong and Luxembourg), have banks operating in sterling markets which have credit ratings of green or above in the Link creditworthiness service.

***Based on lowest available rating***

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

**AA+**
- Canada
- Finland
- U.S.A.

**AA**

- Abu Dhabi (UAE)
- France

**AA-**

- Belgium
- Qatar
- **U.K.**

## 5.3 Treasury Management Scheme of Delegation

The bodies responsible for various functions are as follows:

### Council

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

### Cabinet

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

### Overview & Scrutiny Committee

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

## 5.4 The Treasury Management Role of the section 151 officer

### The S151 (responsible) officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;

- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.
- preparation of a Capital Strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long-term timeframe *(say 20+ years – to be determined in accordance with local priorities.)*
- ensuring that the Capital Strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the council
- ensure that the council has appropriate legal powers to undertake expenditure on non-financial assets and their financing
- ensuring the proportionality of all investments so that the council does not undertake a level of investing which exposes the council to an excessive level of risk compared to its financial resources
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long-term liabilities
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees
- ensuring that members are adequately informed and understand the risk exposures taken on by the council
- ensuring that the council has adequate expertise, either in house or externally provided, to carry out the above
- creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed, to include the following : -
    - *Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;*

    - *Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;*

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

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

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

## 5.5 MRP method change to apply from 2022-23

### 5.5.1 Minimum Revenue Provision (MRP) for Debt Repayment

In accordance with the Local Authorities (Capital Finance and Accounting) (England) regulations 2003, the council is required to pay off an element of accumulated General Fund capital expenditure financed from borrowing through an annual revenue charge known as the Minimum Revenue Provision (MRP).

The Local Authorities (Capital Finance and Accounting) (England) (Amendment) regulations 2008 require the council to determine a level of MRP it considers to be prudent, whilst having regard to the current MRP Guidance issued by MHCLG (now renamed DLUHC) in 2018. The Guidance gives four ready-made options for determining MRP which it considers to be prudent but does not rule out alternative approaches.

The overriding requirement of the Guidance is to set a prudent provision which ensures that debt is repaid over a period that is reasonably commensurate with that over which the capital expenditure provides benefits.

The Guidance requires that before the start of each financial year the council prepares a statement of its policy on making MRP in respect of the forthcoming financial year and submits it to full Council for approval.

The Guidance allows the council to change the MRP policy at any time during the year.

The Government has recently consulted on changes to the MRP regulations with an intention to make explicit that (i) capital receipts may not be used in place of the revenue charge, and (ii) there should be no intentional exclusion of debt from the MRP determination because it relates to an investment asset or capital loan. Following the consultation, the government issued a further survey seeking views on further proposed amendments to the MRP regulations that would provide additional flexibilities with respect to capital loans. The proposed changes along with updated MRP Guidance are anticipated to be implemented in April 2024 but they are not expected to have a major impact for this Authority.

#### 5.5.2 Proposed updated method for calculating MRP

A review of the council's MRP policy was recently undertaken by Link Group (Link). The objective of the review was to identify opportunities to move to a more suitable and cost effective MRP strategy whilst ensuring that the provision remains prudent and compliant with statutory guidance. The review identified various options for unsupported borrowing which could be implemented within statutory guidance. The council has chosen within these options to adopt the policies which is deemed best suited to Hart.

The council's current MRP policy for unsupported borrowing is the asset life method in accordance with the MRP guidance. The guidance allows either a straight line or annuity approach to be used for calculating MRP when using the asset life method. The council currently uses the straight line method.

The council could alternatively use an annuity method over the asset life, having the benefit of a reduction in MRP charges in the near term. Such a change would be a change in the method of calculating MRP rather than a change in policy, since the current policy allows either a straight line or annuity approach, in line with the MRP guidance.

An annuity method is as prudent as the current straight line method since the asset lives currently being used will not be changed. It can be argued that the annuity method provides a fairer charge than the straight-line method since it results in a consistent charge over the asset's life, considering the time value of money.

Link have carried out extensive research on current MRP policies in England and have observed that the annuity method of calculating MRP on unsupported borrowing is used by over 50% of Authorities throughout the country.

Main advantages of the changes in method:

- The annuity method of charging MRP can be seen as a more prudent basis for providing for capital expenditure which provides a steady flow of benefits over their useful life.
- It can provide a fairer charge than a straight line methodology as it provides a consistent charge over an asset's life when considering the time value of money.
- It provides a charge that is better matched to how the benefits of the asset financed by borrowing are consumed over its useful life. That is, a method that reflects the fact that asset deterioration is slower in the early years of an asset and accelerates towards the latter years.
- A weighted average method of calculation is a much simpler calculation than the current method, providing for more concise and user friendly working papers.

Main disadvantages of the changes in method:

- The proposed changes will lead to the Capital Financing Requirement in the short term reducing more slowly than under the council's current MRP policy. The potential associated cost will depend on the council's Balance Sheet position.

Whilst the proposed changes to the MRP calculation methodology do not constitute a change in MRP policy, the council proposes to update the wording in the MRP policy to make the methodology being used explicit. The updated MRP policy is shown at Appendix A.

The MRP guidance allows the council to review its MRP policy every year and set a policy that it considers prudent at that time. The impact of the revised MRP calculation methodology will be kept under regular review in order to ensure that the annual provision is prudent.