REPORT OF THE OVERVIEW & SCRUTINY COMMITTEE

1 CAPITAL AND TREASURY MANAGEMENT STRATEGY 2023/24

1.1 This item of business was referred by the Overview & Scrutiny Committee on 1 February 2023 to Council recommending that the capital and treasury management strategy for 2023/24 be approved. An extract of the key elements of the report to the Overview & Scrutiny Committee is attached at Appendix 1.

2 SALIENT INFORMATION

2.1 At the meeting of Overview & Scrutiny Committee held on 1 February 2023 it was noted that a key priority for the Council's treasury management strategy was to .

2.2 It was also noted that

3 RECOMMENDATION

3.1 It is proposed that Council **RESOLVES**

That the capital and treasury management strategy for 2023/24 be approved.

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CAPITAL AND TREASURY MANAGEMENT STRATEGY 2023/24

1 INTRODUCTION

1.1 This report sets out the Council's Capital and Treasury Management Strategy for 2023/24 and seeks the views of the Overview & Scrutiny Committee on the approach proposed in this Strategy, before it is presented for approval by Full Council on 21 February 2023.

1.2 In financing capital expenditure, local authorities are governed by legislative frameworks, including the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code) and the CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes (Treasury Management Code). An updated Prudential Code and Treasury Management Code were published by CIPFA in December 2021, with a requirement for local authorities to report in line with these from 2023/24 onwards.

1.3 The revised Treasury Management Code requires all investments and investment income to be attributed to one of three purposes:-

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

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

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

1.4 The following are also required to be implemented under the new code:-

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

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

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

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

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

- **Environmental, social and governance (ESG)** issues to be addressed within an authority's treasury management policies and practices (TMP1).

1.5 The Prudential Code was developed by CIPFA as a professional code of practice to support local authorities in taking their decisions. Local authorities are required by regulation to have regard to the Prudential Code when carrying out their duties under Part 1 of the Local Government Act 2003. Local authorities determine their own programmes for investment; however, in order to demonstrate that capital expenditure and investment decisions are taken in line with service objectives and properly take account of stewardship, value for money, prudence, sustainability and affordability, the Prudential Code requires authorities to have in place a Capital Strategy that sets out the long term context in which capital expenditure and investment decisions are made, and gives due consideration to both risk and reward and impact on the achievement of priority outcomes.

1.6 There are requirements of the Prudential Code in relation to service and commercial investments, however this authority does not currently have these investments and therefore these requirements are not detailed in this report. Key to this is that there should be Investment Management Practices to manage risks associated with non-treasury investments, (similar to the current Treasury Management Practices). These will be developed if the Council move into these investment types.

1.7 This Strategy provides an overview of the governance process for approval and monitoring of capital expenditure. It provides a projection of the Council's capital financing requirement and explains how the Council will make prudent revenue provision for the repayment of any debt. The Strategy also sets out the Council's policy approach to commercial investment activities, including processes, due diligence and defining the Council's risk appetite in respect of these.

1.8 The Strategy also sets out the Council's approach to treasury management investment activities and includes the criteria for determining how and where funds will be invested to ensure that the principal sums are safeguarded from loss and that sufficient liquidity is maintained to ensure that funds are available when needed. The Council's policies, objectives and approach to risk management of its treasury management activities, and the manner in which it seeks to achieve its policies and objectives for treasury management are set out, alongside the knowledge and skills available to the Council and provides confirmation that these are commensurate with the Council's risk appetite.

1.9 The treasury management investment strategy proposed for 2023/24 is consistent with that applied in previous years. The Council has a good track record with regard to its treasury investment activity, adhering to the statutory requirement to give priority to security and liquidity over yield. Internal Audit's most recent review issued a 'good' assurance opinion on the management of these activities, confirming that internal controls are consistently adhered to.

1.10 The distinct, but inter-related, elements of this Strategy therefore collectively demonstrate that the Council's capital expenditure and investment decisions properly take account of stewardship, value for money, prudence, sustainability and affordability, by setting out the long-term context in which capital expenditure and investment decisions are made, and by giving due consideration to both risk and reward and impact on the achievement of priority outcomes.

1.11 The Capital Strategy should include:-

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

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

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

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

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

1.12 An Economic Background Summary is provided by LINK Group, the Authorities Treasury Management Advisors. This can be found at Appendix Two to this report.

2 REPORTING

2.1 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. These reports are:-

1. The Capital and Treasury Management Strategy (this report), which 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 investment strategy (the parameters on how investments are to be managed).

2. The Mid-Year Treasury Management Report which will update Council with the progress of the capital position, update prudential indicators as necessary, and consider whether the Treasury Strategy is delivering its objectives or whether any policies require revision.

3. Annual Strategy report (reported to Council in June/July). This provides details of actual performance of prudential and treasury indicators compared to the estimates within this report.

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

2.3 In addition to the three major reports detailed above, from 2023/24 quarterly reporting is also required. However, these additional reports do not have to be reported to Full Council/Board but do require to be adequately scrutinised.

The updated Treasury/ Prudential indicators will form part of the quarterly finance reports that are taken to The Executive.

3 CAPITAL AND TREASURY MANAGEMENT STRATEGY

3.1 The CIPFA The Capital and Treasury Management Strategy comprises a number of distinct, but inter-related, elements including:

Capital issues

- **Capital expenditure (see Section 4)**; which includes an overview of the governance process for approval and monitoring of capital expenditure, including the Council's policies on capitalisation, and an overview of its capital expenditure and financing plans.

- **Capital financing and borrowing (see Section 5)**; provides a projection of the Council's capital financing requirement, how this will be funded and repaid and explains how it will discharge its duty to make prudent revenue provision for the repayment of debt (Minimum Revenue Provision (MRP) Policy Statement).

Treasury Management Issues

- **Other Prudential Indicators (see Section 6)**

- **Borrowing Strategy (see Section 7)**

- **Treasury Management Investments (see Section 8)**; explains the Council's approach to treasury management investment activities, including the criteria for determining how and where funds will be invested to ensure that the principal sums are safeguarded from loss and that sufficient liquidity is maintained to ensure that funds are available when needed. Includes Treasury Indicators.

- **Annual Investment Strategy (see Section 9)** (including current treasury position)

- **Commercial Investments (see Section 10**); provides an overview of those of the Council's policy on commercial investment activities that count as capital expenditure, including processes, due diligence and defining the Council's risk appetite in respect of these.

- **Credit Ratings (see Section 11)**, including policy on use of external providers, and interest rate forecasts.

- **Liquidity Risk Management (see Section 12)**

- **Cash Flow Management (see Section 13)**

- **Scheme of Delegation (see Section 14)**

- **Treasury Management Policy and Practices (see Section 15)**

- **Knowledge and skills (see Section 16)**; summarises the knowledge and skills available to the Council and provides confirmation that these are commensurate with the Council's risk appetite.

4 CAPITAL EXPENDITURE

Capitalisation policies

4.1 Expenditure is classified as capital expenditure when it results in the acquisition or construction of an asset (e.g. land, buildings, roads and bridges, vehicles, plant and equipment etc.) that:

- Will be held for use in the delivery of services, for rental to others, or for administrative purposes; and

- Are of continuing benefit to the Council for a period extending beyond one financial year.

- Subsequent expenditure on existing assets is also classified as capital expenditure if these two criteria are met.

4.2 There may be instances where expenditure does not meet this definition but would nevertheless be treated as capital expenditure, including:

- Where the Council has no direct future control or benefit from the resulting assets, but would treat the expenditure as capital if it did control or benefit from the resulting assets; and

- Where statutory regulations require the Council to capitalise expenditure that would not otherwise have expenditure implications according to accounting rules.

Governance

4.3 The Section 151 Officer manages the preparation of a capital programme on an annual basis which is presented to Full Council for approval as part of the Medium-Term Financial Strategy report.

4.4 Schemes will usually only be added to, or removed from, the capital programme as part of the annual budget setting process. Any request outside of this process to change the capital programme by adding or removing schemes, or by allocating additional scheme and payment approvals to an approved scheme, must be approved by Full Council in line with the Council's financial regulations.

4.5 Any project that is added to the Capital Programme will be for the purposes of delivering public services (including housing, regeneration and local infrastructure) or in support of joint working with others to deliver such services.

4.6 The Section 151 Officer will also monitor performance against the Council's approved capital programme on an on-going basis, as part of the quarterly financial reports, which are presented to Executive by the Portfolio Holder for Finance. These financial overview reports will provide a comparison of the Council's projected expenditure with the latest approved capital programme.

Capital Expenditure Plans

4.7 When expenditure is classified as capital expenditure, this means that the Council is able to finance that expenditure from the following sources:

- Capital grants and contributions - amounts awarded to the Council in return for past or future compliance with certain stipulations.
- Capital receipts – amounts generated from the sale of assets and from the repayment of capital
- Loans, grants or other financial assistance.
- Revenue contributions – amounts set aside from the revenue budget or earmarked reserves
- Borrowing/Finance Leases - amounts that the Council does not need to fund immediately from cash resources, but instead charges to the revenue budget over a number of years into the future. The implications of financing capital expenditure from borrowing are explained in Section 7.

5 CAPITAL FINANCING AND BORROWING

5.1 The Council's capital expenditure plans are one of the key drivers of treasury management activity. The capital expenditure plans are reflected in prudential indicators, which are designed to assist Members' overview and confirm capital expenditure plans.

5.2 The table below summarises the Council's proposed capital expenditure plans for the period to 2025/26 and how this would be financed. The detail of the proposed capital investment of £4.750m in 2023/24 will be presented to Full Council on 21 February 2023 as part of the Medium-Term Financial Strategy.

Capital Expenditure and the Capital Financing Requirement

£000s	2021/22 Outturn	2022/23 Forecast	2023/24 Forecast	2024/25 Forecast	2025/26 Forecast
Opening CFR	**777**	**777**	**777**	**777**	**777**
Capital Expenditure	1,106	4,424	4,750	3,525	1,051
Financed by:					
Capital Receipts Reserve	363	1,081	2,403	993	-
Capital Grants	617	621	540	540	540
Other Earmarked Reserves	126	2,252	-	1,069	-
Revenue Contribution	-		1,640	852	441
Developer Contributions	-	95	70	70	70
New Homes Bonus Income	-	305	97	-	-
Match Funding	-	70	-	-	-
Closing CFR	**777**	**777**	**777**	**777**	**777**

5.3 The Capital Expenditure reflected in the table above is the draft position before approval by Council so may change. Any changes will then be reflected in future CFR predictions.

5.4 The CFR is 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 underlying borrowing need. Any capital expenditure above, which has not immediately been paid for by capital receipts or grants, will increase the CFR. The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is the statutory annual revenue charge.

5.5 The adoption of IFRS16 has been further delayed until April 2025. Existing leases have not yet been reviewed, however the purchase of new assets through a finance lease arrangement are now included with the capital programme and therefore balance sheet.

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

There are four components to the LB: -

1. **Existing loan debt outstanding**: the Authority'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 Authority'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.

Liability benchmark £000s	2022/23 Forecast	2023/24 Forecast	2024/25 Forecast	2025/26 Forecast
Existing Loan Debt Outstanding	-	-	-	-
Net Loans Requirement	(24,000)	(24,000)	(24,000)	(24,000)
Loans CFR	777	777	777	777
Liability Benchmark	(23,800)	(23,800)	(23,800)	(23,800)
(Over)/Under Liability Benchmark	(23,800)	(23,800)	(23,800)	(23,800)

Minimum Revenue Provision (MRP) Policy Statement

5.7 As noted above the Capital Financing Requirement (CFR) provides a measure of the amount of capital expenditure that the Council yet to fund from cash resources. Instead, the Council is required to set aside monies from the revenue budget each year to repay the borrowing. This practice is referred to as making minimum revenue provision (or MRP) for the repayment of debt. Statutory guidance requires MRP to be provided annually on a prudent basis, and interprets ‘prudent’ to mean that MRP charges on unsupported borrowing should be made over a period commensurate with the period the assets financed from borrowing continue to provide benefit. Where it is practical or appropriate to do so, the Council may make voluntary revenue provision, or apply capital receipts, to reduce debt over a shorter period.

5.8 Any future borrowing by the Council will require an MRP recognition through the revenue account, which will be considered as part of any future business case and the preferred method would be the Asset Life method (by way of either Equal Instalment or Annuity). MRP will only start to be charged in the year after the asset becomes operational.

5.9 Where assets are funded through finance lease agreements, MRP is made over the life of the contract. This includes expenditure on some assets where lease repayments would have been treated directly as operational revenue expenditure in prior years, but are now treated as capital expenditure and included on the balance sheet, per the requirements of IFRS16.

5.10 The MRP Policy Statement requires full council approval in advance of each financial year.

6 OTHER INDICATORS

The Use of the Council's Resources and the Investment Position

6.1 The application of resources (capital receipts, reserves etc) to either finance capital expenditure or other budget decisions to support the revenue budget will have an on-going impact on investments unless resources are supplemented each year from new sources (asset sales etc). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Affordability Prudential Indicators

6.2 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.

Year End Resources £000	**2022/23 Forecast**	**2023/24 Forecast**	**2024/25 Forecast**	**2025/26 Forecast**
Earmarked Reserves & General Fund Balance	9,273	5,617	4,697	4,382
Capital Receipts Reserve	276	993	-	-
Total Core Funds	**9,549**	**6,611**	**4,697**	**4,382**
Expected Investments	**11,049**	**8,111**	**6,197**	**5,882**

6.3 The indicators are designed to support and record local decision making in a manner that is publicly accountable but are not designed to be comparative performance indicators to other organisations. There are no recommended limits or values for the indicators.

6.4 These provide an indication of the impact of the capital investment plans on the Council's overall finances. Members are asked to approve the following indicators.

Ratio of financing costs to net revenue stream (revenue budget).

6.5 The table below shows the impact of borrowing compared to the general fund. It is negative because the Council does not currently borrow and so this represents only the interest received on investments as a comparison to the revenue budget.

%	2022/23 Forecast	2023/24 Forecast	2024/25 Forecast	2025/26 Forecast
Ratio of Financing Costs to Net Revenue Stream	-0.48%	-2.40%	-1.32%	-0.92%

Incremental Impact of Capital Investment Decisions on Band D Council Tax

6.6 If the capital programme was to be funded through revenue (council tax) this indicator identifies the revenue costs associated with proposed changes to the capital programme.

	2022/23 Forecast	2023/24 Forecast	2024/25 Forecast	2025/26 Forecast
Capital Expenditure (£000s)	4,424	4,750	3,525	1,051
Incremental impact of capital investment (£000s)	3,317	326	(1,226)	(2,474)
Council tax base (Units)	32,707.6	32,888.9	33,217.8	33,550.0
Council tax Band D impact(£s)	£101	£10	(£37)	(£74)

7 BORROWING

7.1 The Council does not currently have any borrowing. Dependent on the Council's approval of particular business cases put forward for consideration, it is possible that borrowing would be considered in future for larger capital schemes. However; this would need to be agreed on a case by case basis.

7.2 Borrowing may be considered for "invest to save" projects providing the cost of servicing the debt is contained within the revenue savings/income the project generates, the project generates a positive net present value and the payback period is shorter than the life of the asset.

7.3 Per paragraph 51 of the Prudential Code in relation to investments for commercial purposes, this authority would not borrow to invest primarily for financial return. Nor will it borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed.

Asset Delivery Programme

7.4 The Asset Delivery Programme is currently undergoing review. If there are any requirements for borrowing, approval will be requested in future reports to Council.

7.5 The following issues will be considered prior to undertaking any external borrowing:

– Affordability

- Maturity profile of existing debt
- Interest rate and refinancing risk
- Borrowing source including Internal

7.6 In conjunction with advice from its treasury advisor, the council will keep under review the following external borrowing sources:

- Public Works Loan Board (PWLB) (or its replacement)
- any institution approved for investments
- any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds (except for Essex Pension Fund)
- Capital market bond investors
- Municipal Bonds Agency - created to enable local authority bond issues
- Capital markets (stock issues, commercial paper and bills)
- Finance Leases

7.7 Borrowing would add pressure on the revenue budget as MRP and interest would become payable. The capacity to make these payments would need to be identified in advance, to ensure they are affordable.

7.8 Where capital expenditure on an asset is financed wholly or partly by borrowing or credit arrangements, MRP is to be determined by reference to the life of the asset. With the Equal Instalment approach, MRP is determined by reference to the life of the asset and an equal amount charged in each year. The Annuity method involves a more complex calculation. Here, MRP is the principal element for the year of the annuity required to repay over the asset life the amount of capital expenditure financed by borrowing.

8 TREASURY MANAGEMENT

8.1 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.

8.2 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.

8.3 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.

8.4 The core investment policy objective for this Council is the prudent investment of its treasury balances. The Council's investment priorities are security of capital and liquidity of its investments so that funds are available for expenditure when needed.

8.5 Both the CIPFA Code and the MHCLG guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its Treasury Management investments before seeking the highest rate of return, or yield. The generation of investment income to support the Council's spending plans is an important, but secondary objective. Investment in commercial activities or for wider strategic objectives may be subject to different criteria than those applied to funds invested purely for Treasury Management purposes, as set out in Section 10 below.

8.6 The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

8.7 The Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

TREASURY INDICATORS: LIMITS TO BORROWING ACTIVITY

8.8 The Council is only permitted to borrow externally (including via credit arrangements) up to the level implied by its Capital Financing Requirement (CFR).

8.9 To ensure that external borrowing does not exceed the CFR, other than in the short term, limits are established for external debt, as follows:

- **Authorised boundary limit** – this defines the maximum amount of external debt permitted by the Council, and represents the statutory limit determined under section 3 (1) of the Local Government Act 2003.

- **Operational boundary limit** – 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.

8.10 The Authorised and Operational limits are based on the assumption that there will be long-term borrowing to fund capital expenditure and that borrowing will be to fund long and short term cash flow requirements. The limits include balance sheet liabilities such as finance leases and creditors, with the exception of IFRS16 changes noted at paragraph 5.4 above.

£000s	2022/23 Forecast	2023/24 Forecast	2024/25 Forecast	2025/26 Forecast
Operational boundary Limit	777	777	777	777
Authorised boundary Limit	977	977	977	977

Treasury Management Limits on Activity

8.11 There are debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are too restrictive they will impair the opportunities to reduce costs / improve performance.

8.12 The limit indicators are shown separately for borrowing and investments. Fixed rates for investments or borrowing for a period of less than one year are treated as variable by the Prudential Code.

Interest rate Exposures %	2022/23	2023/24	2024/25
	Upper	**Upper**	**Upper**
Limits on fixed interest rates:			
Borrowing	100%	100%	100%
Investments	100%	100%	100%
Limits on variable interest rates:			
Borrowing	25%	25%	25%
Investment	100%	100%	100%

9 ANNUAL INVESTMENT STRATEGY

Investment Policy – Management of Risk

9.1 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. The treasury strategy section of this report deals solely with treasury (financial) investments, (as managed by finance). Non-financial investments would be covered in the Capital Strategy section if applicable.

9.2 The Authority'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

9.3 The Authority's investment priorities will be security first, portfolio liquidity second and then yield (return). The Authority will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with regard to the Authority's risk appetite.

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

1. Minimum acceptable **credit criteria** (section 11) are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short-term and long-term ratings.

2. **Other information:** ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Authority will engage with its advisors to maintain a monitor on market pricing such as **"credit default swaps"** and overlay that information on top of the credit ratings.

3. This Authority has defined the list of **types of investment instruments** (section 9.5) that the treasury management team are authorised to use. There are no 'non-specified' investments.

   Specified investments are those with a high level of credit quality and subject to a maturity limit of one year or have less than a year left to run to maturity, if originally they were classified as being non-specified investments solely due to the maturity period exceeding one year.

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

4. **Lending limits**, (amounts and maturity), for each counterparty will be set through applying the matrix table in 11.3.

5. **Transaction limits** are set for each type of investment in 11.3.

6. This Authority does not invest for **longer than 365 days**.

7. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating**, (see paragraph 11.1).

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

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

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

9.5 The Council has no plans to deviate from its current investment strategy for Treasury Management investments. A full list of those items included in the 2022/23 strategy are:

- Term and Call Deposits with banks and building societies
- Term deposits, call deposits and bonds with other UK Local Authorities
- Certificates of deposit with banks and building societies
- Deposit Facility
- Money Market funds (both Standard and Enhanced)
- Debt Management Agency Deposit Facility (Government Managed)
- Treasury Bills

9.6 As at the end of Quarter 3 2022/23, the Councils investment portfolio was as shown in the table below.

Investments at 31.12.22	Amount (£000)
Money Market Funds – Instant Access	9,000
Handelsbanken – Instant Access	6,000
Santander – 95 days notice	6,000

10 COMMERCIAL INVESTMENTS

10.1 Statutory guidance on local authority investments (issued by the Secretary of State under section 15(1)(a) of the Local Government Act 2003) classifies local authority investments into the following categories:

- Investments held for treasury management purposes
- Other investments

10.2 Investments held for treasury management purposes are dealt with in the 'Treasury Management' section of this document. This section deals with 'other investments', where the intention is for investments to contribute to the Council's service delivery objectives and/or place making role.

10.3 The Council does not currently hold any investments for non-Treasury Management purposes.

10.4 Any project that is added to the Capital Programme will be for the purposes of delivering public services (including housing, regeneration and local infrastructure) or in support of joint working with others to deliver such services. No schemes will be added to the Capital Programme if their only purpose is to achieve a financial return.

Loans to Subsidiaries, Local Enterprises and Third Parties

10.5 Loans to subsidiaries, local enterprises and third parties may be considered, as part of a wider strategy for local economic growth, even though they may not all be seen as prudent if adopting a narrow definition of prioritising security and liquidity.

10.6 Such loans will be considered when all of the following criteria are satisfied:

- The loan is given towards expenditure which would, if incurred by the Council, be capital expenditure;

- The purpose for which the loan is given is consistent with the Council's corporate / strategic objectives and priorities;

- Due diligence is carried out that confirms the Council's legal powers to make the loan, and that assesses the risk of loss over the loan term;

- A formal loan agreement is put in place which stipulates the loan period, repayment terms and loan rate (which will be set at a level that seeks to mitigate any perceived risks of a loss being charged to the General Fund, and takes appropriate account of subsidy control rules) and any other terms that will protect the Council from loss;

11 CREDIT RATINGS

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

- credit watches and credit outlooks from credit rating agencies;

- Credit Default Swap (CDS) spreads to give early warning of likely changes in credit ratings;

- sovereign ratings to select counterparties from only the most creditworthy countries.

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

LINK Colour Coding	Maximum Duration	Maximum Investment
No colour	Not to be used	0
Green	100 days	£6m
Red	6 months 100 days	£3m £6m
Orange	1 year 6 months 100 days	£1m £3m £6m
Blue	1 year 6 months 100 days	£4m £3m £6m

LINK Colour Coding	Maximum Duration	Maximum Investment
Purple	2 years 1 year 6 months 100 days	£3m £4m £3m £6m

11.3 Due Care will be taken to consider the exposure of the Authority's total investment portfolio, and the table below gives the maximum duration and investment for each.

Organisation	Maximum Duration	Maximum Investment
Debt Management Office (Government Body)	6 months	£14m
Lloyds Bank current account The Council's main banker	On call (can be withdrawn immediately)	£5m
Money Market Funds CNAV – AAA long-term credit rating	On call (can be withdrawn immediately)	£5m per fund
Money Market Funds LVNAV – AAA long-term credit rating	On call (can be withdrawn immediately)	£5m per fund
Money Market Funds VNAV – AAA long-term credit rating	On call (can be withdrawn immediately)	£5m per fund
Certificates of Deposit and Treasury Bills.	Will follow the LINK Colour Coding limits as per the above table.	Will follow the LINK Colour Coding limits as per the above table.
Local Authorities	1 year	£3m

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

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

11.6 All credit ratings will be monitored weekly. The Council is alerted to changes in ratings of all three agencies through its use of Link Groups creditworthiness service. If a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately. In addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link Groups. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

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

11.8 Significant levels of downgrades to Short and Long-Term credit ratings have not materialised since the crisis in March 2020. In the main, where they did change, any alterations were limited to Outlooks. However, more recently the UK sovereign debt rating has been placed on Negative Outlook by the three major rating agencies in the wake of the Truss/Kwarteng unfunded tax-cuts policy. Although the Sunak/Hunt government has calmed markets, the outcome of the rating agency reviews is unknown at present, but it is possible the UK sovereign debt rating will be downgraded. Accordingly, when setting minimum sovereign debt ratings, this Authority will not set a minimum rating for the UK.

CDS prices

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

Country Limits

11.10 The Council has determined that it will only use approved counterparties from the UK and countries with a minimum sovereign credit rating of AA+ from Fitch Ratings (or equivalent from other agencies if Fitch does not provide).

11.11 Countries other than the UK will be subject to a £3m investment limit for duration of up to one year, subject to Section 151 Officer authorisation.

Investment Management

11.12 The Council does not use a fund manager and funds are managed in-house. Investments will accordingly be made with reference to the core balances and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. The current shape of the yield curve suggests that is the case at present, but there is the prospect of Bank Rate peaking in the first half of 2023 and possibly reducing as early as the latter part of 2023 so an agile investment strategy would be appropriate to optimise returns.

11.13 Accordingly, while most cash balances are required in order to manage 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.

11.14 The Authority has appointed Link Group as its treasury advisor and part of their service is to assist the Authority to formulate a view on interest rates. Link provided the following forecasts on 19 December 22 which forecast Bank Rate to reach 4.5% in Q2 2023. These are forecasts for certainty rates, gilt yields plus 80 bps.

Link Group Interest Rate View	19.12.22												
	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
BANK RATE	3.50	4.25	4.50	4.50	4.50	4.00	3.75	3.50	3.25	3.00	2.75	2.50	2.50
3 month ave earnings	3.60	4.30	4.50	4.50	4.50	4.00	3.80	3.30	3.00	3.00	2.80	2.50	2.50
6 month ave earnings	4.20	4.50	4.60	4.50	4.20	4.10	3.90	3.40	3.10	3.00	2.90	2.60	2.60
12 month ave earnings	4.70	4.70	4.70	4.50	4.30	4.20	4.00	3.50	3.20	3.10	3.00	2.70	2.70
5 yr PWLB	4.20	4.20	4.20	4.10	4.00	3.90	3.80	3.60	3.50	3.40	3.30	3.20	3.10
10 yr PWLB	4.30	4.40	4.40	4.30	4.10	4.00	3.90	3.80	3.60	3.50	3.40	3.30	3.30
25 yr PWLB	4.60	4.60	4.60	4.50	4.40	4.20	4.10	4.00	3.90	3.70	3.60	3.50	3.50
50 yr PWLB	4.30	4.30	4.30	4.20	4.10	3.90	3.80	3.70	3.60	3.50	3.30	3.20	3.20

11.15 The suggested budgeted investment earnings rates for returns on investments placed for periods up to three months during each financial year are as follows:

Average earnings in each year	
2022/23 (remainder)	4.00%
2023/24	4.40%
2024/25	3.30%
2025/26	2.60%
2026/27	2.50%
Years 6 to 10	2.80%
Years 10+	2.80%

11.16 There are a number of significant risks to the above forecasts, however the forecasted position provided by LINK will continue to be reviewed.

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

11.18 It is expected that this authority will have sufficient funds to invest that will realise a return on investments c£275,000 for financial year 2023/24.

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

Change of investment strategy

11.20 There are now several alternative types for investment opportunities that authorities can utilise. These include the following instruments. The authority will ensure relevant due diligence is taken before entering into any new arrangement. We would continue to apply the same principles of Security, Liquidity and Yield to these investment types. These would then require investment over a period longer than 365 days in order to receive the benefit of the instruments.

- Ultra-Short Dated Bond Funds
- Corporate Bonds - direct, passive and active external management (including Short Dated Bond Funds)
- Multi Asset Funds
- Property Funds
- Equity Funds

Investment Performance / Risk Benchmarking

11.21 This Authority will use an investment benchmark to assess the investment performance of its investment portfolio of overnight, 1, or 3 month Sterling Overnight Index Average (SONIA).

12 LIQUIDITY RISK MANAGEMENT

12.1 This council will ensure it has adequate, though not excessive, cash resources, borrowing arrangements, overdraft or standby facilities to enable it at all times to have sufficient liquidity in its investments, taking into account known and potential cash-flow requirements and the level of funds available to it which are necessary for the achievement of its business/service objectives.

12.2 Giving due consideration to the Council’s level of balances over the next year, the need for liquidity, its spending commitments and provisioning for contingencies, it is considered very unlikely that the Council will have cash balances to invest other than on a temporary basis. For this reason, no cash will be held on term deposit maturities in excess of 1 year.

13 CASH AND CASH FLOW MANAGEMENT

13.1 The objective should be to keep low interest cash balances at an optimum and maximise temporary investments. There is likely to be a difference between forecast activity and actual activity and therefore working capital will need to be subject to regular review and report to Review Committee / Full Council in the light of changing levels of activity.

13.2 The council will prepare reports which include cash flow forecasts and actuals on a 12-month rolling basis so as to be able to determine:

– whether minimum acceptable levels of cash balances plus short-term investments might be (or have been) breached

– the adequacy (or otherwise) of standby/overdraft facilities or contingency arrangements

– the optimum arrangements to be made for investing and managing surplus cash.

14 SCHEME OF DELEGATION

14.1 Under the Code, the Council is required to specify its Scheme of Delegation for Treasury Management and the responsibilities of the Section 151 Officer, and this is shown below:-

(i) Full Council

- receiving and reviewing reports on treasury management policies, practices and activities.
- approval of annual strategy
- budget consideration and approval.
- receiving the end of year report on treasury management.

(ii) Overview & Scrutiny Committee

- scrutiny of the three main treasury reports, before recommendation to Council or Executive.
- Reviewing the treasury management policy and procedures and making recommendations to the responsible body.

(iii) Executive

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

(iv) Audit Committee

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

(v) Section 151 Officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance.
- submitting regular treasury management policy reports.
- submitting budgets and budget variations.
- receiving and reviewing management information reports.
- reviewing the performance of the treasury management function.
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function.
- ensuring the adequacy of internal audit and liaising with external audit.
- Recommending the appointment of external service providers.
- ensuring that members are adequately informed and understand the risk exposures taken on by the Authority
- preparation of a Capital Strategy to include capital expenditure, capital financing, non-financial investments and treasury management, ensuring it is prudent, sustainable and affordable.

15 TREASURY MANAGEMENT POLICY STATEMENT AND TREASURY MANAGEMENT PRACTICES

15.1 A revised Treasury Management Code was published by CIPFA in December 2021; there is a requirement to report on this from 2023/24 onwards.

15.2 The Treasury Management Code has a particular significance under the provisions of the Local Government Act 2003 which requires local authorities ‘*to have regard (a) to such guidance as the Secretary of State may issue, and (b) to such other guidance as the Secretary of State may by regulations specify*’.

15.3 The current Treasury Management Code contains the following definition of treasury management activities which has been adopted by CIPFA:

The management of the organisation’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.

This definition is intended to apply to all public service organisations in their use of capital and project financings, borrowings and all investments.

15.4 It clarifies that ‘investments’ in the above definition covers all the Council’s financial assets, as well as other non-financial assets held primarily for financial returns if applicable. This means that it encompasses investments which are not managed as part of normal treasury management or under treasury management delegations.

15.5 The Treasury Management Code identifies three key principles for treasury management:

- Public service organisations should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities.

- Their policies and practices should make clear that the effective management and control of risk are prime objectives of their treasury management activities and that responsibility for these lies clearly within their organisations. Their appetite for risk should form part of their annual strategy, including any use of financial instruments for the prudent management of those risks, and should ensure that priority is given to security and portfolio liquidity when investing treasury management funds.

- They should acknowledge that the pursuit of value for money in treasury management, and the use of suitable performance measures, are valid and important tools for responsible organisations to employ in support of their business and service objectives, and that within the context of effective risk management, their treasury management policies and practices should reflect this.

15.6 In accordance with these principles, the Council had previously adopted a Treasury Management Policy Statement, which set out the policies, objectives and approach to risk management of its treasury management activities, and a series of Treasury Management Practices (TMPs), which set out the manner in which the Council sought to achieve its policies and objectives for treasury management.

15.7 These have been updated to reflect the new requirement for a policy for Environment, Social and Governance considerations, and a general review and update and are found at Appendix One.

16 KNOWLEDGE AND SKILLS

16.1 The Council recognises the importance of ensuring that all officers involved in the treasury management function (including commercial investment activities) are fully equipped to undertake the duties and responsibilities allocated to them. The Section 151 Officer is responsible for recommending and implementing the necessary arrangements and does this by:

- **Ensuring officers are both capable and experienced**. All individuals involved in the delivery of the treasury management function are required to undertake continuing professional development.

- **Providing training and technical guidance**
All individuals involved in the delivery of the treasury management function are provided with access to relevant technical guidance and training necessary to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills to undertake the duties and responsibilities allocated to them.

- **Appointing a treasury management and other professional advisors**
By employing external providers of treasury management services, the Section 151 Officer ensures that the individuals involved in delivery of the Council's treasury management activities have access to specialist skills and resources.

16.2 In order to assure this:-

- Attendance at training should be recorded and action taken where poor attendance is identified.
- Learning plans should be put in place for treasury management officers and members, and tailored for need.
- Officers and members should be required to undertake self assessments against required competencies.
- Encourage officers and members to highlight training needs on an ongoing basis.

16.3 The Council uses the services of Link Groups "Link" as its external treasury management advisors.

16.4 The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

16.5 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.

16.6 The Section 151 Officer will ensure that elected members tasked with treasury management responsibilities, including those responsible for scrutiny, have access to training relevant to their needs and those responsibilities. This is fulfilled via annual training sessions. Those charged with governance recognise their individual responsibility to ensure that they have the necessary skills to complete their role effectively.

17 RISK IMPLICATIONS

17.1 As an authority that does not currently have any debt the Council's highest priority in its treasury management function is the security of its investments in accordance with the priorities set out in the CIPFA Code. Sums are invested with a range of counter parties to minimise the risk of the capital sum being diminished through movements in prices.

17.2 The Council, whilst fundamentally risk adverse, will accept some modest degree of risk in its Treasury Management activities. It will consider first the range of risks and secondly how prudently to manage those different risks. It will ensure that priority is given to security and liquidity when investing funds for Treasury Management purposes before seeking to optimise yield. The use of different investment instruments and diversification of high credit quality counter parties along with country, sector and group limits, as set out in the Strategy, enables the Council to minimise the nature and extent of the different risks.

17.3 The Council does not currently hold any investments for non-Treasury Management purposes. Non-core activities and investments may be considered by the Council in future, subject to the appropriate governance, to support the Council's wider strategic objectives and/or place-making role. Such investments would only be entered into following a full assessment of the risks and having secured expert external advice (where it is relevant to do so).

18 RESOURCE IMPLICATIONS

18.1 All interest paid and received is accounted for within the General Fund. The amount of income generated is dependent upon interest rates and level of balances.

19 LEGAL IMPLICATIONS

19.1 This strategy complies with the statutory requirements set out in the Local Government Act 2003 and associated guidance and regulations.