TREASURY MANAGEMENT STRATEGY 2023/24

1 Introduction

1.1 Treasury management is the management of the Authority's cash flows, borrowing and investments, and the associated risks. The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Authority's prudent financial management.

1.2 Treasury risk management at the Authority is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2021 Edition (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year. This report fulfils the Authority's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

1.3 Investments held for service purposes or for commercial profit are considered in a different report, the Capital Strategy.

1.4 Should the assumptions on which this report is based change significantly, it may be necessary to seek approval to a revised Treasury Management Strategy. Such circumstances could include, for example, a large unexpected change in interest rates, or in the Authority's capital programme or in the level of investments made or borrowing required.

2 External Context

Economic Background:

2.1 The ongoing impact on the UK from the war in Ukraine, together with higher inflation, higher interest rates, uncertain government policy, and a deteriorating economic outlook, will be major influences on the Authority's treasury management strategy for 2023/24.

2.2 The Bank of England (BoE) increased Bank Rate by 0.5% to 4.0% in February 2023. This followed a 0.5% rise in December and a 0.75% rise in November which was the largest single rate hike since 1989 and the ninth successive rise since December 2021. The February decision was voted for by a 7-2 majority of the Monetary Policy Committee (MPC), with two dissenters voting for a no-change at 3.5%.

2.3 The November quarterly Monetary Policy Report (MPR) forecast a prolonged but shallow recession in the UK with CPI inflation remaining elevated at over 10% in the near-term. While the projected peak of inflation is lower than in the August report, due in part to the government's support package for household energy costs, inflation is expected to remain higher for longer over the forecast horizon and the economic outlook remains weak, with unemployment projected to start rising.

2.4 The UK economy contracted by 0.3% between July and September 2022 according to the Office for National Statistics, and the BoE forecasts Gross Domestic Product (GDP) will decline 0.75% in the second half of the calendar year due to the squeeze on household income from higher energy costs and goods prices. Growth is then expected to continue to fall throughout 2023 and the first half of 2024.

2.5 CPI inflation is expected to have peaked at around 11% in the last calendar quarter of 2022 and then fall sharply to 1.4%, below the 2% target, in two years' time and to 0% in three years' time if Bank Rate follows the path implied by financial markets at the time of the November MPR (a peak of 5.25%). However, the BoE stated it considered this path to be too high, suggesting that the peak in interest rates will be lower, reducing the risk of inflation falling too far below target. Market rates have fallen since the time of the November MPR.

2.6 The labour market remains tight for now, with the most recent statistics showing the unemployment rate was 3.7%. Earnings were up strongly in nominal terms by 6.1% for both total pay and for regular pay but factoring in inflation means real pay for both measures was -2.7%. Looking forward, the November MPR shows the labour market weakening in response to the deteriorating outlook for growth, leading to the unemployment rate rising to around 6.5% in 2025.

2.7 Interest rates have also been rising sharply in the US, with the Federal Reserve increasing the range on its key interest rate by 0.5% in December 2022 to 4.25%-4.5%. This rise follows four successive 0.75% rises in a pace of tightening that has seen rates increase from 0.25%-0.50% in March 2022. Annual inflation has been slowing in the US but remains above 7%. GDP grew at an annualised rate of 3.2% (revised up from 2.9%) between July and September 2022, but with official interest rates expected to rise even further in the coming months, a recession in the region is widely expected at some point during 2023.

2.8 Inflation has risen consistently in the Euro Zone since the start of the year, hitting a peak annual rate of 10.6% in October 2022, before declining to 10.1% in November. Economic growth has been weakening with an upwardly revised expansion of 0.3% (from 0.2%) in the three months to September 2022. As with the UK and US, the European Central Bank has been on an interest rate tightening cycle, pushing up its three key interest rates by 0.50% in December, following two consecutive 0.75% rises, taking its main refinancing rate to 2.5% and deposit facility rate to 2.0%.

Credit Outlook:

2.9 Credit default swap (CDS) prices have followed an upward trend throughout the year, indicating higher credit risk. They have been boosted by the war in Ukraine, increasing economic and political uncertainty and a weaker global and UK outlook, but remain well below the levels seen at the beginning of the Covid-19 pandemic.

2.10 CDS price volatility was higher in 2022 compared to 2021 and the divergence in prices between ringfenced (retail) and non-ringfenced (investment) banking entities has emerged once again.

2.11 The weakening economic picture during 2022 led the credit rating agencies to reflect this in their assessment of the outlook for the UK sovereign as well as several local authorities and financial institutions, revising them to negative from stable.

2.12 There are competing tensions in the banking sector which could impact bank balance sheet strength going forward. The weakening economic outlook and likely recessions in many regions increase the possibility of a deterioration in the quality of banks' assets, while higher interest rates provide a boost to net income and profitability.

2.13 However, the institutions on our adviser Arlingclose's counterparty list remain well-capitalised and their counterparty advice on both recommended institutions and maximum duration remain under constant review and will continue to reflect economic conditions and the credit outlook.

Interest Rate Forecast (December 2022):

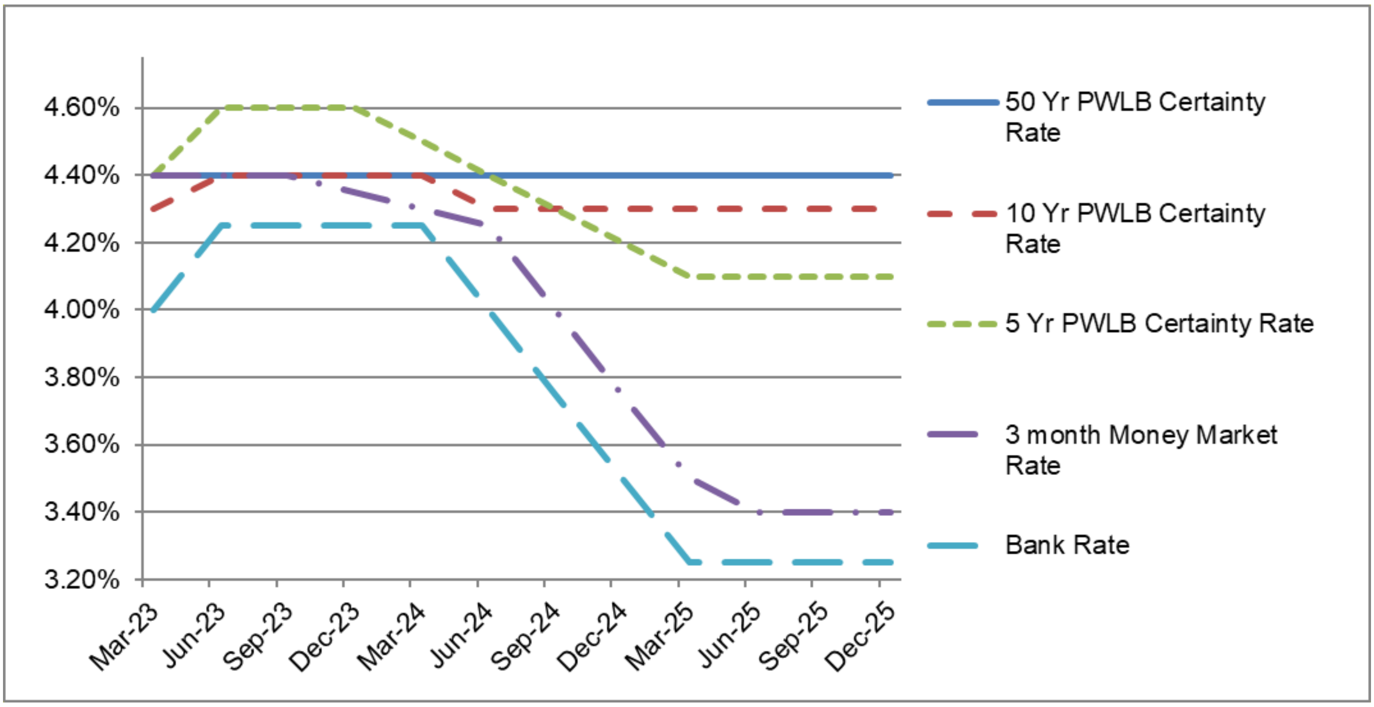
2.14 The Authority's treasury management adviser Arlingclose forecasts that Bank Rate will continue to rise in 2023 as the Bank of England attempts to subdue inflation which is significantly above its 2% target.

2.15 While interest rate expectations reduced during October and November 2022, multiple interest rate rises are still expected over the forecast horizon despite looming recession. Arlingclose expects Bank Rate to rise to 4.25% by June 2023 under its central case, with the risks in the near- and medium-term to the upside should inflation not evolve as the Bank forecasts and remains persistently higher.

2.16 Yields are expected to remain broadly at current levels over the medium-term, with 5-, 10- and 20-year gilt yields expected to average around 3.5%, 3.5%, and 3.85% respectively over the 3-year period to December 2025. The risks for short, medium and longer-term yields are judged to be broadly balanced over the forecast horizon. As ever, there will undoubtedly be short-term volatility due to economic and political uncertainty and events.

2.17 The Council's latest interest rate forecast, reflecting advice from Arlingclose, is shown below.

The Public Works Loan Board (PWLB) rates relate to potential long-term borrowing, and the Money Market rate to short-term borrowing and investment.



For the purpose of setting the budget for 2023/24, it was assumed that:

- any new investments would be at an average rate of 4.00%, and
- new borrowing would be available, if required, at rates around 5.5%.

3 Local Context

At the end of January 2023 the Council held around £215.3M of borrowing and £71.9M of treasury investments:

Table 1: Existing Debt and Investment Portfolio Position

	£m
Short-Term Debt – maturing 22/23	5.0
Short-Term Debt – maturing 23/24	0.0
Long-Term Debt	139.8
Lancashire County Council (LCC) Debt	12.6
Debt re PFI Arrangements	57.9
Gross Borrowings	**215.3**
This was offset by investments of:	71.9
Net Borrowing (gross borrowing less investments)	143.4
Net Borrowing (if LCC and PFI debt are excluded)	**72.9**

3.1 The Council's Capital Financing requirement (CFR) is the key measure of the Council's borrowing **need** in the long term. It is:

the accumulated need to borrow **to finance capital spend** (not funded from grants, etc.)

LESS the accumulated Minimum Revenue Provision (MRP) charges already made - councils must make a prudent MRP charge in their accounts, to finance their debt

LESS any capital receipts applied to finance outstanding debt.

The CFR tends to increase if capital spend financed from borrowing exceeds MRP.

3.2 Forecast changes in CFR and borrowing needs are shown in the table below:

Table 2: Balance Sheet Summary and Forecast

	31.3.22 Actual £m	31.3.23 Estimate £m	31.3.24 Forecast £m	31.3.25 Forecast £m	31.3.26 Forecast £m
General Fund CFR	289.6	284.3	291.8	296.2	298.4
Less: CFR re Other debt liabilities *1	-84.0	-83.6	-83.2	-82.8	-82.3
Loans CFR	**205.6**	**200.7**	**208.6**	**213.4**	**216.1**
Less: External borrowing *2	-141.8	-138.0	-134.6	-124.5	-116.3
Internal Borrowing	**63.8**	**62.7**	**74.0**	**88.9**	**99.8**
Less: Usable reserves *3	-90.4	-82.1	-74.0	-74.0	-74.0
Plus/Minus: Working capital	4.4	-23.3	-2.4	-2.9	-3.3
Remaining Net Borrowing Need	**-22.2**	**-42.7**	**-2.4**	**12.0**	**22.5**

Net Borrowing Need addressed by		
Short Term Borrowing	**20.0**	**0.0**
Treasury Investments	**-42.2**	**-42.7**

*1 CFR regarding PFI liabilities and transferred debt that form part of the Council's total debt

*2 Only loans to which the Council is committed over the longer term

*3 Includes schools balances and grants received in advance of need

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while balance sheet resources are the underlying sums available for investment. The Authority's current strategy is to maintain borrowing below their underlying levels, sometimes known as internal borrowing.

The Council's "Loans CFR" remains relatively steady in the medium-term because, based on current Capital Programme plans, the level of MRP being made is broadly similar to the increase in CFR resulting from additional spend financed from borrowing.

3.3 CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that total debt should be lower than the highest forecast CFR over the next three years. Table 2 shows that the Council expects to comply with this recommendation during 2023/24.

4 Liability Benchmark

4.1 To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as Table 2 above, but that cash and investment balances are kept to a minimum level of £10M at each year-end to maintain sufficient liquidity but minimise credit risk.

4.2 The liability benchmark is an important tool to help establish whether the Council is likely to be a long-term borrower or long-term investor in the future, and so shape its strategic focus and decision making. The liability benchmark itself represents an estimate of the cumulative amount of external borrowing the Council must hold to fund its current capital and revenue plans while keeping treasury investments at the minimum level required to manage day-to-day cash flow.

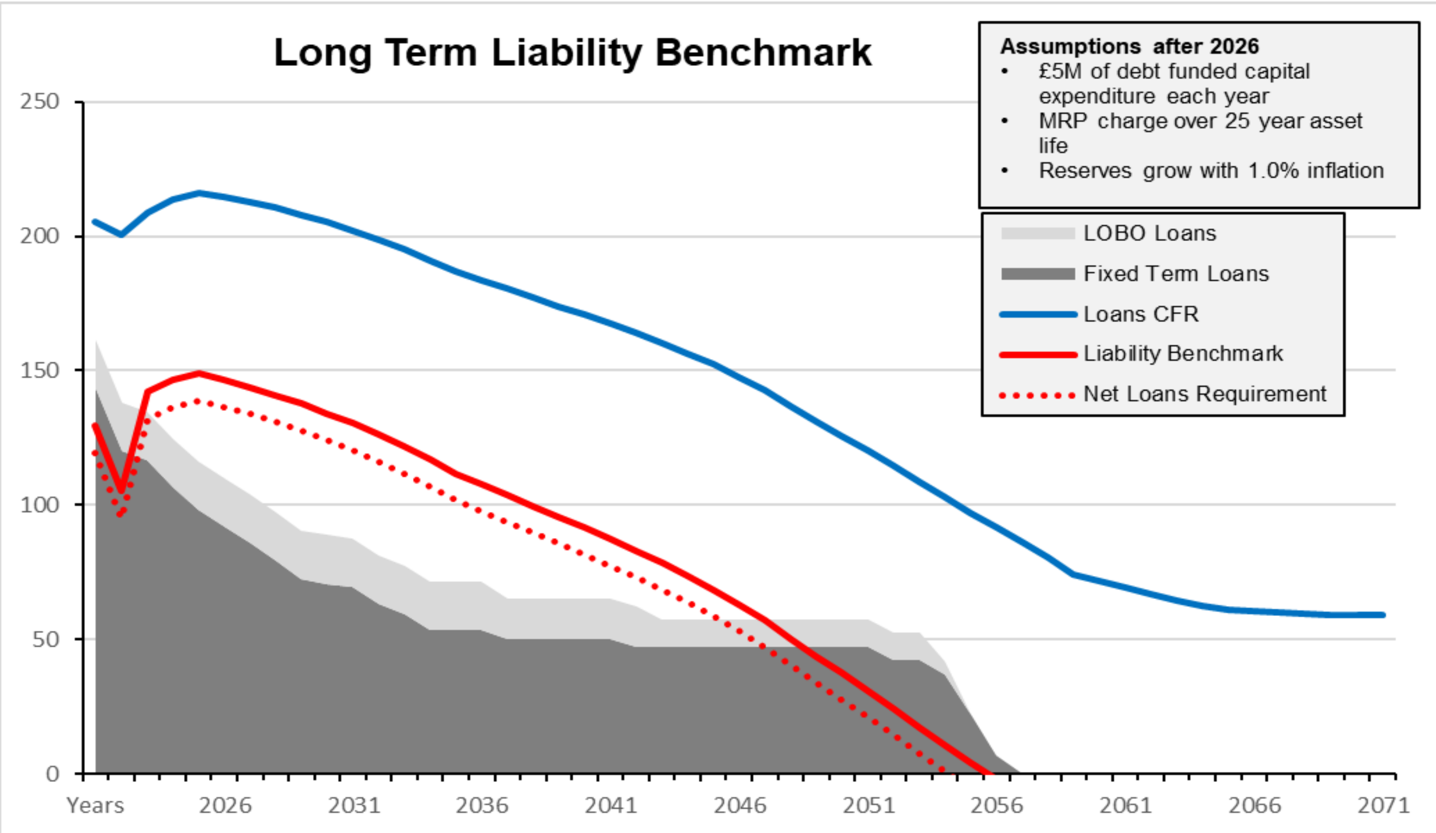
Table 3: Liability Benchmark

	31.3.22 Actual £m	31.3.23 Estimate £m	31.3.24 Forecast £m	31.3.25 Forecast £m	31.3.26 Forecast £m
Loans CFR	205.6	200.7	208.6	213.4	216.1
Less: Balance sheet resources	-90.4	-82.1	-74.0	-74.0	-74.0
Net loans requirement	**115.2**	**118.6**	**134.6**	**139.4**	**142.1**
Plus: Liquidity allowance	14.4	-13.3	7.6	7.1	6.7
Liability Benchmark	**129.6**	**105.3**	**142.2**	**146.5**	**148.8**
Actual Borrowing	**161.8**	**138.0**	**134.6**	**124.5**	**116.3**

4.3 The above table shows that the borrowings the Council has already committed to are forecast to be below the liability benchmark in the future, and therefore the Council would be expecting to enter into new borrowings over the next 3 years. The majority of this would be replacing maturing short-term loans.

4.4 Current borrowing levels are above the liability benchmark for the following reasons:
- additional borrowings required for the advance of pension costs made in April 2020
- low levels of capital expenditure during 2022/23 offset by high value capital receipts, reducing the borrowing requirement
- high cash balances at the end of 2022/23, partly as a result of grant funding received but not spent during the year

4.5 Following on from the medium-term forecasts shown in Table 3 above, the long-term liability benchmark assumes capital expenditure funded by borrowing of £5m a year, minimum revenue provision on new capital expenditure based on a 25 year asset life and income, expenditure and reserves all increasing by inflation of 1.0% a year. This is shown in the chart below together with the maturity profile of the Authority's existing borrowing:



5 Borrowing Strategy

5.1 The authority currently holds £139.8M of loans (excluding PFI and transferred debt), a decrease of £3.8M on the previous year, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in Table 2 shows the authority's borrowing expectations for the next three years. The authority may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £329.4M. However, given the current high level of interest rates, this is unlikely to be a strategy adopted in 2023/24.

5.2 **Objectives:** The authority's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Authority's long-term plans change is a secondary objective.

5.3 **Strategy:** Given the significant cuts to public expenditure and in particular to local government funding, the authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With both short and long-term interest rates currently at high levels, it is likely to be more cost effective in the short-term to maximise the use of internal resources. By doing so, the Council can reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

5.4 Long-term borrowing rates, already high, are forecast to rise modestly in 2023/24 before dropping in 2024/25 and beyond. The benefits of deferring long-term borrowing for as long as possible will be monitored regularly against the costs of internal and short-term borrowing. Arlingclose will assist the Authority with this analysis.

5.5 The Authority has previously raised much of its long-term borrowing from the PWLB, but will consider long-term loans from other sources including banks, pensions and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; if the Council was to undertake such activities, alternative long term funding options would need to be explored. It is likely that this would take longer to arrange, and the process would require additional resources to complete. The interest rates at which such borrowing could be obtained are uncertain but may be at rates higher than those currently available from the PWLB.

5.6 Alternatively, the Council may arrange forward starting loans, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

5.7 In addition, the Council may take further short-term loans to cover cash flow requirements.

5.8 The authority will continue to maintain a flexible approach to borrowing.

5.9 **Sources of Borrowing:** The approved sources of long-term and short-term borrowing will be:

- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- any other UK public sector body
- UK public and private sector pension funds (apart from the Lancashire County Council Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

Other Sources of Debt Financing: In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- leasing
- hire purchase
- Private Finance Initiative
- sale and leaseback

5.10 **Municipal Bonds Agency:** The UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. Blackburn with Darwen BC was one of a number of local authorities investing in the Agency to help to establish it. It issues bonds on the capital markets and lends the proceeds to local authorities.

This is a more complicated source of finance than the PWLB for two reasons:

(a) borrowing authorities will be required to provide bond investors with a guarantee to refund their investment in the event that the agency is unable to for any reason; and
(b) there will be a lead time of several months between committing to borrow and knowing the interest rate payable.

Any decision to borrow from the Municipal Bonds Agency will be subject to a separate report to the Executive Board.

5.11 **LOBOs:** The Council holds £13M of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. £8M of these LOBOs have options which may be exercised during 2023/24, and with interest rates having risen recently, there is now a reasonable chance that lenders will exercise their options. If they do, the Authority may take the option to repay LOBO loans to reduce refinancing risk in later years. It is not currently expected that the Council will take any further LOBO loans - however in order to allow for some flexibility, the Council will limit its total exposure to LOBO loans to £25M.

5.12 **Short-Term and Variable Rate Loans:** Short-term and variable rate loans leave the authority exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below. Financial derivatives may be used to manage this interest rate risk (see section below).

5.13 **Debt Rescheduling:** The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Authority may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk. The recent rise in interest rates means that more favourable debt rescheduling opportunities should arise than in previous years.

6 Treasury Investment Strategy

6.1 On a day-to-day basis the Council can hold significant invested funds representing income received in advance of expenditure requirements, in addition to balances and reserves held. In the past 12 months, the Council's treasury investment balance has ranged between £35M and £83M, reflecting in particular the profiles of capital spending, grant funding, short-term borrowing levels and long-term debt repayments. Treasury investment levels are expected to reduce over the forthcoming year based on forecast capital expenditure plans, and the spending of grants in 2023/24 that have been received in the current year.

6.2 **Objectives:** The CIPFA Code requires the Council to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will try, whilst balancing the above, to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested. The Authority aims to be a responsible investor and will consider environmental, social and governance (ESG) issues when investing.

6.3 **Strategy:** As demonstrated by the liability benchmark above, the Authority expects to be a long-term borrower, but is likely to use internal resources to defer borrowing for as long as possible in the expectation of interest rate reductions by the end of 2023/24. This will inevitably diminish the funds available for investment, but there will be opportunities in the first half of the year to take advantage of current yields, albeit the focus will remain on relatively short-term, low risk opportunities. The existing portfolio of strategic pooled funds will be maintained to diversify risk into different sectors and boost investment income, and the Authority will work with its brokers to investigate other, appropriate lending opportunities.

6.4 In order to prioritise the security of investments, the Council sets limits on the amounts placed with different institutions and as to the duration of the investment. This is to maintain a diversified investment portfolio and to align amounts and durations of investments to the perceived risks associated with different counterparties.

6.5 **ESG policy:** Environmental, social and governance (ESG) considerations are increasingly a factor in global investors' decision making, but the framework for evaluating investment opportunities is still developing and therefore the Authority's ESG policy does not currently include ESG scoring or other real-time ESG criteria at an individual investment level. When investing in banks and funds, the Authority will prioritise banks that are signatories to the UN Principles for Responsible Banking and funds operated by managers that are signatories to the UN Principles for Responsible Investment, the Net Zero Asset Managers Alliance and/or the UK Stewardship Code.

6.6 **Business Models:** Under the IFRS 9 standard, the accounting for certain investments depends on the Authority's "business model" for managing them. The Authority aims to achieve value from its treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

6.7 **Approved Counterparties:** The Authority may invest its surplus fund with any of the counterparty types in Table 4 below, subject to the limits shown.

6.8 The counterparty limits set out below do allow for a wider range of investment opportunities to be taken up than have been used by the Council to date. Should the circumstances arise under which this would be appropriate, this would allow an increased diversification of the overall portfolio and in some instances, increase the security of investments made. The take up of any new investment opportunities will be closely managed by Officers in the Treasury Management Group, following advice given by the Council's Treasury Management Advisers.

Table 4: Treasury Investment Counterparties and Limits

Approved Investment Counterparties	Time Limit	Cash Limit	Sector Limit
The UK Government	50 years	Unlimited	N/A
Local Authorities* & Other Government Entities	25 years	£5M each	Unlimited
** as defined in the Local Government Act 2003*			
Banks and Building Societies - Secured			
long-term credit ratings no lower than AA- (or equivalent)	25 years	£5M each	Unlimited
long-term credit ratings no lower than AA (or equivalent)	25 years	£4M each	
long-term credit ratings no lower than A- (or equivalent)	25 years	£3M each	
Banks and Building Societies - Unsecured			
long-term credit ratings no lower than AA- (or equivalent)	13 months	£5M each	Banks - Unlimited Building societies - £6M in total
long-term credit ratings no lower than AA (or equivalent)	13 months	£4M each	
long-term credit ratings no lower than A- (or equivalent)	13 months	£3M each	
The Council's **current account banker** - provided long-term credit rating no lower than BBB- (or equivalent)	next day	£3M each	
Corporates or **Registered Providers** with long-term credit ratings no lower than A- (or equivalent)	5 years	£3M each	£5M in total
Money Market Funds			
long-term credit ratings no lower than A- (or equivalent)	N/A	£5M each	Unlimited
unrated or long-term credit ratings under A- (or equivalent)	N/A	£4M each	
Strategic Pooled Funds and Real Estate Investment Trusts (incl. money market funds)			
long-term credit ratings no lower than A- (or equivalent)	N/A	£5M each	£10m in total
unrated or long-term credit ratings under A- (or equivalent)	N/A	£4M each	

Other Investment Limits	Cash Limits
Any group or organisation under the same ownership	Group or overall limit same as would be set for parent company
Foreign Countries - limited to those with sovereign credit rating of AA+ or better (from all agencies)	£5M each
UK investments will not be limited by the UK's sovereign credit rating	
Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.	

6.9 Cash flow surpluses can be considered as falling into three categories -

(a) **Short-term funds** that are required to meet cash flows occurring in the next month or so, and for which the preservation of capital and liquidity is therefore of paramount importance. Generating investment returns is of limited concern here, although should not be ignored. Instant access AAA-rated money market funds and bank deposit accounts will be the main methods used to manage short-term cash.

(b) **Medium-term funds** that may be required in the next one to twelve months will be managed concentrating on security, with less importance attached to liquidity but a slightly higher emphasis on yield. The majority of investments in this period will be in the form of fixed term deposits with banks and building societies. A spread of counterparties and maturity dates will be maintained to maximise the diversification of credit and interest rate risks.

(c) **Long-term funds** that are not required to meet any liquidity need and can be invested with a greater emphasis on achieving higher returns. Security remains fundamental however, as any losses from defaults will impact on the total return. Liquidity is of lesser concern, although it should still be possible to sell investments with due notice if large cash commitments arise unexpectedly. This is where a wider range of instruments, including structured deposits, certificates of deposit, gilts, corporate bonds and pooled funds in bond, equity and property funds, which could be used to diversify the portfolio.

6.10 The overall Investment Strategy will be to prioritise security of funds and maintain a mix of short-term (largely instant access) and medium-term investments to generate investment income as market conditions permit. If the Council expects to have funds available for long-term investment, the Council will consider its options for such funds, including potential investment in strategic pooled funds. However, long-term investment is unlikely in 2023/24 give the aspiration to defer borrowing.

6.11 **Government:** Loans to, and bonds and bills issued or guaranteed by, national government, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Government are deemed to be zero credit risk due to its ability to create additional currency and therefore may be made in unlimited amounts for up to 50 years.

6.12 **Secured investments:** Investments secured on the borrower’s assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments.

6.13 **Banks and building societies (unsecured):** Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

6.14 **Registered providers (unsecured):** Loans to, and bonds issued or guaranteed by, registered providers of social housing or registered social landlords, formerly known as housing associations. These bodies are regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

6.15 **Money market funds:** Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the Authority will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

6.16 **Strategic pooled funds:** Bond, equity and property funds that offer enhanced returns over the longer term but are more volatile in the short term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.

6.17 **Real estate investment trusts:** Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.

6.18 **Other investments:** This category covers treasury investments not listed above, for example unsecured corporate bonds and company loans. Non-bank companies cannot be bailed-in but can become insolvent placing the Authority's investment at risk.

6.19 **Operational Bank Accounts:** The Authority may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £3 million per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Authority maintaining operational continuity.

6.20 **Risk Assessment and Credit Ratings:** Credit ratings are obtained and monitored by the Authority's treasury advisers, who will notify changes in ratings as they occur. The credit rating agencies in current use are listed in the Treasury Management Practices document. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled at no cost will be recalled and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

6.21 Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "negative watch"), so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

Where a credit rating agency awards a different rating to a particular class of investment instrument as opposed to the credit rating of the counter-party as a whole, the Council will base its investment decisions on the instrument credit rating rather than the counterparty credit rating.

6.22 **Other Information on the Security of Investments:** The Authority understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Authority's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

6.23 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Authority will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Authority's cash balances, then the surplus will be deposited with the UK Government, or with other local authorities. This will cause investment returns to fall but will protect the principal sum invested. The Authority will continue to seek information and advice from Arlingclose when assessing the creditworthiness of potential counterparties.

6.24 **Liquidity Management:** The Council uses a cash flow model to determine the period for which funds may prudently be committed. The forecast is compiled on a prudent basis, to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Furthermore, a prudent level of funds is maintained in 'instant access' investments, to cover most likely eventualities. However to mitigate risk further, it is possible to borrow funds to cover short-term needs.

The Authority will spread its liquid cash over at least four providers (e.g. bank accounts and money market funds) to ensure that access to cash is maintained in the event of operational difficulties at any one provider.

7 Treasury Management Prudential Indicators

7.1 The Council measures and manages its exposures to treasury management risks using the following indicators:

7.2 **Maturity Structure of Borrowing:** This indicator is set to control the Council's exposure to refinancing risk - i.e. to prevent too much debt maturing at any one time, with a risk the Council will have to refinance at the rates then prevailing. The limits for up to 24 months continue to be relaxed to allow for a higher level of short-term borrowing.

The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	Upper	Lower
Under 12 months	50%	0%
12 months and within 24 months	30%	0%
24 months and within 5 years	30%	0%
5 years and within 10 years	30%	0%
10 years and above	95%	20%

This indicator applies to the financial years 2023/24 and 2024/25, from the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment. Where there is a prospect that a LOBO may be called, this has been reflected in setting these limits.

7.3 **Long term treasury management investments:** The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end will be:

	2023/24 £M	2024/25 £M	2025/26 £M
Limit on principal invested beyond year end	7.0	5.0	3.0

So a maximum of £7M can be invested for a period of greater than one year, a maximum of £5M for a period of greater than two years and a maximum of £3M for a period of greater than three years.

Long-term investments with no fixed maturity date include strategic pooled funds and real estate investment trusts but exclude money market funds and bank accounts with no fixed maturity date as these are considered short-term.

The Indicators above are "standard" Treasury Management Indicators that are generally adopted by local authorities, in line with individual circumstances. These indicators have not directly addressed the key treasury priorities of Security and Liquidity, though these issues are already closely tracked throughout the year. However, working in conjunction with the Council's Treasury Advisers, options for the formal monitoring of performance in regard to these priorities remain under consideration.

7.4 **Interest Rate Risk:** CIPFA has withdrawn the previous recommendation for standard indicators for Upper Limits on Fixed and Variable Interest Rate Risk. Nonetheless, this Council recognises that it must have regard to the risk that fluctuations in interest rates could create an unexpected burden on its finances, and will therefore continue to monitor its exposure to Fixed and Variable Interest Rate Risk. In addition, without setting a formal limit, this Council will also monitor, on an ongoing basis, the potential impact of a 1% change in interest rates on its current borrowing and investment portfolio.

The upper limits on fixed and variable rate interest rate exposures, expressed as an amount of net principal borrowed will be:

	2023/24 £M	2024/25 £M	2025/26 £M
Upper limit on Fixed Interest rate exposures	212.1	216.6	219.3
Upper limit on Variable Interest rate exposures	92.8	95.0	96.2

The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at new market rates.

8 Related Matters

8.1 **Financial Derivatives:** Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

8.2 The Authority will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Authority is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

8.3 Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria, assessed using the appropriate credit rating for derivative exposures. An allowance for credit risk calculated using the methodology in the Treasury Management Practices document will count against the counterparty credit limit and the relevant foreign country limit.

8.4 In line with the CIPFA Code, the Authority will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.

8.5 **Markets in Financial Instruments Directive (MiFID):** The Authority has opted up to professional client status with its providers of financial services, including advisers, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Authority's treasury management activities, the Director of Finance believes this to be the most appropriate status.

9 Financial Implications

9.1 Excluding PFI costs (which are offset by Government grant funding), the budget for debt interest payable in 2023/24 is £7.0M (including the interest element of payments to LCC for debt managed on our behalf), reflecting:

(a) £5.9 million interest payable, at an average interest rate of around 3.8%, on the long-term debt portfolio (forecast to average £149 million over the year),

(b) up to £1.1 million for short-term borrowing, at interest rates averaging 5.5%. This is a prudent estimate given that, as described elsewhere in this strategy, internal resources will be used to defer borrowing for as long as possible.

Projected investment income in 2023/24 is around £1.3M, based on an average investment portfolio of circa £32.5M, and interest rates averaging 4.00%.

If actual levels of investments and borrowing and/or actual interest rates differ from those forecast, performance against budget will be correspondingly different.

10 Other Options Considered

The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Director of Finance, having consulted with the Executive Member for Finance and Governance, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain