Prudential Indicators and Treasury Management and Investment Strategy 2023/24 – 2026/27

1. Purpose of the Report

1.1 To seek approval of the Treasury Management Strategy and the Investment Strategy.

2. Background

2.1 The Local Government Act 2003 and supporting regulations require the Council to ‘have regard to’ the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice and prepare, set and publish prudential indicators and treasury indicators that ensure the Council’s capital expenditure plans are affordable, prudent and sustainable in the long-term.

2.2 The prudential indicators consider the affordability and impact of capital expenditure plans and set out the Council’s overall capital framework. Each prudential indicator either summarises the expected activity or introduces limits upon the activity and reflects the underlying capital programme.

2.3 Within the overall prudential framework there is a clear impact on the Council’s treasury management activity, either through borrowing or investment activity. As a consequence, a Treasury Management Strategy is prepared which considers the effective funding of the capital expenditure decisions and complements the prudential indicators.

2.4 The Council is required to operate a balanced revenue 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.

2.5 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.

2.6 This means that increases in capital expenditure must be limited to a level whereby charges to revenue remain affordable within the projected income of the Council for the foreseeable future. These increased charges may arise from:

- increases in interest charges and debt repayments caused by increased borrowing to finance additional capital expenditure; and
- any increases in operational running costs from new capital projects.

2.7 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 authority'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."

2.8 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.

2.9 The Council's treasury activities are strictly regulated by statutory requirements and guidance, including;

- CIPFA Treasury Management Code
- CIPFA Prudential Code
- DLUHC Investment Guidance
- DLUHC Minimum Revenue Provision (MRP) Guidance

2.10 The Council's Constitution (via Financial and Procurement Procedure Rules) requires the annual Treasury Management Strategy to be reported to Council outlining the expected treasury activity for the forthcoming 3 years. A key requirement of this report is to explain both the risks, and the management of the risks, associated with the treasury service. As a minimum a mid-year monitoring report is produced with a further report produced after the year-end to report on actual activity for the year.

2.11 Reports on Treasury matters are also required to be adequately scrutinised before being recommended to the Council and this role is undertaken by Audit Committee.

3. Key Issues

Overview

3.1 The Council's 2023/24 Prudential Indicators and Treasury Management Strategy was approved by Council on 1 March 2023, whilst a Mid-Year report which updated the 2023/24 approved indicators was considered by Audit Committee on the 28 November 2023. This report provides an update for the period 2023/24 to 2026/27.

3.2 The Treasury Management Strategy (including the Investment Strategy) is detailed in Sections 5 and 6. Supporting detail is provided in Section 4, of the key elements of the Council's Capital Expenditure Plans and associated Prudential Indicators. The Treasury the Appendices.

3.3 The Treasury Management Strategy has been drawn up taking account of advice from the Council's treasury management advisors, Link Treasury Services Ltd.

3.4 This is a technical and complex report however the key messages are:

- **Investments** – the primary governing principle will remain security over return and the criteria for selecting counterparties reflect this.

- **Borrowing** – The Council will maintain its strategy of being under-borrowed against the capital financing requirement. The Council borrowed £227m of long term PWLB funds during 2021/22 to take advantage of the low PWLB interest rates available at the time (average 1.53% interest rate). This was replacing short-term borrowing as it matured.

  Since the mid-year report presented to Audit Committee in November 2023 the Council has borrowed £25m from the South Yorkshire Mayoral Combined Authority and further borrowing is expected to be required before the end of the financial year. As previously reported, the Council will predominantly adopt a short-term borrowing strategy to cover borrowing need in anticipation of lower interest rates in the medium term to long term.

  There is also discounted rate with the PWLB for borrowing long term funds specifically for HRA purposes which is available until June 2025. Depending on the prevailing interest rate position the Council may utilise this rate for some HRA long term borrowing.

- **Governance** – strategies and risk are reviewed by the Audit Committee with continuous monitoring which includes the Mid-Year and Year End reporting.

- Whilst the Council's approach to Treasury Management in recent years, utilising short term borrowing in particular, has generated significant savings for the Council, essential to achieving balanced budgets, the future outlook is more challenging. With increased interest rates for borrowing, as a result of the increases in the Bank of England Base Rate, when the Council does need to borrow, it will be at much higher levels than had previously been assumed in the Council's approved Medium Term Financial Strategy. The increases in borrowing rates could not have been projected by the Council and work is underway to plan how the Council can best navigate through the current challenges presented by the financial markets. It should be noted that it is expected that borrowing rates have now peaked and will reduce over the next couple of years, linked to the projections that inflation will return back to the Bank of England's target 2% level.

The current 50 year PWLB borrowing level is 5.11%. Short term borrowing is available for 5.6% for 6 months. The Council keeps interest rates under constant review along with its borrowing strategies and decisions on the mix of long-term and short-term borrowing.

Reporting Requirements

3.5 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. The **Prudential and Treasury Indicators and Treasury Strategy** is reported to and approved by Council, the **Annual Treasury Report** & **Mid-Year Treasury Management Report** are presented to Audit Committee, with the former being referred onto Council.

a. **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)

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

c. **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.

<u>Treasury Management Strategy for 2024/25</u>

3.6 The strategy for 2024/25 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

3.7 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.

<u>Training</u>

3.8 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. Training will be arranged with the Council's treasury advisors Link for Members of the Audit Committee.

3.9 The Code states that it is expected that 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.

3.10 The council is required to record attendance at training and prepare learning plans for treasury management officers, board/Council members.

3.11 A formal record of the training received by officers central to the Treasury function will be maintained by the Treasury Manager. Similarly, a formal record of the treasury management/capital finance training received by Members will also be maintained by the Finance Manager responsible for Treasury Management.

Treasury Management Consultants

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

3.13 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.

3.14 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.

3.15 The company provides a range of services which include:

- Technical support on treasury matters, capital finance issues and the drafting of Member reports;
- Economic and interest rate analysis;
- Debt services which includes advice on the timing of borrowing;
- Debt rescheduling advice surrounding the existing portfolio;
- Generic investment advice on interest rates, timing and investment instruments; and,
- Credit rating/market information service comprising the three main credit rating agencies.

4. THE CAPITAL PRUDENTIAL INDICATORS 2023/24 – 2026/27

4.1 The Council's capital expenditure plans are summarised below and form the first of the prudential indicators. A certain level of capital expenditure is grant supported by the Government; any decisions by the Council to spend above this level will be considered unsupported capital expenditure. This unsupported capital expenditure needs to have regard to:

- Service objectives (e.g. strategic planning);
- Stewardship of assets (e.g. asset management planning);
- Value for money (e.g. option appraisal)
- Prudence and sustainability (e.g. implications for external borrowing and whole life costing);
- Affordability (e.g. implications for the council tax and rents)
- Practicality (e.g. the achievability of the Capital Programme).

4.2 The revenue consequences of capital expenditure, particularly the unsupported expenditure, will need to be paid for from the Council's own revenue resources.

4.3 This capital expenditure can be paid for immediately (by applying capital resources such as capital receipts, capital grants etc., or revenue resources), but if these resources are insufficient any residual expenditure will add to the Council's borrowing need.

4.4 The key risks to the plans are that the level of Government support has been estimated and is therefore subject to change. Similarly, some of the estimates for other sources of funding, such as capital receipts, may also be subject to change over this timescale. For example, anticipated asset sales resulting from the Council's on-going asset rationalisation programme may be deferred due to the on-going impact of the current economic & financial conditions on the property market.

4.5 The revised capital expenditure plans in the updated Capital Strategy and Capital Programme being presented within this report, are summarised in the table below.

4.6 It should be noted that these represent the capital investment forecasts under traditional forms of financing and excludes assets acquired under PFI and finance lease arrangements which are a type of borrowing but which are budgeted for separately outside of the capital financing budget.

4.7 With regards to the Council's capital spending plans, the Council will need to closely consider the level of prudential borrowing it incurs moving forwards post the 2024/25 Budget to ensure that the Council's overall debt position is manageable, can be sustainably financed within the Council's Treasury Management Budgets (revenue) and to help guard against interest rate risk.

Capital Expenditure and Financing

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

Capital expenditure £m	**2023/24 Estimate**	**2024/25 Estimate**	**2025/26 Estimate**	**2026/27 Estimate**
Children and Young People's Services	6.760	9.955	17.719	6.360
Assistant Chief Executive	0.345	0.210	0.210	0.210
Adult Care & Housing	5.722	20.893	5.427	4.827
Finance and Customer Services	3.976	5.143	21.300	3.559
Regeneration and Environment	94.847	143.472	59.572	14.420
Total Non-HRA	**111.651**	**179.674**	**104.228**	**29.376**
HRA	40.736	65.601	35.268	30.321
Total HRA	**40.736**	**65.601**	**35.268**	**30.321**
Total expenditure	**152.387**	**245.275**	**139.496**	**59.697**

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

4.10 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.

Financing of capital expenditure £m	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate
Capital receipts	4.866	8.430	1.095	0.206
Capital grants, capital contributions & other capital funding sources	81.544	130.471	77.500	39.893
Prudential borrowing requirement for the year	**65.977**	**106.374**	**60.901**	**19.598**

<u>The Council's Borrowing Need (the Capital Financing Requirement)</u>

4.11 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.

4.12 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. Therefore, in order to reduce the CFR the Council would need to have a planned MRP charge that is greater than the level of borrowing incurred in that year (as demonstrated in the table below 2026/27).

4.13 The CFR includes any other long-term liabilities (e.g., PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of schemes include a borrowing facility by the PFI, PPP lease provider and so the Council is not required to separately borrow for these schemes. The Council currently has £112m of such schemes within the CFR.

4.14 The Council is asked to approve the CFR projections below:

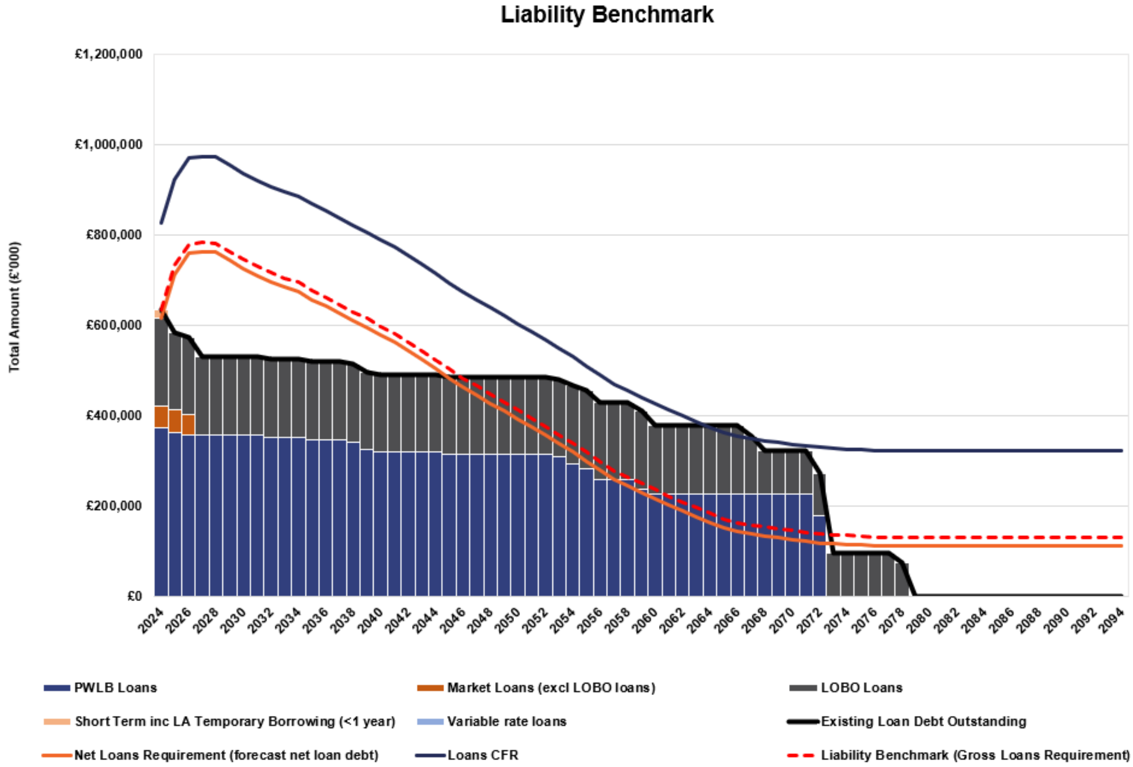
£m	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate
Capital Financing Requirement				
CFR – General Fund	631.061	708.001	745.985	741.572
CFR - HRA	307.608	324.575	329.511	329.511

Total CFR	**938.669**	**1032.576**	**1075.496**	**1071.083**
Movement in CFR	**55.995**	**93.908**	**42.920**	**-4.412**
				Of which:
CFR – Capital investment	825.865	923.387	970.658	971.582
OLTL	112.804	109.189	104.838	99.501
Movement in CFR represented by				
Prudential borrowing requirement for the year (table above)	65.977	105.374	60.901	19.598
Net financing need for the year for OLTL	-4.079	-3.615	-4.351	-5.336
Less MRP and other financing movements	-5.903	-8.851	-13.630	-18.675
Movement in CFR	**55.995**	**93.908**	**42.920**	**-4.412**

Liability Benchmark

4.15 The Council is required to estimate and measure the Liability Benchmark (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.



4.16 Any years where actual loans are less than the benchmark indicate a future borrowing requirement; any years where actual loans outstanding exceed the benchmark represent an overborrowed position, which will result in excess cash requiring investment.

4.17 The index shows that in the short to medium term the net loans requirement exceeds the existing debt so borrowing will be required to finance capital expenditure. In 2045 the level of loans exceeds the gross loan requirement which results in a cash balance to invest. This index is based on the current 5 year capital programme. In reality it is likely that further borrowing will be required to fund the capital programme beyond this 4 year time horizon and the actual loan requirement will be greater than shown on the index.

Minimum Revenue Provision (MRP) Policy Statement

4.18 Under Regulation 27 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, where the Council has financed capital expenditure by borrowing it is required to make a provision each year through a revenue charge (MRP). Repayments included in annual PFI charges or finance lease payments are also applied as MRP. No MRP charge is currently required for the HRA. The HRA charges depreciation on its assets, which is a revenue charge.

4.19 The Council is required to calculate a prudent provision of MRP which ensures that the outstanding debt liability is repaid over a period that is reasonably commensurate with that over which the capital expenditure provides benefits.

The MRP Guidance (2018) gives four ready-made options for calculating MRP, but the Council can use any other reasonable basis that it can justify as prudent.

4.20 The Strategic Director of Finance & Customer Services will, where it is prudent to do so, use discretion to review the overall financing of the capital programme and the opportunities afforded by the regulations to maximise the benefit to the Council whilst ensuring it meets its duty to charge a ‘prudent’ provision. To provide maximum flexibility the recommended MRP policy includes the use of the annuity method and the equal instalments method.

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

4.22 The Council is recommended to approve the following MRP Statement:

a) The MRP charge in relation to capital expenditure incurred prior to 2007/08 where the expenditure was funded by either supported or unsupported borrowing will be calculated using the expected useful life of the asset and the calculation of the provision will be by the annuity method;
b) The MRP charge in relation to capital expenditure incurred since 2007/08 where the expenditure is funded by either supported or unsupported borrowing will be calculated using the expected useful life of the asset at the point the asset is brought into use. The calculation of the provision will be either the annuity method or the equal instalments method depending on which is most appropriate; and
c) The MRP charge in relation to capital expenditure incurred since 2007/08 where the expenditure is funded by a ‘capitalisation directive’ (e.g. equal pay) will be calculated on the basis of the specified period(s) set down within the regulations. The calculation of the provision will be either the annuity method or the equal instalments method depending on which is most appropriate.
d) For the sake of clarity, where MRP has been overcharged in previous years, the recovery of the overcharge will be affected by taking an MRP holiday in full or in part against future years charges that would otherwise have been made. The MRP holiday adjustment to the future years charge will be done in such a way as to ensure that:
    - the total MRP after applying the adjustment will not be less than zero in any financial year
    - the cumulative amount adjusted for will never exceed the amount over-charged;
    - the extent of the adjustment will be reviewed on an annual basis

In order to meet the requirement to make an annual, prudent repayment of debt, the Council may use prior year capital receipts to pay down debt, reducing the level of MRP charged to revenue. This policy has been factored into the planned capital programme and management of capital programme resources.

5. Borrowing Strategy

5.1 The capital expenditure plans set out in Section 3 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.

Current Portfolio Position

5.2 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.

£m	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate
External Debt				
Debt at 1 April	653.670	731.912	797.889	903.500
Expected change in Debt	78.242	65.977	105.611	60.901
Other long-term liabilities (OLTL)	116.883	112.804	109.189	104.838
Expected change in OLTL	-4.079	-3.615	-4.351	-5.337
Actual gross debt at 31 March	**844.716**	**907.078**	**1008.338**	**1063.902**
The Capital Financing Requirement	938.668	1,031.812	1,074.732	1,070.319
Under / (over) borrowing	93.952	124.734	66.394	6.417

5.3 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 2024/25 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.

5.4 The Strategic Director of Finance & Customer Services 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.

Treasury Indicators: Limits to Borrowing Activity

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

Operational Boundary £m	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate
Debt	761.912	827.889	934.263	985.164
Other long-term liabilities	112.804	109.189	104.838	99.501
Total	**874.716**	**937.078**	**1,039.101**	**1,084.665**

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

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

Authorised Limit £m	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate
Debt	845.864	942.623	989.894	990.818
Other long-term liabilities	115.060	111.373	106.935	101.491
Total	**960.924**	**1,053.996**	**1,096.829**	**1,092.309**

5.7 Under IFRS16 the Council is required from 2024/25 to recognise on balance sheet for the first time certain assets held under operating or peppercorn leases. The precise value of these arrangements has not yet been determined but current indications are that the additional liabilities can be accommodated within the total 2024/25 operational boundary and authorised limit above. These prudential indicators are revisited annually and therefore can be updated for future periods if IFRS16 adjustments require. It is worth highlighting that the changes under IFRS16 have an impact on the Council's financial reporting of liabilities but will not require the council to undertake any additional borrowing.

Expected Movement in Interest Rates

5.8 The Council's treasury advisors Link now expect the MPC will keep Bank Rate at 5.25% for the remainder of 2023 and the first half of 2024 to combat on-going inflationary and wage pressures. Their expectation is that the MPC will not increase Bank Rate above 5.25%, but it is possible.

Gilt yields and PWLB rates

5.9 The overall longer-run trend is for gilt yields and PWLB rates to fall back over the medium term, as inflation starts to fall through the remainder of 2023 and into 2024.

Borrowing Strategy

5.10 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 remains elevated through to the second half of 2024.

5.11 Against this background and the risks within the economic forecast, caution will be adopted with the 2024/25 treasury operations. The Strategic Director of Finance & Customer Services, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast above.

5.12 While short term borrowing provides lower cost opportunities in the short to medium term, in a rising interest rate environment it can be advantageous to lock in long term borrowing. In the current situation where interest rates are forecast to fall in the medium term it is advantageous to defer long term borrowing and utilise short term borrowing. Subsequently locking in long term borrowing when rates are lower.

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

Policy on Borrowing in Advance of Need

5.14 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.

5.15 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.

Rescheduling

5.16 Rescheduling of current borrowing in our debt portfolio may be considered whilst premature redemption rates remain elevated but only if there is surplus cash available to facilitate any repayment, or rebalancing of the portfolio to provide more certainty is considered appropriate.

5.17 The reasons for any rescheduling to take place will include:

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

6. ANNUAL INVESTMENT STRATEGY

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

- The guidelines for investment decision making, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which investments can be made.
- The specified investments the Council may use.
- The non-specified investments the Council may use.

6.2 This strategy is to be approved by Council. The investment policy proposed for the Council is detailed in the following paragraphs.

Investment Policy – Management of Risk

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

6.4 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

6.5 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.

Creditworthiness Policy

6.6 The primary principle governing the Council’s investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that: -

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and
- It has sufficient liquidity in its investments. For this purpose, it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council’s prudential indicators covering the maximum principal sums invested.

6.7 The Strategic Director of Finance & Customer Services will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

6.8 Credit rating information is supplied by Link Group, our treasury advisors, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating Watches (notification of a likely change), rating Outlooks (notification of the longer-term bias outside the central rating view) are provided to officers almost immediately after they occur, and this information is considered before dealing. For instance, a negative rating Watch applying to a counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.

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

- **Banks** - The Council will use banks which are rated by at least two rating agencies and have at least the following Fitch, Moody’s and Standard and Poors’ ratings (where rated):

	Fitch	Moody's	Standards & Poor's
Short-term	**F1**	**P-1**	**A-1**
Long-term	**A-**	**A3**	**A-**

- To allow for the day to day management of the Council's cash flow the Council's bankers will also be retained on the list of counterparties if ratings fall below the above minimum criteria.
- **Building societies** - the Council will use the top 20 Building Societies ranked by asset size but restricted to a maximum of 20% of the investment portfolio
- **Money Market Funds (MMFs) (CNAV or LVNAV)** – restricted to a maximum investment of £20m per fund. The Council works with its specialist Treasury Advisors to review and select appropriate MMF's to ensure that those selected are AAA rated and therefore highly secure, with cash available for withdrawal each day, therefore these are very low risk accounts.
- **UK Government** – Debt Management Office
- **UK Local Authorities**

6.10 A limit of 35% will be applied to the use of Non-Specified investments within the investment portfolio, excluding day to day cash management through the Council's own bank.

6.11 Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market and sovereign information will continue to be applied before making any specific investment decision from the agreed portfolio of counterparties.

6.12 The time and monetary limits for institutions on the Council's Counterparty List are as follows (these will cover both Specified and Non-Specified Investments):

	Fitch	Moody's	Standard & Poor's	Money Limit	Time Limit
Upper Limit Category	**F1+/AA-**	**P-1/Aa3**	**A-1+/AA-**	**£20m**	**5 years**
Middle Limit Category	**F1/A-**	**P-1/A3**	**A-1/A-**	**£10m**	**364 days**
Lower Limit Category *	**All Building Soc's ranked 1 to 10 All Building Soc's ranked 11 to 20**			**£5m £1m**	**6 mths 3 mths**
Debt Management Office	**-**	**-**	**-**	**Unlimited ****	**6 months**
Money Market Funds	**-**	**-**	**-**	**£20m**	**n/a**

UK LA's	**-**	**-**	**-**	**£20m**	**5 years**
Council's Bankers	**-**	**-**	**-**	**£20m*** **	**364 days**
The above money limits are exclusive of bank balances held by schools * Based on maximum of 20% of the investment portfolio ** Provides maximum flexibility *** There may be occasions where the Council has to exceed this limit, where government issues out significant grant funding, such as Covid Business Grants and the Council is unable to invest those resources within the options available on the day. This risk is mitigated by daily review of the cashflow forecast, however, the volume of government funding issued during the pandemic has been significant.					

The proposed criteria for specified and non-specified investments are shown in Appendix C for approval.

Investment Strategy

6.13 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 having peaked in the second half of 2023 and possibly reducing as early as the second half of 2024 so an agile investment strategy would be appropriate to optimise returns.

6.14 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.

6.15 The current forecast shown in paragraph 3.3, includes a forecast for Bank Rate to have peaked at 5.25% in Q4 2023.

6.16 The Council's Treasury advisor's current forecast 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	Average Interest Rate
2023/24 (residual)	5.30%
2024/25	4.70%
2025/26	3.20%

2026/27	3.00%
2027/28	3.25%
Years 6 to 10	3.25%
Years 10+	3.25%

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

6.18 For its cash flow generated balances, the Council will seek to utilise its Money Market Funds and short-dated deposits, in order to benefit from the compounding of interest.

6.19 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.

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

Upper limit for principal sums invested for longer than 365 days			
£m	**2024/25**	**2025/26**	**2026/27**
Principal sums invested for longer than 365 days	£m 10	£m 8	£m 6

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

6.21 These benchmarks are already intrinsic to the approved treasury strategy through the counterparty selection criteria and some of the prudential indicators, e.g. the maximum funds which may be invested for more than 364 days, the limit on the use of non-specified investments, etc.

6.22 Security – Security is currently evidenced by the application of minimum criteria to investment counterparties, primarily through the use of credit ratings supplied by the three main credit rating agencies. Whilst this approach embodies security considerations, benchmarking the levels of risk is more subjective and therefore problematic.

6.23 One method to benchmark security risk is to assess the historic level of default against the minimum criteria used in the Council's investment strategy. The default rates are little changed from last year.

Credit Rating	1 year	2 years	3 years	4 years	5 years
AAA	0.04%	0.09%	0.16%	0.25%	0.34%
AA	0.02%	0.04%	0.09%	0.16%	0.22%
A	0.05%	0.13%	0.24%	0.36%	0.50%
BBB	0.14%	0.38%	0.65%	0.97%	1.29%

6.24 The Council's minimum long term rating criteria (over one year) is "AAA" meaning the average expectation of default for a three year investment in a counterparty with a "AAA" long term rating would be 0.16% of the total investment (e.g. for a £1m investment the average potential loss would be £1,600).

6.25 The Council's minimum long term rating criteria (up to one year) is "BBB" and the average expectation of default for such an investment would be 0.14% (e.g. for a £1m investment the average loss would be £1,400).

6.26 These are only averages but do act as a benchmark for risk across the investment portfolio.

6.27 The Council's maximum security risk benchmark for the estimated maximum portfolio during 2023/24 is 0.063% which means that for every £1m invested the average potential loss would be £630. This position remains largely unchanged from 2022/23 (benchmark was 0.060% or £600).

Policy on Environmental, Social and Governance (ESG) considerations

6.28 This Council is supportive of the Principles for Responsible Investment (www.unpri.org) and will seek to bring ESG (environmental, social and governance) factors into the decision-making process for investments. Within this, the Council is also appreciative of the statement on ESG in Credit Risk and Ratings which commits signatories to incorporating ESG into credit ratings and analysis in a systemic and transparent way. The Council uses ratings from Fitch, Moody's and Standard & Poor's to support its assessment of suitable counterparties. Each of these rating agencies is a signatory to the ESG in credit risk and ratings statement.

6.29 For short term investments with counterparties, this Council utilises the ratings provided by Fitch, Moody's and Standard & Poor's to assess creditworthiness, which do include analysis of ESG factors when assigning ratings. The Council will continue to evaluate additional ESG-related metrics and assessment processes that it could incorporate into its investment process and will update accordingly.

Liquidity

6.30 This is defined as “having adequate, though not excessive cash resources, borrowing arrangements, overdrafts or standby facilities to enable the Council at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives” (CIPFA Treasury Management Code of Practice). The Council seeks to maintain:

- Liquid, short term deposits of at least £6m available with a week’s notice.

6.31 The availability of liquidity and the inherent risks arising from the investment periods within the portfolio is monitored using the Weighted Average Life (WAL) of the portfolio. This measures the time period over which half the investment portfolio would have matured and become liquid

6.32 A shorter WAL generally represents less risk and in this respect the benchmark to be used for 2023/24 is:

- 0.25 years which means that at any point in time half the investment portfolio would be available within 90 days.

Yield

6.33 These benchmarks are currently widely used to assess investment performance and the Council’s local measure of yield is:

- Internal returns above the Sterling Overnight Index Average (SONIA) which has replaced the London Interbank Bid rate (LIBID).

End of Year Investment Report

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

APPENDICES

A. Prudential and treasury indicators

B. Economic background

C. Treasury management practice 1 – credit and counterparty risk management

Appendix A

THE CAPITAL PRUDENTIAL AND TREASURY INDICATORS 2024/25 – 2026/27

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.

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.

%	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate
Non-HRA	10.11	12.66	15.48	17.07
HRA	15.95	13.70	13.11	12.85

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

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 borrowing 2024/25				
	Indicator		Current position	
	Lower	Upper	%	£m
Under 12 months	0%	50%	4.86%	30.223
12 months to 2 years	0%	35%	7.27%	45.232
2 years to 5 years	0%	45%	0.12%	0.76
5 years to 10 years	0%	45%	1.84%	11.479
10 years to 20 years	0%	45%	5.53%	34.430

20 years to 30 years	0%	50%	4.90%	30.521
30 years to 40 years	0%	50%	12.18%	75.815
40 years to 50 years	0%	60%	48.04%	299.000
50 years and above	0%	60%	15.26%	95.000

Control of Interest Rate Exposure

RMBC	2023/24	2024/25	2025/26	2026/27
Interest rate Exposures				
	Upper	**Upper**	**Upper**	**Upper**
Limits on fixed interest rate debt based on fixed net debt	100%	100%	100%	100%
Limits on variable interest rate debt based on variable net debt	50%	50%	50%	50%

Compliance with Treasury and Prudential Limits

It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. During the quarter ended 31st December 2023, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2023/24. The tables below set out the actual position as at 31 December 2023 compared to these indicators. The Strategic Director of Finance & Customer Services reports that no difficulties are envisaged for the current or future years in complying with these indicators.

All treasury management operations have also been conducted in full compliance with the Council's Treasury Management Practices.

Treasury Indicators	2023/24 Budget £'000	31.12.23 Actual £'000
Authorised limit for external debt	979,397	625,612
Operational boundary for external debt	959,998	

Gross external debt	929,998	
Investments	20,000	27,420
Net borrowing	909,998	598,192

Maturity structure of borrowing	**Upper limit**	**Actual as at 31.12.23**
Under 12 months	60%	4.86%
12 months to 2 years	35%	7.27%
2 years to 5 years	45%	0.12%
5 years to 10 years	45%	1.84%
10 years to 20 years	45%	5.53%
20 years to 30 years	50%	4.9%
30 years to 40 years	50%	12.18%
40 years to 50 years	55%	48.04%
50 years and above	60%	15.26%

	Limit	**Actual as at 31.12.23**
Sums invested >364 days	£10m	£0m

Appendix B

ECONOMIC BACKGROUND

The first half of 2023/24 saw:

- Interest rates rise by a further 100bps, taking Bank Rate from 4.25% to 5.25% and, possibly, the peak in the tightening cycle.
- Short, medium and long-dated gilts remain elevated as inflation continually surprised to the upside.
- CPI inflation falling from 8.7% in April to 6.7% in September, its lowest rate since February 2022, but still the highest in the G7.
- Core CPI inflation declining to 6.1% in September from 7.1% in April and May, a then 31 years high.
- A cooling in labour market conditions, but no evidence yet that it has led to an easing in wage growth (as the 3myy growth of average earnings rose by 7.8% for the period June to August, excluding bonuses).

Appendix C

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

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

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

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

- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments that the Council may use. These are high security and high liquidity investments in sterling and with a maturity of no more than a year.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

The investment policy proposed for the Council is:

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

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

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

- The UK Government (such as the Debt Management Account deposit facility, UK Treasury Bills or a Gilt with less than one year to maturity).

- UK Local Authorities.
- Money Market Funds that have been awarded a AAA credit rating by a credit rating agency e.g., Standard and Poor's, Moody's and/or Fitch rating agencies restricted to £20m.
- A bank or building society that has been awarded a minimum short-term rating of F1 by Fitch, P-1 by Moody's and A-1 by Standard and Poor's rating agencies. For Building Societies investments will be restricted to 20% of the overall investment portfolio and:

    - a maximum of £5m for a period not exceeding 6 months if the society is ranked in the top 10 by asset size; or
    - a maximum of £1m and a period not exceeding 3 months if the society is ranked 11 to 20 by asset size.

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

Non-specified investments would include any sterling investments with: -

1. A bank that has been awarded a minimum long term credit rating of AA- by Fitch, Aa3 by Moody's and AA- by Standard & Poor's for deposits with a maturity of greater than 1 year.
2. The Council's own bank if ratings fall below the above minimum criteria.
3. A Building Society which is ranked in the top 20 by asset size. Investments will be restricted to 20% of the overall investment portfolio and:
    - a maximum of £5m for a period not exceeding 6 months if the Society is ranked in the top 10 by asset size; or
    - a maximum of £1m and a period not exceeding 3 months if the Society is ranked 11 to 20 by asset size.

This Council will seek further advice on the appropriateness and associated risks with investments in these categories.

The monitoring of investment counterparties - The credit rating of counterparties will be monitored regularly. The Council receives credit rating information (changes, rating watches and rating outlooks) from Link as and when ratings change, and counterparties are checked promptly.

On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest.

Any counterparty failing to meet the criteria will be removed from the list immediately by the Strategic Director of Finance & Customer Services, and if required new counterparties which meet the criteria will be added to the list.