APPENDIX A

Capital Prudential Indicators and Treasury Management Strategy 2023/24 to 2027/28

1. INTRODUCTION

1.1 Background

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

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

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.

CIPFA defines treasury management as:

"The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities, (arising usually from capital expenditure), and are separate from the day-to-day treasury management activities.

1.2 Reporting Requirements

Capital Strategy

The CIPFA 2021 Prudential and Treasury Management Codes require all local authorities to prepare a capital strategy report which will provide the following:

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

The aim of the capital strategy is to ensure that all elected members fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

Treasury Management Reporting

The Council is currently required to receive and approve, as a minimum, three main treasury reports each year, which incorporate a variety of policies, estimates and actuals.

Prudential and treasury indicators and treasury strategy (this report) – The first, and most important, report covers:

- the capital plans (including prudential indicators);
- a Minimum Revenue Provision (MRP) Policy (how residual capital expenditure is charged to revenue over time);
- the Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an Annual Investment Strategy (the parameters on how investments are to be managed)

A mid-year treasury management report – This is primarily a progress report and will update members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision.

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

Scrutiny

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

Quarterly reports

In addition to the three major reports detailed above, from 2023/24 the Code also specifies that quarterly updates are provided. However, these additional reports do not need to be reported to the full Council, although they do need to be adequately scrutinised. It is proposed that the quarterly updates, which should include reporting on treasury and prudential indicators, are reported to Cabinet Executive.

1.3 Treasury Management Strategy for 2023/24

The strategy for 2023/24 covers two main areas:

Capital issues

- The capital expenditure plans and the associated prudential indicators;
- The minimum revenue provision (MRP) policy.

Treasury Management issues

- The current treasury position;
- Treasury indicators which limit the treasury risk and activities of the Council;
- Prospects for interest rates;
- The borrowing strategy;
- Policy on borrowing in advance of need;
- Debt rescheduling;
- The investment strategy
- Creditworthiness policy; and
- Policy on the use of external service providers.

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, the Department for Levelling Up, Housing and Communities (DLUHC) MRP Guidance, the CIPFA Treasury Management Code, and DLUHC Investment Guidance.

1.4 Training

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

Furthermore, the Code also expects “all organisations to have a formal and comprehensive knowledge and skills or training policy for the effective acquisition and retention of treasury management knowledge and skills for those responsible for management, delivery, governance and decision making.

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

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

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

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

Cabinet members last received refresher training from our treasury consultants, Link Treasury Services, in October 2018, and further training is planned for Spring 2023.

The training needs of treasury management officers are periodically reviewed.

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

1.5 Treasury Management Consultants

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

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

It also recognises that there is value in employing external providers of treasury management services in order 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.

The Council does not currently have any non-treasury investments but, in September 2022, the Council approved budget provision to be used for strategic property investment purposes, subject to it meeting the criteria set out in the CIPFA Code. The Council has secured specialist advice in this area through a fixed term shared service with Charnwood Borough Council.

2 THE CAPITAL PRUDENTIAL INDICATORS 2023/24 – 2027/28

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

2.1 Capital expenditure and financing

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. This indicator also covers how those plans are to be financed by capital or revenue resources. Members are asked to approve the estimated capital expenditure and resources in the table below. Any shortfall in resources results in a need to borrow.

	2021/22 Actual £000	2022/23 Revised £000	2023/24 Estimate £000	2024/25 Estimate £000	2025/26 Estimate £000	2026/27 Estimate £000	2027/28 Estimate £000
Capital Expenditure	**2,147**	**7,669**	**3,619**	**2,724**	**1,220**	**882**	**2,657**
Financed by: Capital Receipts	(286)	(365)	(525)	(520)	(150)	0	(500)
Capital Grants & Contributions	(984)	(2,135)	(706)	(758)	(703)	(674)	(692)
Capital Reserves	(357)	(260)	(92)	0	(32)	0	.0
Revenue Contributions	(76)	(151)	0	0	0	0	.0
Net financing need for the year	**444**	**4,758**	**2,296**	**1,446**	**335**	**208**	**1,465**

2.2 The Council's borrowing need (the Capital Financing Requirement)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It represents a measure of the Council's underlying need to borrow. Any capital expenditure above, which has not immediately been paid for, will increase the CFR. The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each asset's life, and so charges the economic consumption of capital assets as they are used.

The CFR includes any other long-term liabilities such as finance leases. Whilst this increases the CFR and, therefore, the Council's borrowing requirement, these types of schemes include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has just under £0.5m of finance lease liabilities within the CFR.

The Council is asked to approve the following CFR projections:

	2021/22 Actual £000	2022/23 Revised £000	2023/24 Estimate £000	2024/25 Estimate £000	2025/26 Estimate £000	2026/27 Estimate £000	2027/28 Estimate £000
Total CFR	13,965	18,334	19,902	20,354	19,485	18,397	18,487
Movement in CFR	(701)	4,369	1,568	452	(869)	(1,088)	90

Movement in CFR represented by:							
Net financing need for the year (above)	444	4,758	2,296	1,446	335	208	1,465
MRP/VRP and other financing movements	(1,145)	(389)	(728)	(992)	(1,202)	(1,296)	(1,375)
Movement in CFR	(701)	4,369	1,568	452	(869)	(1,088)	90

The following table analyses the planned external borrowing for capital expenditure purposes and conforms to the DLUHC requirements for applying for certainty rate borrowing from the Public Works Loan Board (PWLB).

	2021/22 Actual £000	2022/23 Revised £000	2023/24 Estimate £000	2024/25 Estimate £000	2025/26 Estimate £000	2026/27 Estimate £000	2027/28 Estimate £000
Service spend	444	2,258	2,296	1,446	335	208	1,465
Housing	0	0	0	0	0	0	0
Regeneration	0	2,500	0	0	0	0	0
Preventative action	0	0	0	0	0	0	0
Projects for yield	0	0	0	0	0	0	0
Total	**444**	**4,758**	**2,296**	**1,446**	**335**	**208**	**1,465**

Borrowing for schemes that fall under the heading of "projects for yield" will automatically disqualify the Council from being able to borrow from the PWLB in any year, so this table demonstrates that The Council is complying with the Code in this regard.

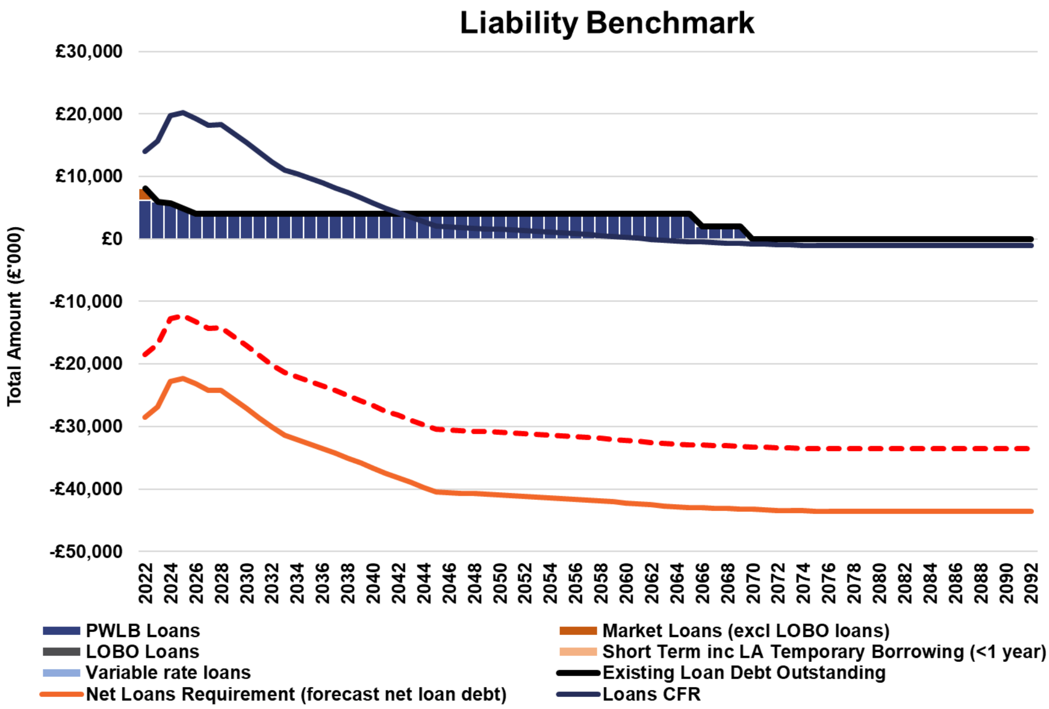
2.3 Liability Benchmark

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

There are four components to the Liability Benchmark:

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.

The graph below shows that the Council's borrowing is below the CFR and will reduce over time. However, it should be noted that this is a snapshot and when the debt matures those loans will need to be refinanced. The graph also shows that the liability benchmark is negative, meaning that the Council has sufficient cash reserves to maintain internal borrowing for the foreseeable future, even when allowing for a liquidity buffer.



2.4 Core funds and expected investment balances

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

	2021/22 Actual £000	2022/23 Revised £000	2023/24 Estimate £000	2024/25 Estimate £000	2025/26 Estimate £000	2026/27 Estimate £000	2027/28 Estimate £000
Fund Balances & Reserves	(18,780)	(12,936)	(10,907)	(8,956)	(8,219)	(7,514)	(6,809)
Capital Receipts	(2,124)	(1,829)	(1,374)	(924)	(844)	(914)	(484)
Provisions	(2,103)	(1,980)	(3,007)	(4,160)	(5,338)	(6,638)	(7,964)
Other	2,958	1,872	(388)	(388)	(388)	(388)	(388)
Total Core Funds	**(20,049)**	**(14,873)**	**(15,675)**	**(14,428)**	**(14,789)**	**(15,454)**	**(15,645)**
Working Capital*	(21,973)	(13,076)	(9,558)	(5,614)	(2,092)	1,962	3,561
(Over)/Under Borrowing	5,368	10,649	10,433	10,242	9,081	7,692	6,284
Expected Investments	**(36,654)**	**(20,000)**	**(15,000)**	**(10,000)**	**(8,000)**	**(6,000)**	**(6,000)**

* Working capital balances shown are estimated year end; these may be higher mid-year.

2.5 Minimum revenue provision (MRP) policy statement

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

The Council is required to calculate a prudent MRP which ensures that the outstanding debt liability is repaid over a period that is reasonably commensurate with that over which the capital expenditure provides benefits. The MRP Guidance (2018) gives four ready-made options for calculating MRP, but the Council can use any other reasonable basis that it can justify as prudent.

The MRP policy statement must be approved by full Council in advance of each financial year. The Council is recommended to approve the following MRP statement:

For supported capital expenditure incurred before 1st April 2008, the Authority will apply the Asset Life Method using an annuity calculation over 50 years.

Unsupported borrowing will be subject to MRP under option 3 of the guidance (Asset Life Method), which will be charged over a period which is reasonably commensurate with the estimated useful life applicable to the nature of the expenditure. For example, capital expenditure on a new building, or on the refurbishment or enhancement of a building, will be related to the estimated life of that building. An annuity method will be used for the MRP calculation on a weighted average basis.

The interest rate applied to the annuity calculations will reflect the market conditions at the time and will for the current financial year be the Council's weighted average borrowing rate.

The following table gives an indication of the useful asset lives of different categories of assets/capital expenditure type, and hence the period over which MRP will be charged.

Capital Expenditure incurred on:	Estimated Asset Life for MRP purposes
Construction of new buildings	40 – 60 years
Disabled Facilities Grants – Stairlifts	5 years
Disabled Facilities Grants – Bathrooms/Major Adaptations	20 years
Enhancement and refurbishment of land and buildings	10 years
Refuse vehicles	7 years
Other vehicles, plant and equipment	5 – 7 years
Other capital grants	5 years
IT Systems	2 - 5 years

Capital expenditure incurred during 2022/23 will not be subject to an MRP charge until 2023/24, or in the year after which the asset becomes operational.

The Council will apply the asset life method for any expenditure capitalised under a Capitalisation Direction.

MRP in respect of assets acquired under Finance Lease will be charged at a rate equal to the principal element of the annual lease rental for the year in question.

MRP Overpayments - Under the MRP guidance, any charges made in excess of the statutory MRP can be made, known as voluntary revenue provision (VRP).

VRP can be reclaimed in later years if deemed necessary or prudent. In order for these amounts to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year.

There have been no cumulative VRP overpayments made to date.

3 BORROWING

The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council’s cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury/prudential indicators, the current and projected debt positions and the Annual Investment strategy.

3.1 Current portfolio position

The overall treasury management portfolio as at 31st March 2022 is shown below compared with the position as at 31st January 2023.

	Actual 31/03/22 £000	Actual 31/03/22 %	Actual 31/01/23 £000	Actual 31/01/23 %
Treasury Investments				
Banks	23,560	64%	27,337	63%
Local Authorities	0	0%	2,000	5%
Money Market Funds	12,000	33%	12,637	30%
Total managed in house	**35,560**	**97%**	**41,974**	**98%**
Property Funds	1,094	3%	857	2%
Total managed externally	**1,094**	**3%**	**857**	**2%**
Total Treasury Investments	**36,654**	**100%**	**42,831**	**100%**
External Borrowing				
Local Authorities	2,000	25%	0	0%
Public Works Loans Board	6,142	75%	6,037	100%
Total External Borrowing	**8,142**	**100%**	**6,037**	**100%**
Net Treasury Investments/(Borrowing)	**28,512**		**36,794**	

The Council's forward projections for borrowing are summarised below. The table shows the actual external debt, against the underlying capital borrowing need, (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

	2021/22 Actual £000	2022/23 Revised £000	2023/24 Estimate £000	2024/25 Estimate £000	2025/26 Estimate £000	2026/27 Estimate £000	2027/28 Estimate £000
Loans at 1st April	8,349	8,142	7,230	9,013	9,658	9,950	10,250
Leases at 1st April	456	455	455	455	454	454	454
Gross Opening Debt	**8,805**	**8,597**	**7,685**	**9,468**	**10,112**	**10,404**	**10,704**
New loans in year	0	1,300	2,000	1,500	1,150	300	1,500
New leases in year	0	0	0	0	0	0	0
Loan repayments	(207)	(2,212)	(217)	(855)	(858)	0	0
Lease repayments	(1)	0	0	(1)	0	0	0
Loans at 31st March	8,142	7,230	9,013	9,658	9,950	10,250	11,750
Leases at 31st March	455	455	455	454	454	454	454
Gross Closing Debt	**8,597**	**7,685**	**9,468**	**10,112**	**10,404**	**10,704**	**12,204**
Capital Financing Requirement	**13,965**	**18,334**	**19,902**	**20,354**	**19,485**	**18,397**	**18,487**
Under/(over) borrowing	**5,368**	**10,649**	**10,434**	**10,242**	**9,081**	**7,693**	**6,284**

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

The Executive Director (Section 151) is pleased to report that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes account of current commitments, existing plans, and the proposals in the budget report.

3.2 Treasury Indicators – limits to borrowing activity

The operational boundary – This is the limit 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.

	2022/23 Revised £000	2023/24 Estimate £000	2024/25 Estimate £000	2025/26 Estimate £000	2026/27 Estimate £000	2027/28 Estimate £000
Borrowing	20,200	20,200	20,900	20,900	19,100	19,100
Other long-term liabilities	500	500	2,500	2,500	2,500	2,500
Total	20,700	20,700	23,400	23,400	21,600	21,600

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

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

- The Council is asked to approve the following authorised limit:

	2022/23 Revised £000	2023/24 Estimate £000	2024/25 Estimate £000	2025/26 Estimate £000	2026/27 Estimate £000	2027/28 Estimate £000
Borrowing	22,444	22,444	23,222	23,222	21,222	21,222
Other long-term liabilities	556	556	2,778	2,778	2,778	2,778
Total	23,000	23,000	26,000	26,000	24,000	24,000

Both the Authorised Limit and the Operational Boundary for 2024/25 onwards have been increased by £2m to allow for the introduction of IFRS16. This acts as a provision for leases that are currently off-balance sheet (accounted for as operating leases) to be brought onto the balance sheet on 1st April 2024. The increase is based broadly on the outstanding operating lease liability on 31st March 2022.

3.3 Prospects for interest rates

The Council has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Link's central view appears at Appendix B. Their forecasts take account of certainty rates, gilt yields plus 80 basis points.

Link's central forecast for interest rates was updated on 19th December 2022 and reflected a view that the Monetary Policy Committee (MPC) would be keen to further demonstrate its anti-inflation credentials by delivering a succession of rate increases. Bank Rate stands at 3.5% currently but is expected to reach a peak of 4.5% in the first half of 2023.

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

The CPI measure of inflation looks to have peaked at 11.1% in Q4 2022 (currently 10.7%). Despite the cost-of-living squeeze that is still taking shape, the Bank will want to see evidence that wages are not spiralling upwards in what is evidently a very tight labour market.

Regarding the plan to sell £10bn of gilts back into the market each quarter (Quantitative Tightening), this has started and will focus on the short, medium and longer end of the curve in equal measure, now that the short-lived effects of the Autumn Statement unfunded dash for growth policy are firmly in the rear-view mirror.

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

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

PWLB Rates

- The yield curve movements have become less volatile of late and PWLB 5 to 50 years Certainty Rates are, generally, in the range of 4.10% to 4.80%.

- Link view the markets as having built in, already, nearly all the effects on gilt yields of the likely increases in Bank Rate and the elevated inflation outlook.

The balance of risks to the UK economy:

- The overall balance of risks to economic growth in the UK is to the downside.

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

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

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

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

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

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

- The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly and for a longer period within the UK economy, which then necessitates Bank Rate staying higher for longer than currently projected or even necessitates a further series of increases in Bank Rate.

- The Government acts too quickly to cut taxes and/or increases expenditure in light of the cost-of-living squeeze.

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

- Longer term US treasury yields rise strongly and pull gilt yields up higher than currently forecast.

- Projected gilt issuance, inclusive of natural maturities and QT, could be too much for the markets to comfortably digest without higher yields consequently.

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

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

- 2022/23 4.00%
- 2023/24 4.40%
- 2024/25 3.30%
- 2025/26 2.60%
- 2026/27 2.50%
- Years 6 to 9 2.80%
- Year 10+ 2.80%

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

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

3.4 Borrowing Strategy

The Council is currently maintaining a position whereby its outstanding debt is lower than the underlying need to borrow (the CFR). This means that the capital borrowing need, (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as medium and longer dated borrowing rates are expected to fall from their current levels once prevailing inflation concerns are addressed by tighter near-term monetary policy. That is, the Bank Rate increases over the first half of 2023.

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

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

- if it was felt that there was a significant risk of a much sharper **rise** in borrowing rates than that currently forecast, perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

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

3.5 Policy on borrowing in advance of need

The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved CFR estimates and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

Borrowing in advance will be made within the constraints that:

- It will be limited to no more than the sum of the expected increase in borrowing need (CFR) over the next three years; and
- The Council would not look to borrow more than 24 months in advance of need.

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

3.6 Debt rescheduling

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

If any rescheduling is done, it will be reported to Council at the earliest opportunity following its enactment.

3.7 New Financial Institutions as a source of borrowing

Currently the PWLB Certainty Rate is set at gilts + 80 basis points. However, consideration may still need to be given to sourcing funding from the following sources for the following reasons:

- Local authorities (primarily shorter dated maturities out to 3 years or so – generally still cheaper than the Certainty Rate).
- Financial institutions (primarily insurance companies and pension funds but also some banks, out of forward dates where the objective is to avoid a "cost of carry" or to achieve refinancing certainty over the next few years).
- Municipal Bonds Agency (possibly still a viable alternative depending on market circumstances prevailing at the time).
- UK Infrastructure Bank (as above)

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

3.8 Approved Sources of Long- and Short-Term Borrowing

On Balance Sheet	Fixed	Variable
PWLB	●	●
Municipal Bond Agency	●	●
Local authorities	●	●
Banks	●	●
Pension funds	●	●
Insurance companies	●	●
UK Infrastructure Bank	●	●
Market – long term	●	●
Market – temporary	●	●
Market – LOBOs	●	●
Stock issues	●	●
Local temporary	●	●
Local bonds	●	
Local authority bills	●	●
Overdraft		●
Negotiable bonds	●	●
Internal – capital receipts and revenue balances	●	●
Commercial paper	●	
Medium term notes	●	
Finance leases	●	●

4. ANNUAL INVESTMENT STRATEGY

4.1 Investment policy – management of risk

The Department of Levelling Up, Housing and Communities (DLUHC) and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with treasury (financial) investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy, part of the 5 Year Capital Programme report.

The Council's investment policy has regard to the following:

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

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

In the current economic climate, it is considered appropriate to maintain a degree of liquidity to cover cash flow needs. However, where appropriate (from an internal as well as external perspective), the Council will also consider the value available in periods up to 12 months with high credit rated financial institutions, as well as wider range fund options.

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

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

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

3. Other information sources used will include the financial press, share price and other such information pertaining to the financial sector in order to

establish the most robust scrutiny process on the suitability of potential investment counterparties.

4. The Council has defined the list of types of investment instruments that the treasury management team are authorised to use. There are two lists in Appendix D under the categories of ‘specified’ and ‘non-specified’ investments.

   - **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year or have less than a year left to run to maturity if originally, they were classified as being non-specified investments solely due to the maturity period exceeding one year.
   - **Non-specified investments** are those with less high credit quality, may be for periods more than one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.

5. **Non-specified and loan investment limits.** The Council does not currently place a limit on the maximum total exposure to non-specified investments as a percentage of the total investment portfolio.

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

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

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

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

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

11. All investments will be denominated in sterling.

12. As a result of the change in accounting standards for 2022/23 under IFRS 9, the Council will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. In November 2018, the Ministry of Housing, Communities and Local Government, [MHCLG], concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years ending 31st March 2023. At the current juncture it has not been determined whether a further extension to the over-ride will be agreed by the government. This will apply to the Council’s investment in the Lothbury Property

Fund. Once the statutory override expires, the Council will need to reflect movements in its Property Fund in the General Fund, in accordance with IFRS 9.

However, the Council will also pursue value for money in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see paragraph 4.5). Regular monitoring of investment performance will be carried out during the year.

Changes in risk management policy from last year

The above criteria are unchanged from last year.

4.2 Creditworthiness policy

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

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ranges;
- sovereign ratings to select counterparties from only the most creditworthy countries.

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

- Yellow — 5 years
- Dark Pink — 5 years for Ultra-Short Dated Bond Funds with a credit score of 1.25
- Light Pink — 5 years for Ultra-Short Dated Bond Funds with a credit score of 1.5
- Purple — 2 years
- Blue — 1 year (nationalised/or semi nationalised UK Banks)
- Orange — 1 year
- Red — 6 months
- Green — 100 days
- No Colour — not to be used (NB: except building societies)

	Colour/long term rating	Money and/or % limit	Time Limit
UK Banks/Non-UK Banks	Yellow	£5m/£3m	5 years
UK Banks/Non-UK Banks	Purple	£5m/£3m	2 years
UK Banks/Non-UK Banks	Orange	£5m/£3m	1 year
Banks – part nationalised • RBS	Blue	£8m	1 year
UK Banks/Non-UK Banks	Red	£8m/£5m/£3m	6 months
UK Banks/Non-UK Banks	Green	£5m/£3m	100 days
UK Banks/Non-UK Banks	No colour	n/a	n/a
Building Societies	No colour/P-2	£5m	100 days
Council's own banker (not meeting usual criteria)	No colour	£8m	Overnight
DMADF	AAA	unlimited	6 months
Local authorities	n/a	£5m	5 years
Property Funds	n/a	£1m	Unlimited
Money Market Funds			
• CNAV	AAA	£8m	Liquid
• LVNAV	AAA	£8m	Liquid
• VNAV	AAA	£8m	Liquid
Ultra-Short Dated Bond Funds with a credit score of 1.25	Dark pink/AAA	£3m	Liquid
Ultra-Short Dated Bond Funds with a credit score of 1.50	Light pink/AAA	£3m	Liquid

In respect of building societies, the Council will use those societies that have assets in excess of £10 billion, subject to them having a minimum credit rating of P-2 (Moody's).

The Link creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not place undue emphasis on just one agency's ratings.

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.

All credit ratings will be monitored on an ongoing basis. The Council is alerted to changes to ratings of all three agencies through its use of the Link Asset Services' 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 CDS spreads against the iTraxx European Financials benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

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

Creditworthiness

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

Although bank CDS prices, (these are market indicators of credit risk), spiked upwards at the end of March/early April 2020 due to the heightened market uncertainty and ensuing liquidity crisis that affected financial markets, they have returned to more average levels since then. However, sentiment can easily shift, so it will remain important to undertake continual monitoring of all aspects of risk and return in the current circumstances. Link monitor CDS prices as part of their creditworthiness service to local authorities and the Council has access to this information via its Link-provided Passport portal.

4.3 Country limits

The Council has determined that it will only use approved counterparties from the UK and from countries with a minimum sovereign credit rating of AA- from Fitch (or equivalent counterparty rating). Furthermore the maximum amount which may be invested with non-UK banks will be limited to £3m per institution. The list of countries that qualify using the sovereign credit rating criteria as at the date of this report are shown in Appendix F. This list will be maintained by officers in accordance with this policy if ratings change.

4.4 Investment strategy

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

Accordingly, while most cash balances are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer-term investments will be carefully assessed. Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

The Council's proposed Approved Counterparty List appears at Appendix E.

Investment returns expectations

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

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

- 2022/23 4.00%
- 2023/24 4.40%
- 2024/25 3.30%
- 2025/26 2.60%
- 2026/27 2.50%
- Years 6 to 9 2.80%
- Year 10+ 2.80%

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

Investment treasury indicator and limit - Total principal funds invested for greater than 365 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of investments after each year-end.

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

Upper limit for principal sums invested for longer than 365 days	**2023/24**	**2024/25**	**2025/26**	**2026/27**	**2027/28**
Principal sums invested> 365 days	£6.0m	£6.0m	£6.0m	£6.0m	£6.0m
Current investments as at 31/01/23, in excess of 1 year, maturing in each year	£1.0m	£1.0m	£1.0m	£1.0m	£1.0m

4.5 Performance indicators

The Council will use the 3 month average earnings as a benchmark for assessing its investment performance.

4.6 End of year investment report

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

4.7 Property Fund Managers

Property funds are a longer-term investment tool, generally with an investment period of greater than 5 years. Investment balances are normally based on the projected level of reserves and balances available for longer-term investment and appropriate due diligence should be undertaken before investing in Property Funds. Following Council approval in December 2018 and a full property fund selection, the Authority has invested £1m in the Lothbury Property Trust.

4.8 Ethical Investment Policy

The Council will not knowingly invest directly in businesses whose activities and practices pose a risk of serious harm to individuals or groups, or whose activities are inconsistent with the Council's mission and values. This would include, inter alia, avoiding direct investment in institutions with material links to:

- Human rights abuse (e.g. child labour, political oppression)
- Environmentally harmful activities (e.g. pollutants, destruction of habitat, fossil fuels)
- Socially harmful activities (e.g. tobacco, gambling)

In addition to this, and in furtherance of the Council's carbon neutral ambitions, the Council will invest in green deposit notice accounts, providing that they are in accordance with the Council's prevailing investment criteria.

5. THE CAPITAL PRUDENTIAL AND TREASURY INDICATORS 2023/24 – 2027/28

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

5.1 Capital Expenditure

	2021/22 Actual £000	2022/23 Revised £000	2023/24 Estimate £000	2024/25 Estimate £000	2025/26 Estimate £000	2026/27 Estimate £000	2027/28 Estimate £000
Capital Expenditure	**2,147**	**7,669**	**3,619**	**2,724**	**1,220**	**882**	**2,657**
Financed by: Capital Receipts	(286)	(365)	(525)	(520)	(150)	0	(500)
Capital Grants & Contributions	(984)	(2,135)	(706)	(758)	(703)	(674)	(692)
Capital Reserves	(357)	(260)	(92)	0	(32)	0	.0
Revenue Contributions	(76)	(151)	0	0	0	0	.0
Net financing need for the year	**444**	**4,758**	**2,296**	**1,446**	**335**	**208**	**1,465**

5.2 Affordability prudential indicators

The previous sections deal with the prudential indicators relating to overall capital expenditure and control of borrowing, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall financial position. The Council is asked to approve the following indicators:

Ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream. The estimates of financing costs include current commitments and the proposals in the budget report.

	2021/22 Actual	2022/23 Revised	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate	2027/28 Estimate
General Fund	11.23%	7.03%	8.10%	10.76%	12.90%	14.23%	15.31%

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

Commercial and Service Investment Income to Net Revenue Stream

This Indicator is aimed at showing the financial exposure of the Council to the loss of its non-treasury investment income. The higher the ratio, the more reliant the Council is on income from commercial and service investments which represents a potential affordability risk should those investments perform badly or fail.

Local Authorities without commercial and service investments need not report this indicator which is currently the case for Blaby as it does not hold any commercial investments that are held for purely financial return. Where assets generate income, these are long standing assets held for historic or regeneration benefit such as the Enderby Road Industrial Estate Units, or for housing purposes like the Old Bank.

5.3 Maturity structure of borrowing

These gross limits are set to reduce the Council's exposure to large, fixed rate sums falling due for refinancing, and are required for upper and lower limits.

The Council is asked to approve the following treasury indicators and limits:

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

The maturity structure limits are designed to ensure that the Council has the maximum possible flexibility to be able to restructure its loans portfolio in order to maximise the financial benefit to the General Fund.

5.4 Control of Interest Rate Exposure

See paragraphs 3.3, 3.4 and 4.4