5. TREASURY MANAGEMENT STRATEGY

Background

5.1 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.

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

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

5.4 CIPFA (the Chartered Institute of Public Finance & Accountancy) 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."

5.5 This section of the budget report fulfils the council's legal obligation under the Local Government Act 2003 to have regard to relevant codes of practice and guidance issued by CIPFA (Chartered Institute of Public Finance & Accountancy) and the DLUHC (Department for Levelling Up, Housing and Communities).

5.6 This section therefore fulfils the need for council to approve:

- A treasury management strategy before the start of each financial year (as required by CIPFA's Treasury Management Code).
- Prudential indicators to ensure that the council's capital investment plans are affordable, prudent and sustainable (as required by CIPFA's Prudential Code).
- An investment strategy before the start of each financial year (as required by DLUHC's Investment Code).

- A Minimum Revenue Provision (MRP) policy (as required by DLUHC's MRP guidance).

5.7 The council's investment in commercial property, equity shares, and lending to third parties is considered in the capital strategy in Section 4.

5.8 However, for the purposes of clarity, the projections, indicators and limits given in this section of the budget report include:

- The general fund and HRA proposed capital programme and its funding as set out in Section 4, tables 4.4 and 4.5.
- The implications for the council's capital financing requirement and borrowing position arising from the non-financial investments proposed in section 4 of this report.

Treasury management reporting requirements

5.9 The council is required to receive and approve as a minimum, three main reports each year, which incorporate a variety of, polices, estimates and actuals.

- Prudential and treasury indicators and treasury strategy (this report)
- A mid-year treasury management report – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision.
- An annual treasury report – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Treasury management role of the Section 151 Officer

5.10 The S151 (responsible) 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 information required by internal or external audit is supplied;
- Recommending the appointment of external service providers;
- Ensuring that due diligence has been carried out on all treasury investments and is in accordance with the risk appetite and approved policies of the authority;
- Ensuring that members are adequately informed and understand the risk exposures taken on by an authority;

- Ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above;
- Training and qualifications of members responsible for treasury management approval and scrutiny as well as officers responsible for the day to day operations of treasury management.

Treasury management practices

5.11 Norwich City Council has adopted the CIPFA Treasury Management Code. The recently published update to the Code (December 2021) has included a requirement under TMP1 that ‘the organisation’s credit and counterparty policies should set out its policy and practices relating to environmental, social and governance (ESG) investment considerations’. The Code acknowledges that this is a developing area, and it is not implied that the organisation’s ESG policy will currently include ESG scoring or other real-time ESG criteria at the individual investment level. The council will continue to review and build on the emerging guidance in this area of treasury management as well as seek updates on good practice from its Treasury Management advisors.

Training

5.12 The CIPFA Code requires the responsible officer to ensure that all members with responsibility for treasury management receive adequate training in this area. The S151 officer is responsible for this function. The training needs of treasury management officers are periodically reviewed.

Treasury management advisers

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

5.14 Responsibility for treasury management decisions remains with the council at all times. Although the council will from time to time require the services of specialists, consultants and advisers in order to acquire access to specialist skills, undue reliance will not be placed upon the services and advice provided.

Treasury Management Strategy

Current Treasury Portfolio Position

Table 5.1: The Council's current investment and borrowing position

	31/03/2021 Actuals £000	%	31/12/2021 Actuals £000	%
Investments				
Banks	38,750	51.8	82,120	46.9
Building Societies	0	0.0	30,000	17.1
Local Authority	15,000	20.0	27,000	15.4
UK Government	0	0.0	11,000	6.3
Money Market Funds	21,070	28.2	25,000	14.3
TOTAL	**74,820**	**100.0**	**175,120**	**100.0**
Borrowing				
PWLB	214,107	97.4	259,107	97.9
Banks	5,000	2.3	5,000	1.9
Others	745	0.3	693	0.3
TOTAL	**219,852**	**100.0**	**264,800**	**100.0**

5.15 On the 31st of December 2021, the council held £264.800m of external borrowing and £175.120m of treasury investments.

5.16 During 2021/22 the council has taken £45m of new long-term borrowing from the Public Works Loan Board, which is reflected in the increased level of debt in Table 5.1. Although the council does not maintain separate balance sheets for the general fund and housing revenue account, it has historically allocated borrowing between the two funds. The borrowing in year has included £15m in relation to the general fund and £30m relating to the Housing Revenue Account. The latter has enabled the Housing Revenue Account to secure new borrowing at historically low levels ahead of a scheduled repayment of self-financing debt in March 2023.

5.17 The additional borrowing, combined grant receipts front loaded in the year, has meant that investment balances have increased since the start of 2021/22. These are expected to decrease towards the year end following a scheduled repayment of business rates grant to the government.

The Prudential and Treasury Indicators 2022/23 – 2026/27

5.18 The council's capital expenditure plans are a key driver of treasury management activity. A summary of the council's capital budget plans and how these are being financed is shown in table 5.2.

5.19 The Capital Financing Requirement (CFR) calculation is shown in table 5.3. This is the total historic outstanding capital expenditure yet to be financed from revenue or capital resources and a future projection of CFR based on capital expenditure plans. It is a measure of the council's indebtedness, and therefore its underlying borrowing need. The CFR also includes other long-term liabilities such as finance leases.

5.20 The CFR incorporates interim figures in relation to the new reporting requirements detailed within IFRS16. The reporting standard requires certain leases currently accounted for through the revenue spend of the Council, to have its liabilities shown on the balance sheet if the lease has more than a year to run or is above a de-minimis value. An example for Norwich are the vehicles procured through an operating lease.

5.21 This is a requirement of closing the accounts for 2022/23 and officers continue to undertake the required data gathering exercise, which will clarify the full impact on the CFR for the Council. It is therefore important to note that there may be a requirement to refresh the authorised limit and operational boundary once the review is substantially complete later in the 2022/23 financial year.

5.22 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 expected life.

5.23 The repayment of loan debt by the council's wholly owned company NRL will also reduce the CFR where the loan is financed by borrowing.

5.24 Table 5.3 sets out the required affordable borrowing limit, namely:

a. The operational boundary - the limit beyond which external debt is not normally expected to exceed.
b. The authorised limit for gross external debt - a statutory limit determined under section 3 (1) of the Local Government Act 2003. It represents the legal limit on the maximum level of borrowing beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It is also the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.
c. The estimated capital financing requirement for the HRA as at 1 April 2022 is £207.517m and this has been included in the authorised limit.
d. The HRA debt cap at the time it was removed in October 2018 was £236.989m.

Chart 5.1: Forecast of CFR and borrowing limits

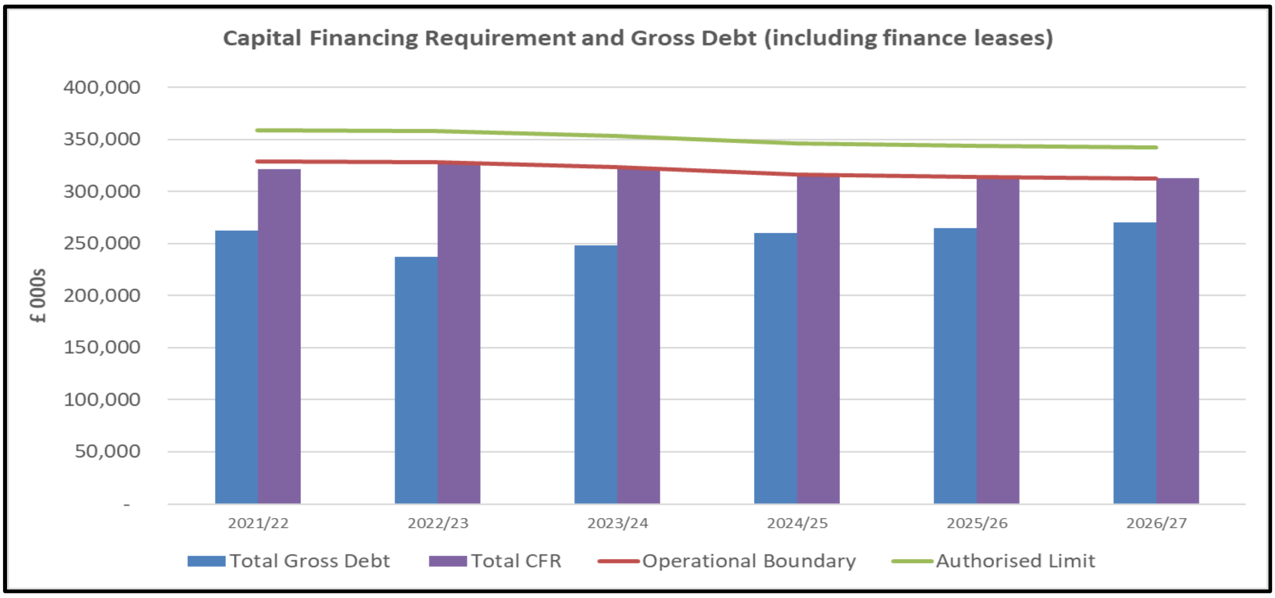

Table 5.2: The council's capital expenditure and financing plans

	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000	2025/26 Estimate £000	2026/27 Estimate £000
Capital expenditure						
General Fund	13,412	23,347	7,952	3,026	3,680	1,761
Equity investment	0	0	0	0	0	0
Capital Loans	0	6,000	0	0	0	0
Total General Fund Expenditure	**13,412**	**29,347**	**7,952**	**3,026**	**3,680**	**1,761**
Housing Revenue Account	**32,069**	**38,861**	**44,026**	**37,260**	**26,850**	**24,583**
TOTAL CAPITAL EXPENDITURE	**45,481**	**68,208**	**51,978**	**40,286**	**30,530**	**26,344**
Financing						
Capital receipts	1,940	9,743	12,648	8,078	1,648	2,583
Capital receipts (ringfenced)	0	715	0	0	0	0
Retained "one for one" RTB receipts	5,266	5,754	7,838	6,352	2,200	1,228
Major repairs reserve	21,514	18,454	14,768	14,722	14,676	14,572
Contributions and grants	8,936	16,820	4,614	1,690	1,690	250
Revenue contribution	5,063	6,342	10,256	8,029	8,263	5,953
Revenue contribution (earmarked reserves)	175	1,090	0	0	0	0
Greater Norwich growth partnership	120	502	1	8	0	0
Community infrastructure levy	1,562	1,810	1,853	1,407	2,053	1,758
S106	33	977	0	0	0	0
Total	44,609	62,208	51,978	40,286	30,530	26,344
Borrowing need for the year	**872**	**6,000**	**0**	**0**	**0**	**0**
TOTAL FINANCING	**45,481**	**68,208**	**51,978**	**40,286**	**30,530**	**26,344**

5.25 The 2021/22 estimated capital outturn in Table 5.2 does not include possible carry forwards of budgets into the next financial year. No potential carry forward will be funded from borrowing and therefore there is no impact on the capital financing requirement or borrowing assumptions.

Table 5.3: Prudential and treasury Indicators

	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000	2025/26 Estimate £000	2026/27 Estimate £000
Capital financing requirement at end of year						
General Fund	114,306	120,074	114,948	107,767	106,031	104,397
Housing Revenue Account	207,517	208,174	208,174	208,174	208,174	208,174
TOTAL	**321,823**	**328,248**	**323,122**	**315,941**	**314,205**	**312,571**
Annual change in capital financing requirement						
General fund	(6,874)	5,769	(5,127)	(7,181)	(1,736)	(1,634)
Housing Revenue Account	-	657	-	-	-	-
TOTAL	**6,874**	**6,426**	**5,127**	**7,181**	**1,736**	**1,634**
Gross Debt						
Borrowing	262,287	237,466	248,338	260,086	264,619	270,099
Operational boundary for external debt						
Operational boundary	328,818	328,248	323,122	315,941	314,205	312,571
Authorised limit for external debt						
Authorised limit	358,818	358,248	353,122	345,941	344,205	342,571
Actual external debt						
Borrowing	261,607	236,907	247,907	259,790	264,467	270,099
Debt maturity profile as at end of year all borrowing %						
Less than one year	19%	2%	1%	20%	3%	19%
Between one and two years	2%	1%	21%	3%	20%	1%
Between 2 and 5 years	24%	48%	25%	22%	2%	3%
Between 5 and 10 years	23%	5%	6%	6%	5%	5%
Between 10 and 15 years	5%	3%	2%	1%	1%	0%
Between 15 and 20 years	0%	0%	0%	0%	0%	0%
Over 20 years	27%	41%	45%	48%	69%	73%
Upper limit for fixed interest rates	100%	100%	100%	100%	100%	100%
Upper limit for variable interest rates	20%	20%	20%	20%	20%	20%
Upper limit for investments > 365 days	£30m	£30m	£30m	£30m	£30m	£30m
Current treasury investments as at 31/12/2021 in excess of 1 year maturing in each year	-	-	-	-	-	-

Maturity Structure of borrowing Strategy

5.26 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.

Table 5.4: Maturity structure of borrowing

Maturity structure of fixed interest rate borrowing		
	Lower	Upper
Under 12 months	0%	30%
12 months to 2 years	0%	50%
2 years to 5 years	0%	60%
5 years to 10 years	0%	60%
10 years to 15 years	0%	60%
15 years to 20 years	0%	60%
20 years and above	0%	80%

Borrowing Strategy

5.27 The capital expenditure plans set out in tables 5.2 above, 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, ensuring that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities.

The table below summarises the council's forward projections for borrowing based on the assumptions given in tables 5.2 above.

Table 5.5: Estimated forward projections for borrowing

	2021/22 Estimate £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000	2025/26 Estimate £000	2026/27 Estimate £000
External Debt						
Debt as at 1 April	219,107	261,607	236,907	247,907	259,790	264,467
Expected change in debt	42,500	(24,700)	11,000	11,883	4,677	5,632
Other long-term liabilities	680	559	432	296	152	-
Actual gross debt as at 31 March	**262,287**	**237,466**	**248,338**	**260,086**	**264,619**	**270,099**
Capital Financing Requirement	321,823	328,248	323,122	315,941	314,205	312,571
Under/(Over) borrowing	**59,535**	**90,782**	**74,783**	**55,855**	**49,586**	**42,472**

N.B. Other long-term liabilities are any liabilities are other credit arrangements that are outstanding for periods in excess of 12 months e.g. finance leases.

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

5.29 The council has been well served by this policy over the last few years. The Section 151 Officer will continue to review and adopt a pragmatic approach to changing circumstances in order to avoid incurring higher borrowing costs in the future when interest rates may rise as set out below:

- If it is felt that there was a significant risk of a sharp FALL in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks 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 felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from sudden increase in inflation risks or impact of Covid 19 on the UK economy, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

Policy on borrowing in advance of need

5.30 CIPFA's Prudential Code paragraph allows borrowing in advance of need when changes in interest rates mean that it benefits the council to borrow before the planned expenditure is incurred. This will be considered carefully, and appropriate advice will be sought from the council's treasury management advisers.

5.31 Borrowing in advance of need from a treasury management perspective will be made within the following constraints:

- It will be limited to no more than 75% of the expected increase in borrowing need (CFR) over the three-year planning period; and
- The authority would not look to borrow more than 3 years in advance of need (current and next two financial years).

5.32 The risks associated with any advanced borrowing from a treasury management perspective will be subject to appraisal and will be reported via the mid-year or annual Treasury Management reports.

Debt rescheduling

5.33 As short-term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long-term debt to short-term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

5.34 Any rescheduling will take account of:

- The generation of cash savings and / or discounted cash flow savings;
- Helping to fulfil the treasury strategy;
- Enhancing the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

5.35 Although unlikely in the current interest rate environment, consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely, as short term rates on investments are currently lower than rates paid on existing debt.

UK Municipal Bond Agency (MBA)

5.36 It is possible that the MBA will be offering loans to local authorities in the future at rates expected to be lowered than offered by the PWLB. The Council may make use of this new source of borrowing as and when appropriate.

Minimum Revenue Provision Policy Statement

5.37 The proposed MRP Policy Statement is set out in Appendix 5.

5.38 The Council is required to pay off a proportion of the accumulated unfunded capital expenditure each year (capital financing requirement) through an annual revenue charge (the MRP). This includes MRP for commercial properties and other non-treasury investments financed by borrowing.

5.39 The Council overpaid £6.632m of MRP in previous years. This amount is being gradually released to the general fund revenue budget on a straight-line basis over the next 36 years.

5.40 It should be noted that it is not the council's policy to charge minimum revenue provision (MRP) on loans to third parties so long as there is no indication that the loan will not be repaid in full. All third-party loans will be reviewed annually with an assessment made of any MRP payments required.

5.41 Currently there is no requirement for the HRA to make MRP provisions, although a voluntary revenue provision will be considered as part of the full HRA business plan refresh planned for early 2022/23. This will provide a mechanism for the prudential repayment of debt over the life of the business plan. In the absence of a repayment mechanism debt could continue to be refinanced. However, continued right-to-buy sales will lead to a decrease in the number of properties available to generate the income necessary to continue to make interest repayments. Therefore, given the cumulative impact of increasing interest charges it is considered sensible to put in place a means of extinguishing both the capital and interest element of debt.

Investment Strategy

Investment and borrowing rates

5.42 The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives their central view and the subsequent narrative has been provided by the council's advisors.

5.43 PWLB forecasts shown below have taken into account the 20-basis point certainty rate reduction.

Table 5.6: Interest rate forecast as at December 2021

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

Source: *Link Asset Services – 20/12/21*

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

5.45 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%.

5.46 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 up 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.
- We also recognise there could be further nasty surprises on the Covid front beyond the Omicron mutation.
- Uncertainty over the impact if the UK invokes article 16 of the Brexit deal over the dislocation in trading arrangements with Northern Ireland.

5.47 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.

5.48 It should also be borne in mind that Bank Rate being cut to 0.25% and then to 0.10%, were emergency measures to deal with the Covid crisis hitting the UK in March 2020. At any time, the MPC could decide to simply take away such emergency cuts on no other grounds than they are no longer warranted, and as a step forward in the return to normalisation. In addition, any Bank Rate under 1% is both highly unusual and highly supportive of economic growth.

5.49 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.

5.50 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.

5.51 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.

Treasury investment policy

5.52 The council's treasury management investment policy has regard to DLUHC's Guidance on Local Government Investments ("the Guidance") and CIPFA's Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code") as well as the CIPFA Treasury Management Guidance Notes 2018. The Council's treasury management investment priorities will be Security first, Liquidity second, and then Yield.

5.53 All funds invested by the in-house treasury management team as part of the normal treasury management processes are made with reference to the cash flow requirements of the council and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Careful consideration will be given before investing sums identified for longer term investments.

Risk Assessment and Creditworthiness Policy

5.54 Management of risk is placed in high priority in accordance with the DLUHC and CIPFA Guidance. In order to minimise the risk to treasury investments, the council applies minimum acceptable credit criteria to generate a list of highly creditworthy counterparties which it maintains. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long term ratings.

5.55 Ratings will not be the sole determinant of the quality of an institution; the financial sector will be continuously monitored on both micro and macro basis and in relation to the economic and political environments in which these institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this, the council will engage with its advisors to watch the market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

5.56 Other information sources used will include the financial press, share price and other such information relating to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties. For local authority or related counterparties, the financial standing and other available information will be considered before placing investments.

5.57 Where applicable consideration will be given to the materiality of expected credit losses for treasury investments before they are used.

5.58 The counterparty list for treasury investments will be revised from time to time and submitted to council for approval as necessary.

5.59 In its selection process, the council will apply its approved minimum criteria to the lowest available rating for any institution. Credit rating information is supplied by Link Asset Services; the Council's treasury consultants. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list.

5.60 Any rating changes, rating watches (notification of a possible change), rating outlooks (notification of a possible longer-term change) are provided to officers almost immediately after they occur and this information is considered before dealing. Where a credit rating agency announces that a rating is on review for possible downgrade so that it may fall below the approved rating criteria, then no investments other than existing will be made with that organisation until the outcome of the review is announced.

5.61 The list of types of investment instruments that the treasury management team are authorised to use are categorised as specified and non- specified investments.

- **Specified investments** that the Council will use are high security and high liquidity investments in sterling and with a maturity of no more than a year.
- **Non-specified investments** are high security, high credit quality, in some cases more complex instruments for periods in excess of one year.

5.62 The council will consider the use of new investment instruments after careful consideration by officers and approval by council.

5.63 While all investments will be denominated in sterling, investments will only be placed with counterparties from countries with a specified minimum sovereign rating in table 5.8.

5.64 Lending and transaction limits for each counterparty will be set in the Treasury Management Principles (TMPs) through applying the matrix table 5.7 below.

Table 5.7: specified and non-specified investment approved instruments and limits

<table>
<tr><th rowspan="2">Counterparty/Financial instrument</th><th rowspan="2">Minimum Credit Criteria or Equivalent</th><th colspan="2">Specified Investments</th><th colspan="2">Non specified Investments</th></tr>
<tr><th>Maximum duration</th><th>Counterparty Limit (£m)</th><th>Maximum duration</th><th>Counterparty Limit (£m)</th></tr>
<tr><td>DMAF UK Government</td><td>n/a</td><td>3 months</td><td>£30m</td><td>n/a</td><td>n/a</td></tr>
<tr><td>UK Government gilts</td><td>UK Sovereign rating</td><td>12 months</td><td>£15m</td><td>3 years</td><td>£5m</td></tr>
<tr><td>UK Government Treasury bills</td><td>UK Sovereign rating</td><td>6 months</td><td>£10m</td><td>n/a</td><td>n/a</td></tr>
<tr><td>Money Market Funds CNAV</td><td>AAA</td><td rowspan="3">Liquid</td><td rowspan="3">£10m per fund £25m overall limit</td><td>n/a</td><td>n/a</td></tr>
<tr><td>Money MARKET Funds LVNAV</td><td>AAA</td><td>n/a</td><td>n/a</td></tr>
<tr><td>Money Market Funds VNAV*</td><td>AAA</td><td>n/a</td><td>n/a</td></tr>
<tr><td>UK Local Authority term deposits (LA)**</td><td>n/a</td><td>12 months</td><td>£13m per LA</td><td>5 years</td><td>£5m per LA</td></tr>
<tr><td>Term Deposits with UK Building Societies</td><td>ratings for banks outlined below / Asset worth at least £2.5bn or both</td><td>12 months</td><td>£5m</td><td>n/a</td><td>n/a</td></tr>
<tr><td>Banks (Term deposits, CD, Call & Notice accounts)</td><td>AAA</td><td>12 months</td><td>£20m</td><td>2 years</td><td>£10m</td></tr>
<tr><td rowspan="2">Banks (Term deposits, CD, Call & Notice accounts)</td><td>AA+</td><td rowspan="2">12 months</td><td rowspan="2">£17m</td><td rowspan="2">12 months</td><td rowspan="2">£5m</td></tr>
<tr><td>AA</td></tr>
<tr><td rowspan="3">Banks (Term deposits, CD, Call & Notice accounts)</td><td>AA-</td><td rowspan="3">12 months</td><td rowspan="3">£10m</td><td rowspan="3">n/a</td><td rowspan="3">n/a</td></tr>
<tr><td>A+</td></tr>
<tr><td>A</td></tr>
<tr><td>Banks (Term deposits, CD, Call & Notice accounts)</td><td>A-</td><td>6 months</td><td>£5m</td><td>n/a</td><td>n/a</td></tr>
</table>

Counterparty/Financial instrument	Minimum Credit Criteria or Equivalent	Specified Investments		Non specified Investments	
		Maximum duration	Counterparty Limit (£m)	Maximum duration	Counterparty Limit (£m)
Property Funds	Credit loss analysis, financial and legal due diligence	n/a	n/a	n/a	£5m per fund
Loan Capital and other third party loans including parish councils	Subject to financial & legal due diligence	considered on individual basis	n/a	considered on individual basis	n/a

* Specialist advice will be obtained before the use of VNAV money market funds
** Local authorities will reviewed in line with CIPFA suggested indicators

5.65 Table 5.6 incorporates several increases to the specified investment counterparty limits compared to the 2021/22 Treasury Management Strategy. This decision has been taken in light of the increased cash balances being held by the authority as a result of way Covid-19 grants and reliefs are being funded. The increases have been applied to the lowest credit risk investments and will ensure the council has sufficient capacity to manage its current investments in a secure way. The following increases have been applied:

- Increase in specified investments with AAA rated banks (Term Deposits, CD, Call & Notice accounts) from £15m to £20m (maximum duration 12 months);
- Increase in specified investments with AA+ and AA rated banks (Term Deposits, CD, Call & Notice accounts) from £15m to £17m (maximum duration 12 months);
- Increase in specified investments with UK Local Authority term deposits from £10m to £13m (maximum duration 12 months).

5.66 The identification and rationale supporting the selection of these investments, the maximum limits and monetary limits to be applied are set out in table 5.7 below.

5.67 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.

Sovereign limits

5.68 Alongside changes in banking regulations which are focused on improving the banking sectors resilience to financial and economic stress, due care will be taken to consider the country, group and sector exposure of the Council's investments.

5.69 The Council will only use approved counterparties from the UK and countries with a sovereign credit rating from the three main rating agencies equal to or above AA-. In addition:

- No more than 20% will be placed with any non-UK country at any time and would always be sterling investments
- Sector limits will be monitored regularly for appropriateness.

5.70 Due to COVID, it is possible that credit rating agencies could downgrade the sovereign rating for the UK from the current level of AA-. However, if credit rating agencies downgrade the UK below AA- (the minimum Sovereign rating for 2022/23), the council will immediately seek advice from its treasury adviser and report to cabinet at the earliest possible reporting date.

Table 5.8: Sovereign rating for 2022/23

AAA	Sweden	**AA**
Australia	Switzerland	Abu Dhabi (UAE)
Denmark		France
Germany	**AA+**	**AA-**
Luxembourg	Canada	Belgium
Netherlands	Finland	Hong Kong
Norway	USA	Qatar
Singapore		U.K.

Bank of England iteration UK bank stress tests

5.71 In addition to the use of credit ratings provided by the three main rating agencies the other factors identified in paragraphs 5.55 and 5.56 will be taken into consideration when selecting UK banks.

Money Market Funds (MMFs)

5.72 Money market funds are pooled investment vehicles consisting of instruments similar to those used by the council. They have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager and analyst team. Fees are deducted from the interest paid to the council.

Building societies

5.73 Although the regulation of building societies is no longer any different to that of banks, the council may use building societies which have a minimum asset size of £2bn but will restrict these types of investments to fixed deposits subject to lower cash limit and shorter time limit.

Current account banking

5.74 The council's current accounts are held with Barclays Bank UK Plc (Ring Fenced Bank RFB). In the event of the credit rating of Barclays Bank UK Plc (RFB) falling to a point lower than the council's minimum credit criteria of A- long term rating, the council will treat its bank as "high credit quality" for the purpose of making investments that can be withdrawn on the next working day.

UK banks – ring fencing

5.75 The council will continue to assess any newly formed entities against existing criteria and those with sufficiently high ratings will be considered for investment purposes.

Investment risk benchmarking

5.76 These benchmarks are simple guides to maximum risk, so they may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the mid-year or annual Treasury Management report.

5.77 **Security benchmark** – Counterparty risk will increase as duration of investment increases. The council will continue its policy of investing the majority of its investments with duration of less than 12 months. The council's maximum security risk benchmark for the current portfolio, when compared to the historic default tables is 0.04%. This benchmark is an average risk of default measure and would not constitute an expectation of loss against a particular investment.

5.78 **Liquidity** – in respect of this area the council seeks to maintain:

- Bank overdraft – zero balance
- Liquid short-term deposits of at least £1m available with a week's notice.
- Weighted average life benchmark is expected to be 0.50 years, with a maximum of 1.00 year. However, this benchmark may change if the Council decides to invest longer than 12 months.

5.79 **Yield** - local measures of yield benchmarks are:

- Investments – internal returns above the 7-day SONIA (Sterling Overnight Index Average) rate.

Ethical investment

5.80 The council will not knowingly invest directly in businesses whose activities and practices pose a risk of serious harm to individuals or groups, or whose activities are inconsistent with the council's mission and values.

5.81 This applies to direct treasury investment only. The council's normal money market activity would usually be with financial institutions which may have unknown indirect links with companies which the council will be unable to monitor. However, where known links are publicly available the council will not knowingly invest.

Policy on charging interest to the Housing Revenue Account (HRA)

5.82 Following the reform of housing finance, the council can adopt its own policy on sharing interest costs and income between the General Fund (GF) and the Housing Revenue Account (HRA).

5.83 The CIPFA Code recommends that authorities state their policy on this matter each year in their treasury management strategy. The charge is required to be fair to the general fund and to the HRA. This council's policy is to charge the HRA with an element of any under-borrowing or surplus cash at the Council's pooled borrowing/investment rates.

Policy on use of financial derivatives

5.84 The council will not use standalone derivatives except where they can be clearly demonstrated to reduce the overall level of financial risk that the council is exposed to.

Regulatory Changes

5.85 CIPFA has recently issued revised versions of the Treasury Management Code and its associated guidance, which in themselves interact closely with an updated Prudential Code for capital finance, governing local authority capital investment and borrowing activities.

5.86 CIPFA published the revised codes on 20th December 2021 and has stated that formal adoption is not required until the 2023/24 financial year. The Council has to 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.

5.87 The revised codes will have the following implications:

- a requirement for the Council to adopt a new debt liability benchmark treasury indicator to support the financing risk management of the capital financing requirement;
- clarity on what CIPFA expects a local authority to borrow for and what they do not view as appropriate. This includes the requirement to set a proportionate approach to commercial and service capital investment;
- address ESG issues within the Capital Strategy;
- a requirement to consider annually its commercial property investments, if it intends to have a borrowing need, and to consider the risks and benefits of continuing to hols such investments against the option to divest and realise capital receipts to pay down debt or reduce future borrowing needs;
- create new Investment Practices to manage risks associated with non-treasury investment (similar to the current Treasury Management Practices);
- ensure 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 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 council;
- a new requirement to clarify reporting requirements for service and commercial investment, (especially where supported by borrowing/leverage).

5.88 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.

APPENDIX 5: Minimum Revenue Provision (MRP) policy statement

For capital expenditure incurred:

(A) From 1st April 2008 for all unsupported borrowing (excluding finance leases) the MRP policy will be to; charge MRP on an annuity basis (using the prevailing rate of interest at the time) so that there is provision for the full repayment of debt over 50 years; Asset life is deemed to begin once the asset becomes operational. MRP will commence from the financial year following the one in which the asset becomes operational.

(B) 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 statutory guidance.

(C) Expenditure in respect of loans made to third parties will not be subject to a minimum revenue provision as the Council will have undertaken sufficient due diligence to expect these loans will be repaid in full to the Council by a capital receipt either during the loan agreement term or at the end of the agreement. Therefore, the Council considers that it can take a prudent view that the debt will be repaid in full at the end of the loan agreement (or during if it is an instalment loan), so MRP in addition to the loan debt repayments is not necessary. Each loan will be reviewed on an annual basis to ensure that is no change in the expectation that there will be a full repayment of the loan. If, upon review, this is no longer found to be the case then a minimum revenue provision will be made over a prudent timeframe to cover the potential non-repayment of part, or all of the loan balance.

This is subject to the following details:

1) An average asset life for each project will normally be used. There will not be separate MRP schedules for the components of a building (e.g. plant, roof etc.). The asset life will be determined by the Chief Finance Officer based on the standard schedule of asset lives provided by an appropriately qualified asset valuer will generally be used (as stated in the Statement of Accounts accounting policies).

2) MRP will commence in the year following the year in which capital expenditure financed from borrowing is incurred, except for single assets when expenditure is being financed from borrowing the MRP will be deferred until the year after the asset becomes operational.

3) Other methods to provide for debt repayment may occasionally be used in individual cases where this is consistent with the statutory duty to be prudent, as justified by the circumstances of the case. Where this is the case, the chief finance officer will first seek approval from Full Council.

4) There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made.

5) Repayments included in annual finance leases are excluded from MRP as they are deemed to be a proxy for MRP.