

## **TREASURY MANAGEMENT AND INVESTMENT STRATEGY 2022-23**

Report of the Director of Finance

Please note that the following recommendations are subject to consideration and determination by the Committee before taking effect.

Recommendation: that the Committee consider whether it wishes to draw to the attention of the Cabinet any observations on the proposals contained within the Treasury Management and Investment Strategy or the revised Treasury Management Practices.

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### **1. Introduction**

- 1.1 In December 2021, the Chartered Institute of Public Finance and Accountancy (CIPFA) published a revised Code of Practice for Treasury Management and a revised Prudential Code. As a result, a revised Treasury Management Policy Statement together with a revised statement of 'Treasury Management Practices' (TMPs) are proposed to reflect changes required by the new codes. These are set out at Appendix 1
- 1.2 The policy requires the Council to consider a treasury strategy report, setting out the strategy and plans to be followed in the coming year, as part of the budget process. The Treasury Management Strategy for 2022/23 is set out at Appendix 2.

### **2. Treasury Management Policy and Practices**

- 2.1 The Treasury Management Policy Statement and Treasury Management Practices set out the broad treasury management framework within which the annual Treasury Management Strategy is set. The revised version attached at Appendix 1 reflects the new requirements of the revised CIPFA Treasury Management and Prudential codes and comprises:
  - Treasury Management Code of Practice
  - Treasury Management Policy
  - Treasury Management Practices.
- 2.2 A key feature of the new codes is a renewed and greater emphasis on putting the security of the Council's financial investments above the achievement of yield, and greater restrictions on the use of borrowing to fund commercial activities. Given the Council's prudent policy of restricting external borrowing and not investing directly in commercial property to achieve a return this

should have minimal practical impact on the Treasury Management Strategy, but revised wording has been introduced to reflect these changes in the codes.

- 2.3 Treasury management is to be viewed as the temporary investment of funds that are held in reserves and balances that may be required in the medium term and therefore the expectation is that longer term investments should be limited, and should not be undertaken if there is a requirement for new external borrowing. The codes introduce a new prudential indicator, the liability benchmark, which is designed to show whether external borrowing is required to fund capital expenditure, and/or when it can be funded by internal borrowing.
- 2.4 The Treasury Management Code also requires the inclusion of a schedule of non-treasury investments to include commercial investments designed to achieve a return, and financial investments designed to support the provision of services to the community. These should describe how performance and risk management is undertaken and reported on such investments.

### **3. Treasury Management and Investment Strategy – Key Points**

- 3.1 The Treasury Management and Investment Strategy sets out the minimum revenue provision (MRP) policy, capital expenditure funding, prudential indicators, the current treasury position, debt and investments; prospects for interest rates; the borrowing strategy; and the investment strategy.
- 3.2 The key issues for 2022/23 are set out in the Treasury Management and Investment Strategy Overview section. These include:
  - a) Consideration of the need for prudent management of the Council's cash resources in order to support the capital strategy and meet the Council's strategic priorities.
  - b) The suggestion that a further £10 million be invested in the CCLA (Churches, Charities and Local Authorities) Property Fund.
  - c) The target rates for 2022/23.
  - d) The inclusion of more detail on the Council's financial investments outside of treasury management.
- 3.3 In general, the strategy remains broadly similar to that for 2021/22, with no changes, for example, to the MRP policy, or approved counterparty criteria.

### **4. Conclusion**

- 4.1 The Treasury Management and Investment Strategy will be considered by Cabinet along with the draft budget for 2022/23 on 11 February, and will become part of the budget book to be approved by Council at its budget meeting on 17 February.
- 4.2 The Committee is invited to make observations on these proposals prior to their consideration by the Cabinet on 11 February.

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Electoral Divisions: All

Local Government Act 1972:

List of Background Papers: Nil

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## Treasury Management Code of Practice

1. The County Council will create and maintain, as cornerstones for effective treasury management:
  - a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities; and
  - suitable Treasury Management Practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.
  - Investment Management Practices (IMP) for investments which are not for treasury management purposes.
2. The County Council will receive reports on its treasury and investment management policies, practices and activities, including as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in the TMPs and IMPs.
3. The County Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Cabinet, and for the execution and administration of treasury management decisions to the Chief Financial Officer, who will act in accordance with the County Council's policy statement and TMPs and IMPs, and CIPFA's Standard of professional Practice on Treasury Management.

The County Council nominates the Corporate Infrastructure and Regulatory Services Scrutiny Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

## Treasury Management Policy

1. The Council defines its treasury management activities as: The management of the Council's borrowing, investments and cash flows, including its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.
2. The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.
3. The Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

The Treasury Management Practices (TMPs) will be applied to ensure that this Policy is delivered. The Council will through the use of these practices ensure that security and liquidity are prioritised ahead of yield within the defined risk framework.

## **Treasury Management Practices**

Treasury Management Practices (TMPs) set out the manner in which the Council will seek to achieve its treasury management policies and objectives and how it will manage and control those activities.

### **TMP1 Treasury Risk Management**

The Council regards a key objective of its treasury management activities to be the security of the principal sums it invests. Accordingly, it will ensure that robust due diligence procedures cover all external investment.

The Chief Financial Officer will ensure the design, implementation and monitoring of all arrangements for the identification, management and control of treasury management risk. She will report at least annually on their adequacy and suitability, and will report, as a matter of urgency, the circumstances of any actual or likely difficulty in achieving the Council's objectives in this respect, all in accordance with the procedures set out in TMP6 Reporting requirements and management information arrangements.

In respect of each of the following risks, the arrangements, which seek to ensure compliance with these objectives, are set out.

#### **Credit and counterparty risk management**

The Council regards a prime objective of its treasury management activities to be the security of the principal sums it invests. Accordingly, it will ensure that its counterparty lists and limits reflect a prudent attitude towards organisations with which funds may be deposited, or investments made, and will limit its investment activities to the instruments, methods and techniques referred to in TMP4 'Approved Instruments, methods and techniques'. It also recognises the need to have, and maintain, a formal counterparty policy in respect of those organisations with which it may borrow, or with whom it may enter into other financing or derivative arrangements. This will set out the organisation's policy and practices relating to environmental, social and governance (ESG) investment considerations.

The County Council's arrangements have been formulated to restrict the exposure to risk by taking account of the credit standing of counterparties, and setting limits to different types of borrowers.

The credit ratings of all three major rating agencies (Fitch, Moody's and Standard & Poor's ) will be used to ensure that commercial institutions satisfy the requirements of the current policy. In essence the County looks for the highest rating from banks and sets lending limits against each one. Banks and UK Building Societies that do not attract these ratings are not considered at all. The actual ratings sought by the Council may be varied as part of the regular review of lending policy and counterparties.

Lending to other Local Authorities, and Public Bodies is allowed, with differing credit limits according to the type of institution.

The List of Approved Counterparties is kept under close review and is subject to amendment in the light of changes to credit ratings, takeovers and mergers, or changes to the type of institution.

Approved institutions are placed on the lending list, deposits may not be made to any institution, which does not conform to the requirements of the Lending List, nor is any transaction allowed to be entered into through any money broker not featuring on the approved list. The financial press and other sources are monitored with a view to discovering cases where an institution on the List is in any difficulty, financial or otherwise. If appropriate, any organisation will be immediately suspended from the list until such time that they demonstrate their creditworthiness. The decision to suspend a counterparty is made by the Head of Investments, and notified to other officers by the issue of a revised Approved List.

Funds available to the County for investment are substantial, and the current lending policies ensure a balance of there being no difficulty placing funds, whilst at the same time the credit risk is minimised.

### **Liquidity risk management**

The Council will ensure it has adequate though not excessive cash resources, borrowing arrangements, overdraft or standby facilities to enable it at all times to have the level of funds available which are necessary for the achievement of its business and service objectives.

Should borrowing be required, the Council will not borrow earlier than required to meet cashflow needs unless there is a clear business case for doing so, and will only do so for the current capital programme, to fund future debt maturities, or to ensure an adequate level of short term investments to provide liquidity for the Council.

The daily cash flow is managed by officers in order to 'smooth' the flow of funds into and out of the Council, ensuring best returns on surplus funds, whilst minimising borrowing costs on days where there is a shortage. Short term borrowing and lending is generally undertaken in periods of under one month to ensure as far as is possible that on no one day should there be a requirement to have to fund shortages in excess of £1 million. Days when it is known that large outflows of money will take place e.g. payroll dates, are obvious dates to ensure there is sufficient liquidity.

Balances that are identified as not being for immediate use, say within the next few months, may be invested for longer periods.

### **Interest rate risk management**

The Council will manage its exposure to fluctuations in interest rates with a view to containing its net interest costs or revenue, in accordance with its Treasury Management Policy and Strategy and in accordance with TMP6 Reporting requirements and management information arrangements.

It will achieve these objectives by the prudent use of its approved financing and investment instruments, methods and techniques, primarily to create stability and certainty of costs and revenues, but at the same time retaining a sufficient degree of flexibility to take advantage of unexpected, potentially advantageous changes in the level or structure of interest rates. This should be subject to the consideration and, where required, approval of any policy or budgetary implications.

The level of exposure to Interest Rate Risk depends on the balance of fixed to variable monies. Here the risk is twofold. Being locked in to fixed funding when rates are falling, or failing to take advantage at a time when rates are perceived as low, or are forecast to rise; conversely, being locked into investments when rates are rising, and being unable to take advantage of this situation.

The Council has had, for a number of years, the policy of borrowing the fixed rate long-term element of its loans portfolio with loans from the Public Works Loan Board (PWLB) or the Money Market. This policy is reassessed annually as part of the adoption of the Treasury Policy Statement.

Interest Rate Risk is not increased by this policy as it is still possible to manage by switching existing loans from fixed to variable or vice versa, or re-scheduling existing debt, i.e. repaying existing debt, and re-borrowing over a shorter, or perhaps longer period. However, the existing arrangements operated by the Board of different rates for repaying loans as to those applied to new advances, mean that such changes are often uneconomic. Regard must always be had of the potential costs of any re-scheduling, as often they will attract a premium payable to the lender. This point is also referred to later under 'Re-financing Risk.'

Market Loans, usually in the form of Lender's Option Borrower's Option (LOBOs), offer an alternative to borrowing from the PWLB. Here money is borrowed for an initial period against the issue of a Bond, and gives the Lender the Option of varying the rate at the end of the period. If this Option is taken, the Council as Borrower can in turn agree to the new rate, or repay the loan without penalty. The flexibility offered by such loans can be a great help in managing this type of risk. The lender, who has the choice to (or not to) exercise the first option, has to be seen as having the greater control of the arrangement.

On the investment side, the use of Call Accounts, Notice Money, Money Market Funds, and Callable Deposits all introduce a degree of flexibility not offered by fixed term investments.

The CIPFA Code requires that any hedging tools such as derivatives are only used for the management of risk and the prudent management of financial affairs. Derivatives are securities whose price is dependent upon or derived from one or more underlying assets, the most common being stocks, bonds, commodities, currencies, interest rates and market indexes. They can be used to hedge (provide insurance) against risk or for speculative purposes; however it is the Council's policy not to use derivatives in its treasury management activities.

### **Exchange rate risk management**

The Council will manage its exposure to fluctuations in exchange rates so as to minimise any detrimental impact on its budgeted income/expenditure levels.

It will achieve this objective by the prudent use of its approved financing and investment instruments, methods and techniques, primarily to create stability and certainty of costs and revenues, but at the same time retaining a sufficient degree of flexibility to take advantage of unexpected, potentially advantageous changes in the level or structure of exchange rates. The above is subject at all times to the consideration and, if required, Council approval of any policy or budgetary implications.

The risk from fluctuating exchange rates is not material as far as the Council is concerned, as there is currently very little of either income or expenditure transacted in currencies other than Sterling.

### **Inflation risk management**

The Council will keep under review the sensitivity of its treasury assets and liabilities to inflation, and will seek to manage the risk accordingly in the context of the whole organisation's inflation exposures.

During periods of low and stable inflation, there is little requirement for active consideration of its impact. The key objectives are that investments reap the highest real rate of return, with debt costing the lowest real cost. In periods of higher or more volatile inflation, projections of inflation will become part of the debt and investment decision-making criteria, both strategic and operational.

### **Refinancing risk management**

The Council will ensure that its borrowing and other long term liabilities are negotiated, structured and documented, and the maturity profile of the monies so raised is managed, with a view to obtaining offer terms for renewal or refinancing, if required, which are competitive and as favourable to the organisation as can reasonably be achieved in the light of market conditions prevailing at the time.

It will actively manage its relationships with its counterparties in these transactions in such a manner as to secure this objective, and will avoid over-reliance on any one source of funding if this might jeopardise its achievement.

External long term funding is arranged by the Treasury staff in accordance with the Treasury Strategy, which is adopted by the Council's members before the start of each financial year. All borrowings are with either the Public Works Loan Board or a major bank as lender.

Loans are offered by the Board over periods of one to fifty years and can be either at fixed or variable rates. There are also three methods of repaying loans; Maturity, by Equal Instalments of Principal (EIP), or as Annuity loans. The Council currently uses only the first type, and pays interest half-yearly in September and March.

PWLB loans are fairly flexible; variable loans can be converted to fixed loans and vice versa, debt can be re-scheduled over different periods. Re-scheduling existing fixed rate debt however introduces an element of refinancing risk, which is increased in re-scheduling loans with long maturity profiles. The penalty (or premium) payable is dependent on the relationship between the loan rate and the current repayment rate for loans of a period equal to the unexpired term. As PWLB rates are reviewed daily, the timing of the rescheduling exercise is important if the costs of any penalties are not to cause problems to budgeted expenditure levels.

### **Legal and regulatory risk management**

The Council will ensure that all of its treasury management activities comply with its statutory powers and regulatory requirements. It will demonstrate such compliance, if required to do so, to all parties with whom it deals in such activities. In framing its credit and counterparty policy under TMP1 'credit and counterparty risk management', it will ensure that there is evidence of counterparties' powers, authority and compliance in respect of the transactions they may effect with the organisation, particularly with regard to duty of care and fees charged.

The Council recognises that future legislative or regulatory changes may impact on its treasury management activities and, so far as it is reasonably able to do so, will seek to minimise the risk of these impacting adversely on the Council.

Council officers carry out their duties with reference to Local Government Acts and Regulations, and in accordance with the Council's Treasury Management Policy.

In framing the Lending List, reference is made to official circulars from the Bank of England and to Credit Agency reports in order to vet potential counterparties. In return, the Council, if requested, will provide to those institutions, documentation to support the Council's and Council Officer's powers to enter into any transaction. Annual Accounts, Treasury Management Strategy Statements, and Schemes of Delegation are exchanged with counterparties.

Under no circumstances are officers involved in cash management allowed to borrow or lend for the purpose of generating surpluses from speculative money market dealings.

### **Operational risk, including fraud, error and corruption**

The Council will ensure that it has identified the circumstances that may expose it to the risk of loss through inadequate or failed internal processes, people and systems or from external events. Accordingly, it will employ suitable systems and procedures and will maintain effective contingency management arrangements to these ends.

Systems and procedures are in place to ensure that all money market deals are documented and authorised.

Proprietary systems are used to record money market transactions (Logotech Treasury Management), and to process transactions (Barclays.net). Both of these systems are operated with a clear division of duties between personnel involved in data entry, checking, and authorisation of transactions. Both systems are accessed only through a system of passwords. Reports and records from the systems also allow independent checks by others, for example Internal Audit, on the accuracy and completeness of all transactions, and to verify that they were made in accordance with agreed policy.

A summary of each day's activity is kept which shows the opening bank balances, and record of individual receipts and payments to be transacted during the day. This allows a forecast to be made of the end of day balance, and from this, the requirement to either borrow or lend funds.

Generally, if the forecast closing balance is less than £100,000 overdrawn, it is not economic to borrow at rates just marginally below the rate payable by having an overdrawn balance. The transaction costs, and the cost of brokerage, will more than outweigh any saving of interest.

A forecast credit balance of anything below £250,000 will not be offered to the 'market', but will be simply kept with Barclays Bank.

All borrowing is conducted via money brokers, and every effort is made to ensure that no one broker is given a disproportionate amount of business.

Lending can be arranged either direct with counterparties, or via a broker (as lending does not attract brokerage). It is clearly important to show that the interest rate for deposits made was competitive, and so a record is kept of rates available from other potential borrowers on the day.

Deals are entered into the Logotech system, and reports produced from it confirming the details entered, and a current list of all outstanding borrowing and lending. The Barclays.net system is used to electronically transfer funds where deposits have been agreed, or where borrowings are to be repaid. Hard copy confirmation reports of data input to Barclays.net are created, and together with the Logotech reports and the Summary Sheet are passed to another section for checking and validation.

Authorisation to release electronic payments is restricted to a small number of senior officers, each of whom has been allocated a unique sign in.

Arrangements are in place to ensure that the roles of creator, validation and authoriser are covered for holidays and other absences.

Officers responsible for cash management follow the recommended procedures set out in the London Code of Conduct. This code requires that:

- Officers should not disclose or discuss, or press others to disclose or discuss, any information relating to specific deals transacted without permission from the relevant counterparty or broker;
- Visits to or from brokers should not be organised without the express permission of a senior officer. Any hospitality received must be declared and recorded;
- The dealer must bear in mind that in accepting a firm price, they are committing the Council to dealing at that rate. If a dealer wishes merely an indicative price, this must be made clear; and
- Brokers must be supplied with a copy of the Council's current approved Counterparty Lending List.

### **Price risk management**

The Council will seek to ensure that its stated treasury management policies and objectives will not be compromised by adverse market fluctuations in the value of the sums it invests, and will accordingly seek to protect itself from the effects of such fluctuations.

The majority of lending is in the form of cash deposits. However a proportion of the Council's funds may be invested in alternative forms of investment where the capital value may fluctuate. These will be managed in such a way as to minimise the risk of financial loss.

### **Commercial investments**

The Council does not currently have a policy of making commercial investments outside of its treasury management activity for mainly financial reasons. All capital investments outside of treasury management activities are held explicitly for the purposes of operational services, including regeneration, and are monitored through existing control frameworks.

### **TMP2 Performance Measurement**

The Council is committed to the pursuit of value for money in its treasury management activities, and to the use of performance methodology in support of that aim, within the framework set out in its treasury management policy statement.

Accordingly, the treasury management function will be the subject of ongoing analysis of the value it adds in support of the Council's stated business or service objectives. It will be the subject of regular examination of alternative methods of service delivery, of the availability of fiscal or other grant or subsidy incentives, and of the scope for other potential improvements.

The review of treasury management decisions is carried out at regular officer meetings held to discuss treasury matters. This forum reviews past actions as well as considering the period ahead.

The minutes of these meetings are made available to External Audit as part of their Annual Audit, and to Internal Audit should they be required.

The performance of the treasury management function will be measured against agreed benchmarks. Performance criteria will include measures of effective treasury risk management in addition to measures of financial performance (income or savings).

Long term debt is judged in terms of average rate of all external debt, and comparisons made with previous years.

Investment earnings are measured against published benchmarks, including Base Rate and the Sterling Overnight Index Average (SONIA).

At present the Council has no plans to appoint external cash fund managers. It is not felt that the cost of such an appointment is likely to be covered by any marginal return over what is currently being achieved internally. However, this matter needs to be reviewed from time to time, and records are kept of the performance of a number of fund managers.

### **TMP3 Decision-Making and Analysis**

The Council will maintain full records of its treasury management decisions, and of the processes and practices applied in reaching those decisions, both for the purposes of learning from the past, and for accountability, e.g. demonstrating that reasonable steps were taken to ensure that all issues relevant to those decisions were taken into account at the time.

In respect of every decision made, Devon County Council's Treasury staff will have certainty about the legality of the transaction, and be content that the transaction helps deliver the organisation's objectives as set out in the Strategy Statement.

Third parties will have been checked to ensure their credit worthiness and to ensure that limits have not been exceeded. Rates will be fully checked against the market to ensure they are competitive.

With particular regard to borrowing, market and economic factors will influence the timing of any funding, the most appropriate period, and the repayment profile.

Similarly, before investing, account will be taken of the existing cash flow, and market conditions, before fixing the optimum period.

The Council employs Treasury Management Advisors, who are able to ensure that the officers are informed of any potential changes that may affect treasury decisions.

Records are kept not only of all transactions, but also of all documents that were a part of reaching the decision. For example, when investing, bids will be obtained from a number of banks, and a record kept of these to demonstrate that the one taken was competitive.

### **TMP4 Approved Instruments, Methods and Techniques**

The Council will undertake its treasury management activities by employing only those instruments, methods and techniques detailed, and within the limits defined in 'TMP1, Risk Management'.

The following are approved activities performed by Devon County Council:

- Borrowing;

- Lending;
- Debt repayment and rescheduling;
- Consideration, approval and use of new financial instruments and treasury management techniques;
- Managing the underlying risk associated with capital financing and surplus funds; and
- Managing cash flow.

The Council's policy is not to use derivatives in its treasury management.

There are a number of ways of raising external capital finance, which are set out in Local Government Acts, but the Council has only used two of these, borrowing from the Public Works Loan Board, and from banks, in the form of LOBOs (see TMP 1 Treasury Risk Management – Interest Rate Risk for more information).

The Chief Financial Officer considers these the most appropriate form of borrowing, but alternatives to these, which are allowed to Local Authorities, may well be considered in the future.

(Increasingly, there are other potential sources for the funding of capital projects, e.g. Private Finance arrangements, or the use of leasing, but they are not considered here).

The majority of lending is in the form of cash deposits. However a proportion of the Council's funds may be invested in alternative forms of investment where the capital value may fluctuate. These will be managed in such a way as to minimise the risk of financial loss. The potential list of alternative forms of investment includes UK Government Gilts, bond funds and property funds, but only those specified within the annual Treasury Management Strategy shall be permitted.

The Council has reviewed its classification with financial institutions under MIFID II and will seek elective professional client status where required in order to access the investment opportunity sets set out in its treasury management policies and strategy. The Council will set out in its annual treasury management strategy those organisations with which it is registered as a professional client and those with which it has an application outstanding to register as a professional client.

### **TMP5 Organisation, Clarity and Segregation of Responsibilities, and Dealing Arrangements**

The Council considers it essential, for the purposes of the effective control and monitoring of its treasury management activities, and for the reduction of the risk of fraud or error, and for the pursuit of optimum performance, that these activities are structured and managed in a fully integrated manner, and that there is at all times a clarity of treasury management responsibilities.

The principles on which this will be based is a clear distinction between those charged with setting treasury management policies and those charged with implementing and controlling these policies, particularly with regard to the execution and transmission of funds, the recording and administering of treasury management decisions, and the audit and review of the treasury management function.

If and when the Council intends, as a result of lack of resources or other circumstances, to depart from these principles, the Chief Financial Officer will ensure that the reasons are properly reported in accordance with TMP6 Reporting requirements, and the implications properly considered and evaluated.

The Chief Financial Officer will fulfil all such responsibilities in accordance with the Council's policy statement and TMPs and, as a CIPFA member, the Standard of Professional Practice on treasury management. She will ensure that there are clear written statements of the responsibilities for each post engaged in treasury management, and the arrangement for absence cover.

The Chief Financial Officer will ensure there is proper documentation for all deals and transactions, and that procedures exist for the effective transmission of funds.

There are a number of bodies and individuals with responsibilities in this area.

### **Councillors**

Members will receive reports on treasury management policies, practices and activities, including audit reports. As a minimum, each year, Council will have to consider:

- The Treasury Strategy Report, setting out the strategy and plans to be followed in the coming year. This report is part of the Budget process;
- A Mid-Year Monitoring Report; and
- An Annual Treasury Management Stewardship Report on the performance of the Treasury Management function, and highlighting any areas of non-compliance with agreed policy.

(The content of these three reports are more fully explained in TMP 6 'Reporting Arrangements'.)

Members are required to approve any amendments to the organisation's adopted Treasury Management Policy Statement, and the selection of external service providers, including agreeing terms of appointment.

### **The Chief Financial Officer**

The Chief Financial Officer is responsible for recommending (changes to) Treasury Management Policies to Members for approval, and for ensuring they receive as a minimum, the three annual reports referred to above. The Chief Financial Officer will ensure that Treasury Policies are adhered to, and if not will bring the matter to the attention of elected members as soon as possible.

The Chief Financial Officer will receive reports from the Treasury Team, both Internal and External Audit, and from other sources regarding performance. It is the responsibility of the Chief Financial Officer to consider such reports, and any recommendations arising from them.

Prior to entering into any long term borrowing, lending or investment transaction, it is the responsibility of the Chief Financial Officer to be satisfied, by reference to the Investment Team that the proposed transaction does not breach any statute, external regulation or the Council's Financial Regulations.

The Chief Financial Officer has delegated powers to take the most appropriate form of borrowing from the approved sources, and to take the most appropriate form of investments in approved instruments. In practice these powers are in turn delegated to the Investment Team.

### **The Head of Investments**

The Head of Investments needs to ensure the adequacy of treasury management resources and skills, the effective division of responsibilities within the treasury management function, and that all transactions are authorised in accordance with the financial regulations of the Council.

### **The Treasury Management Team**

The Treasury management Team are responsible for optimising the Council's investment returns commensurate with minimum risk, and in accordance with agreed policy and strategy.

Nominated team members are responsible for the execution of transactions, and for ensuring that they are documented in accordance with agreed practice.

In performing their roles they need to be aware of maintaining relationships with third parties and external service providers, which may well lead to identifying and recommending opportunities for improved practice.

Reports, both verbal and written are required to be made to the Chief Financial Officer and the Head of Investments.

### **Internal Audit**

The responsibilities of Internal Audit include ensuring compliance with approved policy and procedures, reviewing division of duties and operational practice, assessing value for money from treasury activities, and undertaking probity audit of the treasury function.

### **TMP6 Reporting Requirements and Management Information Arrangements**

The Council will ensure that regular reports are prepared and considered on the implementation of its treasury management policies; on the effects of decisions taken and the transactions executed in pursuit of those policies; on the implications of changes, particularly budgetary, resulting from regulatory, economic, market or other factors affecting its treasury management activities; and on the performance of the treasury management function.

Before the start of each financial year, the Council must adopt the Treasury Management Strategy. The Strategy sets out the expected treasury activities for the forthcoming year, and is concerned with:

- The prospects for future interest rates;
- The expected strategy with regard to borrowing and temporary investments (including the appointment of external managers); and
- Policies regarding debt redemption and rescheduling.

A mid-year monitoring report will bring Members up to date with actions taken. This will draw on the regular meetings which the Chief Financial Officer has with the Head of Investments and Treasury staff to consider activity to date, and to discuss particular aspects of treasury management activity.

An annual Treasury Management Stewardship Report will be presented to the Corporate Infrastructure and Regulatory Services Scrutiny Committee, and then to the Cabinet at the end of the financial year. The Treasury Management report includes:

- A comprehensive picture for the financial year of all treasury policies, plans, activities and results;
- Details of transactions executed and their revenue (current) effects;
- A report on risk implications of decisions taken;
- Monitoring of compliance with approved policy, practices and statutory/regulatory requirements;

Details of treasury management indicators and any other investment indicators required by regulation.

- Monitoring of compliance with powers delegated to officers;
- The degree of compliance with the original strategy and explanation of deviations;
- An explanation of future impact of decisions taken on the organisation;
- Measurements of performance; and
- A report on compliance with CIPFA Code recommendations.

### **TMP7 Budgeting, Accounting and Audit Arrangements**

The Chief Financial Officer will prepare, and the Council will approve and, if necessary, from time to time amend, an annual budget for treasury management. This will bring together all of the costs involved in running the treasury management function, together with associated income. The matters to be included in the budget will at a minimum be those required by statute or regulation, together with such information as will demonstrate compliance with TMP1 'Risk Management', TMP2 'Performance Measurement', and TMP4 'Approved Instruments, Methods and Techniques'.

The Treasury Management Budget or supporting papers will identify

- Staffing numbers and related costs, together with on-costs;
- Interest and other investment income;
- Debt and other financing costs;
- Bank and overdraft charges;
- Brokerage, commissions and other transaction-related costs; and
- External advisors' and consultants' charges.

The Chief Financial Officer will exercise effective controls over this budget, and will report upon and recommend any changes required in accordance with TMP6 'Reporting Requirements and Management Information Arrangements'.

The Council will account for its treasury management activities, for decisions made and transactions executed, in accordance with appropriate accounting practices and standards, and with statutory and regulatory requirements in force for the time being.

The Council will ensure that its auditors, and those charged with regulatory review, have access to all information and papers supporting the activities of the treasury management function as are necessary for the proper fulfilment of their roles, and that such information and papers demonstrate compliance with external and internal policies and approved practices.

### **TMP8 Cash and Cash Flow Management**

Unless statutory or regulatory requirements demand otherwise, all monies in the hands of the Council will be under the control of the Chief Financial Officer, and will be aggregated for cash flow and investment management purposes. Cash flow projections will be prepared on a regular and timely basis, and the Head of Investments will ensure that these are adequate for the purposes of monitoring compliance with TMP1 regarding Liquidity Risk Management, and for the purpose of identifying future borrowing needs (using a liability benchmark where appropriate).

A Cash Flow Report is produced at the start of each financial year, based upon information contained in the published Capital and Revenue Budgets.

Items of income and expenditure are examined and in discussion with finance staff from the different services, a time dimension is attached to the flows of cash.

All of the cash flow data is then entered into the Logotech Treasury Management System, which also contains information relating to all of the Council's treasury transactions, both lending and borrowing.

Actual receipts and payments are monitored against the forecast, and regular discussions are held with services staff who are likely to be able to explain the variations. The forecast is updated in the light of them

Cash flow is discussed at weekly meetings of the Treasury Team, and is used in determining investment strategy.

### **TMP9 Money Laundering**

The Council is alert to the possibility that it may become the subject of an attempt to involve it in a transaction involving the laundering of money. Accordingly, it will maintain procedures to minimise the risk of any such event occurring, and for verifying and recording the identity of counterparties and reporting suspicions. It will also ensure that staff involved in treasury transactions are properly trained.

The source of all monies received by the Council is required to be identified. Major unbudgeted income or receipts which had not been forecasted are investigated.

The County Council does not accept loans from individuals. All loans are obtained from the Public Works Loan Board or from authorised institutions under the Banking Act 1987. The names of these institutions formerly appeared on the Bank of England's quarterly list of authorised institutions, but in December 2001, the Financial Services Authority (FSA) took over many of the Bank's responsibilities in this area. In April 2013 the FSA was split up and responsibility passed to the Financial Conduct Authority and it is now responsible for maintaining the register.

## **TMP10 Staff Training and Qualifications**

The Council recognises the importance of ensuring that all staff involved in the treasury management function are fully equipped to undertake the duties and responsibilities allocated to them. It will therefore seek to appoint individuals who are both capable and experienced and will provide training for staff to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills. The Chief Financial Officer will recommend and implement the necessary arrangements, including the specification of the expertise, knowledge and skills required by each role or member of staff.

Career development and planning for succession are similarly the responsibility of the Departmental Management. Qualifications that are required for all treasury posts are contained in their job descriptions.

The Council's Chief Financial Officer, as a member of CIPFA, is committed to her professional responsibilities through both personal compliance and by ensuring that relevant staff are appropriately trained.

She personally, and through her management team, accepts that these matters are ones that should be regularly assessed to ensure compliance.

The Chief Financial Officer will ensure that Council members tasked with treasury management responsibilities, including those responsible for scrutiny, have access to training relevant to their needs and responsibilities.

Those charged with governance recognise their individual responsibility to ensure that they have the necessary skills to complete their role effectively.

## **TMP11 Use of External Service Providers**

The Council recognises that responsibility for treasury management decisions remains with the Council at all times. It recognises that there may be potential value in employing external providers of treasury management services, in order to acquire access to specialist skills and resources.

If and when it employs such service providers, it will ensure it does so for reasons which will have been submitted to a full evaluation of the costs and benefits. It will also 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 will ensure, where feasible and necessary, that a spread of service providers is used, to avoid over-reliance on one or a small number of companies. Where services are subject to formal tender or re-tender arrangements, legislative requirements will always be observed. The Council will be mindful of the requirements of the Bribery Act 2010 in their dealings with external providers. The monitoring of such arrangements rests with the Chief Financial Officer.

## **TMP12 Corporate Governance**

The Council is committed to the pursuit of proper corporate governance throughout its businesses and services, and to establishing the principles and practices by which this can be achieved. Accordingly, the treasury management function and its activities will be undertaken with openness and transparency, honesty, integrity and accountability.

## **Appendix 1**

The Council has adopted and has implemented the key principles of the Code. This, together with the other arrangements detailed in this document, are considered vital to the achievement of proper corporate governance in treasury management, and the Chief Financial Officer will monitor and, if necessary, report upon the effectiveness of these arrangements.

## **Investment Management Practices**

For non-treasury management investments, the Council should ensure that effective risk and performance management arrangements are in place. These should include:

- Investment objectives.
- Investment criteria.
- Risk management, including risk identification, controls, management and monitoring for any material non-treasury investment portfolios.
- Performance measurement and management, including methodology and criteria for assessing the performance and success of non-treasury investments.
- Decision making, governance and organisation, including a statement of the governance requirements for decision making in relation to non-treasury investments, and arrangements to ensure that appropriate professional due diligence is carried out to support decision making.
- Reporting and management information, including where and how often monitoring reports are taken.
- Training and qualifications, including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.

The above issues should be addressed by the service areas concerned in relation to any financial investments undertaken in support of their service priorities. A summary will be provided in the annual treasury management strategy.

# Treasury Management Strategy 2022/23 – 2025/26 and Prudential Indicators 2022/23 - 2026/27

## Introduction

The County Council has adopted the CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management in the Public Services. A revised Code of Practice was published by CIPFA in December 2021 and requires the Council to approve a Treasury Management Policy Statement together with a statement of its 'Treasury Management Practices' (TMPs). These policies have been reviewed for 2022/23 in the light of the revised code and revised TMPs have been submitted for approval.

The policy requires the Council to consider a treasury strategy report, setting out the strategy and plans to be followed in the coming year, as part of the budget process. The strategy for 2022/23 is broadly consistent with that adopted for 2021/22.

The Treasury Management Strategy sets out the County Council's policies in relation to:

- the management of the Council's cashflows, its banking, money market and capital market transactions;
- borrowing and investment strategies;
- monitoring of the level of debt and funding of the capital programme.

The Treasury Management Strategy should be read in conjunction with the Capital Strategy.

The County Council is required to monitor its overall level of debt in line with the national code of practice drawn up by CIPFA. Part of this code requires consideration of a set of "prudential indicators" in order to form a judgement about the affordable, prudent and sustainable level of debt.

The prudential indicators, treasury management strategy and the annual investment strategy have been reviewed in line with the Capital Programme 2022/23 – 2026/27, and the Capital Strategy.

This Treasury Management Strategy document sets out:

- Minimum revenue provision;
- Capital expenditure funding;
- Prudential indicators on the impact of capital financing and monitoring of the level and make-up of debt;
- The current treasury position, debt and investments;
- Prospects for interest rates;
- The borrowing strategy; and
- The investment strategy.

### Treasury Management and Investment Strategy Overview

The Treasury Management and Investment Strategy sets out the MRP policy, capital expenditure funding, prudential indicators, the current treasury position, debt and investments; prospects for interest rates; the borrowing strategy; and the investment strategy.

#### External Borrowing

Since 2009 the Council has followed a policy of containing the capital programme, taking out no new external borrowing and repaying debt whenever this can be done without incurring a financial penalty. Capital expenditure new starts are limited to those that are financed from sources other than external borrowing. To meet the need for capital expenditure, the highest priority schemes across the Authority are funded from corporate capital receipts and internal borrowing over the capital programme timescale.

The capital programme for 2022/23 requires borrowing of £20.2 million, which will be internal borrowing. This is offset by the MRP figure of £12.7 million which will leave the Council with total internal borrowing of £95.3 million, i.e. the Council has borrowed £95.3 million from its cash balances, in addition to the external debt of £507.85 million, to fund the capital programme. However, this is forecast to reduce in future years. The ability to internally borrow from the Council's cash has enabled the Council to fund its capital programme in recent years without taking out further external debt and incurring additional interest costs and other capital financing costs.

The revised Prudential and Treasury Management codes published by CIPFA include a new requirement for a liability benchmark to be included in the Treasury Management Strategy. In effect, this is designed to identify the minimum level of external debt needed to fund the Authority's capital financing requirement. The benchmark assumes that the Council can use its available reserves and balances to fund capital programme borrowing before needing to take out further external debt. The benchmark included within the Treasury Management Strategy demonstrates that based on current capital spending plans and budgeted use of revenue reserves, there is still a gap between the minimum level of external debt required and the current level of external debt. This would indicate that the Council can continue with its current policy of taking out no new external borrowing.

However, the gap is relatively narrow and assumes that the current annual deficits on Special Educational Needs (SEND) will not continue beyond 2022/23. Should the SEND issue not be resolved and/or there are significant additions to the capital programme or calls on revenue reserves, then this may change the picture. If key priorities cannot be delivered due to a reduced availability of external funding, the Authority's cash resources, or capital receipts, then external borrowing may be required. This will need to be balanced against the ability to support additional capital financing costs from within the revenue budget.

#### Target Rates for Investment

For the 2022/23 financial year it has been assumed that the average interest rate earned on lending to banks and building societies will be 0.35% p.a. This is a small increase on the targeted rate for 2021/22 reflecting the Bank of England's announcement in December 2021 of an increase in the base rate to 0.25%, but reflecting that this will not immediately filter through to the average rate achievable on the Council's investments.

The yield from investment in the CCLA Property Fund is assumed to be 4.0%. This assumes a reasonable recovery from the impact of the pandemic. A further investment

in the Fund will be considered during the year, but this has not been factored into the budget. This may be a good time to consider a further investment, as the initial capital loss on the new investment would be largely offset by the capital growth to date on the original investment.

Although provided for within the strategy no investment has yet been made in short-dated bond funds and multi-asset income funds. Should this option be taken up further analysis and a competitive selection process would need to be undertaken to identify funds that would meet the Council's requirements. Any decision to invest in such funds would be subject to agreement by the Cabinet Member for Finance.

### Minimum Revenue Provision

Minimum Revenue Provision (MRP) is a charge to the authority's revenue account to make provision for the repayment of the authority's external debt and internal borrowing. The authority has a statutory obligation to charge to the revenue account an annual amount of MRP.

The authority's MRP strategy is to charge all elements based on the period of benefit of the capital investment i.e. over the life of the asset.

All supported capital expenditure and unsupported borrowing up to 1st April 2008 will be charged over the life of the assets, calculated using the 'asset life: annuity' method. This approach was adopted by the authority in 2018/19 and delivered significant revenue savings. MRP is calculated by dividing the existing debt over the estimated life of the asset, but reflects the fact that an asset's deterioration is slower in the early years of its life and accelerates towards the latter years. In order to calculate MRP under the annuity method, an appropriate annuity rate needs to be selected. The percentage chosen corresponds with the Bank of England Monetary Policy Committee's inflation target rate of 2.1%. MRP will increase by this percentage each year

Any unsupported (internal) borrowing post 1 April 2008 (including Vehicle and Equipment Loans Pool, Capitalisation Direction and charges to other public sector bodies) will be charged over the life of the asset, on a straight line basis. The annuity method will not be applied to projects financed from internal borrowing, as this source of financing is applied to a wider range of projects with differing lives. Therefore, the 'asset life: equal instalment' method is a more appropriate method of calculating MRP.

We will not provide for MRP in circumstances where the relevant expenditure is intended to be financed from external contingent income, where it has not yet been received but where we conclude that it is more probable than not that the income will be collected, for example when forward funding S106 contributions.

Capital financing costs are also affected by PFI/PPP contracts and finance leases coming 'on Balance Sheet'. The MRP policy for PFI/PPP contracts will remain unchanged, with MRP being charged over the period of benefit of the capital investment i.e. over the life of the asset.

The main Prudential Indicator to measure the acceptable level of borrowing remains the ratio of financing costs to total revenue stream. The figures for MRP shown in table 6 reflect the adoption of this strategy.

## Capital Expenditure

Table 1 shown below, summarises the Capital Programme and liabilities from capital projects that will appear on the balance sheet in future years. The Capital Programme has been tested for value for money via option appraisal and for prudence, affordability and sustainability by looking at the impact that the proposed Capital Programme has on the revenue budget and through the Prudential Indicators.

**Table 1 – Capital Expenditure**

|                                        | 2022/23<br>Estimate<br>£'000 | 2023/24<br>Estimate<br>£'000 | 2024/25<br>Estimate<br>£'000 | 2025/26<br>Estimate<br>£'000 | 2026/27<br>Estimate<br>£'000 |
|----------------------------------------|------------------------------|------------------------------|------------------------------|------------------------------|------------------------------|
| <b>Total Capital programme</b>         | <b>165,160</b>               | <b>121,662</b>               | <b>71,486</b>                | <b>66,058</b>                | <b>61,583</b>                |
| Funded by:                             |                              |                              |                              |                              |                              |
| Gross borrowing                        | 20,253                       | 7,923                        | 2,227                        | 2,396                        | 3,228                        |
| Other capital resources                | 144,907                      | 113,739                      | 69,259                       | 63,662                       | 58,355                       |
| <b>Total capital programme funding</b> | <b>165,160</b>               | <b>121,662</b>               | <b>71,486</b>                | <b>66,058</b>                | <b>61,583</b>                |

## Prudential Indicators

### Capital Financing Requirement

The Capital Financing Requirement represents the Council's underlying debt position. It shows the previous and future spend for capital purposes that has been or will be financed by borrowing or entering into other long-term liabilities. Other long-term liabilities include contracts under the Private Finance Initiative (PFI) and as from April 2022 is now required to include liabilities related to any leases of more than 12 months that the Council has entered into.

The Capital Financing Requirement and debt limits will be higher than the Council's external debt, as they will be partly met by internal borrowing from the Council's internal cash resources. This reduces the cost of the required borrowing, but the Council also needs to ensure that a prudent level of cash is retained.

The forecast Capital Finance Requirement for 2022/23 and the following four years are shown in table 2 below.

**Table 2 – Capital Financing Requirement**

|                                      | 2022/23<br>Estimate<br>£'000 | 2023/24<br>Estimate<br>£'000 | 2024/25<br>Estimate<br>£'000 | 2025/26<br>Estimate<br>£'000 | 2026/27<br>Estimate<br>£'000 |
|--------------------------------------|------------------------------|------------------------------|------------------------------|------------------------------|------------------------------|
| Underlying borrowing requirement     | 603,182                      | 597,326                      | 585,295                      | 573,216                      | 561,740                      |
| Other long-term liabilities          | 135,011                      | 129,456                      | 124,175                      | 119,117                      | 114,637                      |
| <b>Capital financing requirement</b> | <b>738,193</b>               | <b>726,782</b>               | <b>709,470</b>               | <b>692,333</b>               | <b>676,377</b>               |

### Limits to Debt

The Authorised Limit represents the level at which the Council is able to borrow and enter into other long-term liabilities. Additional borrowing beyond this level is prohibited unless the limit is revised by the Council. Table 3 details the recommended Authorised Limits for 2022/23 – 2026/27.

**Table 3 – Authorised Limits**

|                                           | 2022/23<br>Estimate<br>£'000 | 2023/24<br>Estimate<br>£'000 | 2024/25<br>Estimate<br>£'000 | 2025/26<br>Estimate<br>£'000 | 2026/27<br>Estimate<br>£'000 |
|-------------------------------------------|------------------------------|------------------------------|------------------------------|------------------------------|------------------------------|
| Authorised Limits:                        |                              |                              |                              |                              |                              |
| Borrowing                                 | 676,182                      | 670,326                      | 658,295                      | 646,216                      | 634,740                      |
| Other long-term liabilities               | 135,011                      | 129,456                      | 124,175                      | 119,117                      | 114,637                      |
| <b>Authorised limit for external debt</b> | <b>811,193</b>               | <b>799,782</b>               | <b>782,470</b>               | <b>765,333</b>               | <b>749,377</b>               |

The Operational Boundary is based on the anticipated level of external debt needed during the year. Variations in cash flow may lead to occasional, short term breaches of the Operational Boundary that are acceptable. Sustained breaches would be an indication that there may be a danger of exceeding the Authorised Limits. Table 4 details the recommended Operational Boundaries for 2022/23 and following years.

**Table 4 - Operational Limits**

|                                            | 2022/23<br>Estimate<br>£'000 | 2023/24<br>Estimate<br>£'000 | 2024/25<br>Estimate<br>£'000 | 2025/26<br>Estimate<br>£'000 | 2026/27<br>Estimate<br>£'000 |
|--------------------------------------------|------------------------------|------------------------------|------------------------------|------------------------------|------------------------------|
| Operational Limits:                        |                              |                              |                              |                              |                              |
| Borrowing                                  | 651,182                      | 645,326                      | 633,295                      | 621,216                      | 609,740                      |
| Other long-term liabilities                | 135,011                      | 129,456                      | 124,175                      | 119,117                      | 114,637                      |
| <b>Operational limit for external debt</b> | <b>786,193</b>               | <b>774,782</b>               | <b>757,470</b>               | <b>740,333</b>               | <b>724,377</b>               |

The forecast opening balance for External Borrowing at 1 April 2022 is £507.85 million and remains unchanged at 31 March 2023.

The Council also needs to ensure that its gross debt does not, except in the short term, exceed the total of the Capital Financing Requirement. Table 5 details the Capital Financing Requirement against the total gross debt plus other long-term liabilities. The level of under borrowing reflects the use of internal borrowing from the Council's internal cash resources.

**Table 5 – Underlying Borrowing Requirement to Gross Debt**

|                                                 | 2022/23<br>Estimate<br>£'000 | 2023/24<br>Estimate<br>£'000 | 2024/25<br>Estimate<br>£'000 | 2025/26<br>Estimate<br>£'000 | 2026/27<br>Estimate<br>£'000 |
|-------------------------------------------------|------------------------------|------------------------------|------------------------------|------------------------------|------------------------------|
| Capital financing requirement                   | 738,193                      | 726,782                      | 709,470                      | 692,333                      | 676,377                      |
| Gross borrowing and other long-term liabilities | 642,861                      | 637,306                      | 632,025                      | 626,967                      | 622,487                      |
| <b>Under/ (over) borrowing</b>                  | <b>95,332</b>                | <b>89,476</b>                | <b>77,445</b>                | <b>65,366</b>                | <b>53,890</b>                |

## Appendix 2

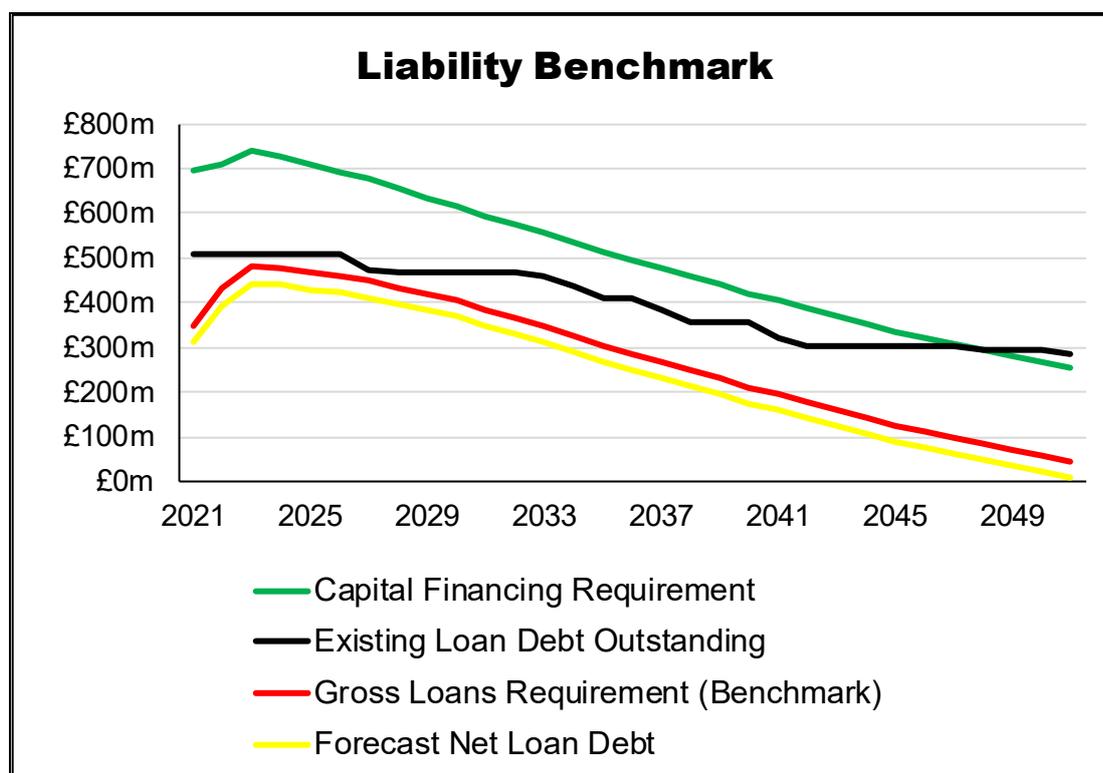
The debt management strategy and borrowing limits for the period 2022/23 to 2026/27 have been set to ensure that over the medium-term net borrowing will only be for capital purposes.

### Liability Benchmark

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 takes the capital financing requirement, and the forecast level of reserves and balances, and assumes that cash and investment balances should be kept to a minimum level of £40 million at each year end to maintain sufficient liquidity but minimise credit risk. This is illustrated in Table 6 below, and in the following chart.

**Table 6 – Liability Benchmark**

|                                     | 2022/23        | 2023/24        | 2024/25        | 2025/26        | 2026/27        |
|-------------------------------------|----------------|----------------|----------------|----------------|----------------|
|                                     | Estimate       | Estimate       | Estimate       | Estimate       | Estimate       |
|                                     | £'000          | £'000          | £'000          | £'000          | £'000          |
| Capital financing requirement       | 738,193        | 726,782        | 709,470        | 692,333        | 676,377        |
| Less: total reserves and provisions | (294,914)      | (287,375)      | (279,579)      | (269,924)      | (263,944)      |
| Plus: minimum liquidity requirement | 40,000         | 40,000         | 40,000         | 40,000         | 40,000         |
| <b>Liability Benchmark</b>          | <b>483,279</b> | <b>479,407</b> | <b>469,891</b> | <b>462,409</b> | <b>452,433</b> |



### Ratio of Financing Cost to Net Revenue Stream

Table 7 below shows the relationship between Capital Financing Costs and the Net Revenue Stream for 2022/23 and future years. Financing cost is affected by Minimum

## Appendix 2

Revenue Provision (MRP), interest receivable and payable and reductions in other long term liabilities.

**Table 7 – Ratio of Financing Costs to Net Revenue Stream**

|                                                                                               | 2022/23        | 2023/24        | 2024/25        | 2025/26        | 2026/27        |
|-----------------------------------------------------------------------------------------------|----------------|----------------|----------------|----------------|----------------|
|                                                                                               | Estimate       | Estimate       | Estimate       | Estimate       | Estimate       |
|                                                                                               | £'000          | £'000          | £'000          | £'000          | £'000          |
| Minimum revenue provision                                                                     | 12,733         | 13,778         | 14,259         | 14,475         | 14,704         |
| Interest payable                                                                              | 26,017         | 26,017         | 26,017         | 26,017         | 26,017         |
| Recharges and other adjustments                                                               | (410)          | (739)          | (899)          | (969)          | (1,113)        |
| Interest receivable                                                                           | (900)          | (900)          | (900)          | (900)          | (900)          |
| <b>Capital financing cost (excluding other long-term liabilities)</b>                         | <b>37,440</b>  | <b>38,156</b>  | <b>38,477</b>  | <b>38,623</b>  | <b>38,708</b>  |
| Capital financing costs of other long-term liabilities                                        | 14,689         | 14,428         | 13,262         | 12,427         | 12,523         |
| Capital financing costs including other long-term liabilities                                 | 52,129         | 52,584         | 51,738         | 51,050         | 51,231         |
| <b>Estimated net revenue stream</b>                                                           | <b>524,271</b> | <b>530,725</b> | <b>543,552</b> | <b>543,552</b> | <b>543,552</b> |
| <b>Ratio of financing costs (excluding other long term liabilities) to net revenue stream</b> | <b>7.14%</b>   | <b>7.19%</b>   | <b>7.08%</b>   | <b>7.11%</b>   | <b>7.12%</b>   |
| Ratio of financing costs (including other long-term liabilities) to net revenue stream        | 9.94%          | 9.91%          | 9.52%          | 9.39%          | 9.43%          |

### Treasury Management Prudential Indicators

Where external borrowing is required it can either be at fixed or variable rates of interest, and can be taken out for periods from a year to 50 years. The use of prudential indicators seeks to reduce the risks associated with fixed and variable interest rate loans and with borrowing for different loan periods.

Borrowing at fixed rates of interest for long periods can give the opportunity to lock into low rates and provide stability, but means that there is a risk of missing possible opportunities to borrow at even lower rates in the medium term. Variable rate borrowing can be advantageous when rates are falling, but also means that there is a risk of volatility and a vulnerability to unexpected rate rises.

Borrowing for short periods or having large amounts of debt maturing (and having to be re-borrowed) in one year increases the risk of being forced to borrow when rates are high.

The Council's policy has been to borrow at fixed rates of interest when rates are considered attractive. However, in recent years no new external borrowing has been undertaken, and the maturity range of the Council's longer-term borrowing has therefore reduced. A lower limit for long dated loans is therefore no longer appropriate.

The proposed Prudential Indicators for 2022/23 and beyond are set out in Table 7.

**Table 8 – Treasury Management Prudential Indicators**

| <b>Prudential Indicators</b>                   | <b>Upper Limit</b> | <b>Lower Limit</b> |
|------------------------------------------------|--------------------|--------------------|
|                                                | <b>%</b>           | <b>%</b>           |
| Limits on borrowing at fixed interest rates    | 100                | 70                 |
| Limits on borrowing at variable interest rates | 30                 | 0                  |
| Percentage of Fixed Rate Debt maturing in:     |                    |                    |
| Under 12 months                                | 20                 | 0                  |
| 12 Months to within 24 months                  | 25                 | 0                  |
| 24 Months to within 5 Years                    | 30                 | 0                  |
| 5 years and within 10 Years                    | 35                 | 0                  |
| 10 years and within 20 years                   | 45                 | 0                  |
| 20 years and within 35 years                   | 60                 | 0                  |
| 35 years and within 50 years                   | 75                 | 0                  |

The limits have been set taking into account the CIPFA Code of Practice which requires that the maturity date for LOBO (Lender Option Borrower Option) loans is assumed to be the next call date, rather than the total term of the loan. This will apply to the Council's Money Market loans.

### **Monitoring the Indicators**

It is important to monitor performance against forward looking indicators and the requirement that borrowing should only be for capital purposes. The total level of borrowing will be monitored daily against both the operational boundary and the authorised limit. If monitoring indicates that the authorised limit will be breached, a report will be brought to the Cabinet outlining what action would be necessary to prevent borrowing exceeding the limit and the impact on the revenue budget of breaching the limit. It will be for the Cabinet to make recommendations to the County Council to raise the limit if it is felt appropriate to do so.

The indicators for capital expenditure, capital financing requirement, capital financing costs and the treasury management indicators will be monitored monthly. Any significant variations against these indicators will be reported to the Cabinet.

### **Analysis of Long Term Debt**

The following Table 8 shows the County Council's fixed and variable rate debt as at 31 March 2021 and 31 December 2021 (current).

The interest rates shown do not include debt management costs or premiums /discounts on past debt rescheduling.

There has been no movement in the Council's external debt over the last financial year, as no new borrowing has been required and no further opportunities have arisen to repay debt.

Table 9 – Analysis of Long Term Debt

|                                 | <b>Actual<br/>31.03.21<br/>£'m</b> | <b>Interest<br/>Rate<br/>%</b> | <b>Current<br/>31.12.21<br/>£'m</b> | <b>Interest<br/>Rate<br/>%</b> |
|---------------------------------|------------------------------------|--------------------------------|-------------------------------------|--------------------------------|
| <b>Fixed Rate Debt</b>          |                                    |                                |                                     |                                |
| PWLB                            | 436.35                             | 4.99                           | 436.35                              | 4.99                           |
| Money Market                    | 71.50                              | 5.83                           | 71.50                               | 5.83                           |
| <b>Variable Debt</b>            |                                    |                                |                                     |                                |
| PWLB                            | 0.00                               |                                | 0.00                                |                                |
| Money Market                    | 0.00                               |                                | 0.00                                |                                |
| <b>Total External Borrowing</b> | <b>507.85</b>                      | <b>5.11</b>                    | <b>507.85</b>                       | <b>5.11</b>                    |

## Schedule of Investments

The following schedule shows the County Council's fixed and variable rate investments as at 31 March 2021 and as at 31 December 2021 (current).

Table 10 – Schedule of Investments

|                                                | <b>Actual<br/>31.03.21<br/>£'m</b> | <b>Interest<br/>Rate<br/>%</b> | <b>Current<br/>31.12.21<br/>£'m</b> | <b>Interest<br/>Rate<br/>%</b> |
|------------------------------------------------|------------------------------------|--------------------------------|-------------------------------------|--------------------------------|
| Maturing in:                                   |                                    |                                |                                     |                                |
| <b>Bank, Building Society and MMF Deposits</b> |                                    |                                |                                     |                                |
| <b>Fixed Rates</b>                             |                                    |                                |                                     |                                |
| Term Deposits < 365 days                       | 80.00                              | 0.86                           | 137.50                              | 0.26                           |
| 365 days & >                                   | 18.00                              | 1.13                           | 16.00                               | 0.73                           |
| Callable Deposits                              |                                    |                                |                                     |                                |
| <b>Variable Rate</b>                           |                                    |                                |                                     |                                |
| Call Accounts                                  | 20.46                              | 0.03                           | 4.14                                | 0.03                           |
| Notice Accounts                                | 70.00                              | 0.16                           | 40.00                               | 0.26                           |
| Money Market Funds                             | 0.00                               |                                | 0.00                                |                                |
| <b>Property Fund</b>                           | 10.00                              | 4.21                           | 10.00                               | 4.01                           |
| <b>All Investments</b>                         | <b>198.46</b>                      | <b>0.72</b>                    | <b>207.64</b>                       | <b>0.47</b>                    |

The Council's cash balance available for investment varies during the year, with peaks when Government grants and Council Tax precepts are received, which then taper down as expenditure is incurred. The cash balance as at 31<sup>st</sup> December 2021 is slightly higher than at the start of the year. It was anticipated that the cash balance would reduce during 2021/22, as a result of the pressure on revenue budgets from the COVID pandemic and the impact of the growing deficit on the provision for Special Educational Needs (SEND). However, the advance receipt of grants that will not be spent until 2022/23 may result in the cash balance being at a similar level at 31<sup>st</sup> March 2022 as at the beginning of the year.

## Appendix 2

The recent investment performance of the County Council's cash has been affected by the coronavirus pandemic which led the Bank of England to reduce its base rate firstly to 0.25% and then to 0.1% during March 2020. This has had an impact on the rates available for investment, which have gradually reduced over the period since March 2020.

The average rate achieved on investments has therefore reduced during the year as Term deposits carried forward from earlier periods have matured and been reinvested at lower rates. While the Bank of England's Monetary Policy Committee increased the base rate at its meeting in December 2021 it will take some time for this to filter through to an increase in the average rate achievable on the Council's investments. This is considered further in the following section.

### Prospects for Interest Rates

Forecasting future interest rate movements even one year ahead is always difficult. The factors affecting interest rate movements are clearly outside the Council's control. Whilst short term rates are influenced by the Bank of England's Base Rate, long term rates are determined by other factors, e.g. the market in Gilts. Rates from overseas banks will be influenced by their national economic circumstances. The County Council retains an external advisor, Link Asset Services, who forecast future rates several years forward. Similar information is received from a number of other sources.

The coronavirus outbreak has done huge economic damage to the UK and economies around the world. The Bank of England took emergency action in March 2020 to cut Bank Rate to first 0.25%, and then to 0.10%. However, in December the Monetary Policy Committee (MPC) confounded market expectations by raising the bank rate back up to 0.25%. The Bank of England now expects inflation to peak at 6% in April, and while the Omicron variant was already having an impact on some sectors, the MPC felt it had to act because it saw "some signs of greater persistence in domestic costs and price pressures".

Typically, an increase in the Bank of England base rate would feed through into market pricing, but with many banks awash with cash and having little appetite for more money this may limit the impact on the rates available for short term investment. Market expectations for further increases in rates during 2022 could improve the prospects for better rates as the year progresses.

The following table outlines current expectations for movements in the base rate and PWLB (Public Works Loans Board) rates. These rates can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment, particularly given the uncertain times we are currently experiencing. Such volatility could occur at any time during the forecast period.

Table 11 – Base Rate Forecasts and PWLB Rates

|                            | Dec (act)<br>2021 | March<br>2022 | June<br>2022 | Sep<br>2022 | Dec<br>2022 | March<br>2023 | June<br>2023 | Sep<br>2023 |
|----------------------------|-------------------|---------------|--------------|-------------|-------------|---------------|--------------|-------------|
| <b>Base Rate Forecasts</b> |                   |               |              |             |             |               |              |             |
| Link Asset Services        | 0.25%             | 0.25%         | 0.50%        | 0.50%       | 0.50%       | 0.75%         | 0.75%        | 0.75%       |
| Capital Economics          | 0.25%             | 0.25%         | 0.50%        | 0.75%       | 0.75%       | 0.75%         | 0.75%        | 1.00%       |

|                              | Dec (act)<br>2021 | March<br>2022 | June<br>2022 | Sep<br>2022 | Dec<br>2022 | March<br>2023 | June<br>2023 | Sep<br>2023 |
|------------------------------|-------------------|---------------|--------------|-------------|-------------|---------------|--------------|-------------|
| <b>PWLB Rates</b>            |                   |               |              |             |             |               |              |             |
| Link Asset Services forecast |                   |               |              |             |             |               |              |             |
| <b>10 Year</b>               | 1.60%             | 1.70%         | 1.80%        | 1.80%       | 1.90%       | 1.90%         | 2.00%        | 2.00%       |
| <b>25 Year</b>               | 1.80%             | 1.90%         | 2.00%        | 2.10%       | 2.10%       | 2.20%         | 2.20%        | 2.20%       |
| <b>50 Year</b>               | 1.50%             | 1.70%         | 1.80%        | 1.90%       | 1.90%       | 2.00%         | 2.00%        | 2.00%       |

When budgeting for interest payments and receipts a prudent approach has been adopted to ensure that, as far as is possible, both budgets will be achieved.

### Borrowing Strategy 2022/23 – 2025/26

The overall aims of the Council's borrowing strategy are to achieve:

- Borrowing at the lowest rates possible in the most appropriate periods;
- The minimum borrowing costs and expenses; and
- A reduction in the average interest rate of the debt portfolio.

Since 2009 the Council has followed a policy of containing the capital programme, taking out no new external borrowing and repaying debt whenever this can be done without incurring a financial penalty. This strategy has worked well in a period of austerity. The Council's external borrowing level has reduced by £102 million since 2008/09, resulting in reduced Capital Financing Charges.

The capital programme for 2022/23 requires borrowing of £20.2 million, which will be internal borrowing. This is offset by the MRP figure of £12.7 million which will leave the Council with total internal borrowing of £95.3 million, i.e. the Council has borrowed £95.3 million from its cash balances, in addition to the external debt of £507.85 million, to fund the capital programme. However, this is forecast to reduce in future years. The ability to internally borrow from the Council's cash has enabled the Council to fund its capital programme in recent years without taking out further external debt and incurring additional interest costs and other capital financing costs.

## Appendix 2

While cash balances remain relatively high, the Council can continue to internally borrow to meet capital commitments and maintain a measured level of future capital investment. The new requirement for a liability benchmark is designed to demonstrate whether and when new external borrowing will be required, based on the Council's current capital programme and call upon revenue reserves. Table 6 and the following graph included within the prudential indicators section of the Treasury Management Strategy show that the benchmark requirement for external debt is below the current level of external debt throughout the period shown, which indicates that further external debt should not be required.

The Medium Term Financial Strategy (MTFS) therefore continues to assume that, over the three year period, no new long-term borrowing will be required. However, the margin between the actual external debt and the minimum requirement shown on the liability benchmark graph is narrow, and assumes that the current annual deficits on Special Educational Needs (SEND) will not continue beyond 2022/23. Should the SEND issue not be resolved and/or there are significant additions to the capital programme or calls on revenue reserves, then this may change the picture. If key priorities cannot be delivered due to a reduced availability of external funding, the Authority's cash resources, or capital receipts, then external borrowing may be required. This will need to be balanced against the ability to support additional capital financing costs from within the revenue budget.

No opportunities have arisen during this financial year to repay external debt without incurring substantial premium penalties, which would negate any benefit of repaying the debt. The PWLB sets premature repayment rates and, where the interest rate payable on a current loan is higher than the repayment rate, the PWLB policy imposes premium penalties for early repayment. With current low rates of interest these penalties would be of a significant cost. Therefore, it will only make financial sense to repay debt early if the PWLB changes its current policy, or if interest rates rise significantly and cancel out the repayment premiums. This is unlikely to happen in the short to medium term.

The earliest date on which any of the Council's external debt matures is 31 March 2027, when the Council is due to repay a PWLB loan of £33.8 million, with a further £5.8 million to be repaid later in 2027. While this may still seem a long time away, the Council has begun to consider plans for the repayment of these loans. Given that the Council's capital programme has borrowed from its internal cash resources, there will need to be careful management of future capital requirements to ensure that cash resources are available so that these loans can be repaid, otherwise there might be a future need to take out new external borrowing to re-finance the debt.

Active treasury management and the maintenance of levels of liquidity aim to ensure that no short term borrowing is required to fund cashflow. Cash positions are monitored daily and modelled over the financial year to ensure that anticipated liquidity levels are forecast accurately. Given current low interest rates, if short-term borrowing is required to aid cashflow, this will be targeted at an average rate of **0.1%**.

### Investment Strategy 2022/23 – 2025/26

The County Council continues to adopt a very prudent approach to its investments. The majority of investments will be “Specified Investments” as defined by the Department for Levelling Up, Housing and Communities (DLUHC), For such investments, only a small number of selected UK banks and building societies, money market funds and overseas banks in highly rated countries are being used, subject to strict criteria and the prudent management of deposits with them. The lending policy is kept under constant review with reference to strict criteria for inclusion in the counterparty list. In addition, non-specified investments are included in the strategy, including the potential to invest in property funds, short-dated bond funds and multi-asset income funds.

The Treasury Management Strategy will continue to be set to ensure a prudent and secure approach.

The full County Council is required under the guidance in the CIPFA Treasury Management Code of Practice to approve an Annual Investment Strategy.

The overall aims of the Council’s strategy continue to be to:

- Limit the risk to the loss of capital;
- Ensure that funds are always available to meet cash flow requirements;
- Maximise investment returns, consistent with the first two aims; and
- Review new investment instruments as they come to the Local Authority market, and to assess whether they could be a useful part of our investment process.

**The overriding objective will be to invest prudently, with priority being given to security and liquidity before yield.**

In 2020/21 the Council made a pre-payment of deficit contributions into the Pension Fund of £32 million, which represented the total deficit contributions set for the Council for the next three years. In return for making an advance payment of three years’ deficit contributions the Pension Fund provided a 4.5% discount on the payment required, resulting in a saving of £0.5 million in each of 2020/21, 2021/22 and 2022/23.

The outlook for cash investment remains challenging. Whereas in the past there was a perception that governments would not allow banks to fail, the current regulatory environment puts more emphasis on the requirement for investors to take a hit by funding a “bail-in”. A bail-in is where the bank’s creditors, including local authorities depositing money with them, bear some of the burden by having part of the debt they are owed written off. The balance of risk has therefore changed, and as a result the Council has considered alternative forms of investment in order to diversify its risk.

Under the Markets in Financial Instruments (MiFID II) directive, local authorities are now classed as retail clients by the Financial Conduct Authority (FCA). This has implications for the range of investments that are available to local authorities. While bank and building society deposits are unaffected by the new regulations, some banks have determined that they will only take term deposits from professional clients, and a range of alternative forms of investments are only available to professional clients. However, if the local authority meets criteria set by the FCA, then it can apply to the financial institutions with which it wishes to invest to request that the institution concerned “opts up” the local authority to elective professional client status. The Council has made applications and been opted up to elective professional client status where required.

Those counterparties who have confirmed that they will treat the Council as a professional client under the MiFID II regulations are set out in Table 12 below.

**Table 12 – Counterparties that have “opted up” the Council to elective professional client status**

| <b>Counterparty</b>            | <b>Counterparty Type</b> |
|--------------------------------|--------------------------|
| Standard Chartered             | UK Bank                  |
| Commonwealth Bank of Australia | Overseas Bank            |
| CCLA                           | Property Fund            |
| Aberdeen Standard              | Money Market Fund        |
| Insight                        | Money Market Fund        |

In addition, brokers Tradition, Tullett Prebon and Imperial Treasury, and our treasury advisors, Link Asset Services, have opted up the Council to professional client status. The majority of bank and building society deposits are unaffected by the MiFID II regulations.

Subject to the MiFID II regulations, a variety of investment instruments are available to the Local Authority market. In addition to the notice accounts and fixed term deposits available from UK and overseas banks, it is also possible for the Council to invest, for example, in UK Government Gilts, bond funds and property funds. These alternative instruments would either require the Council to tie up its cash for significantly longer periods, thus reducing liquidity, or would carry a risk of loss of capital if markets go down. The Council has considered these alternatives and concluded that investment in a range of different funds should be permitted within the Treasury Management Strategy.

The Investment Strategy will be split between “Specified Investments”, which meet criteria specified in guidance issued by DLUHC, and a range of longer term “Non-specified Investments”.

### **Specified Investments**

Specified Investments will be those that meet the criteria in the DLUHC Guidance, i.e. the investment:

- is sterling denominated;
- has a maximum maturity of 1 year;
- meets the “high credit quality” as determined by the Council or is made with the UK government or is made with a local authority in England, Wales, Scotland or Northern Ireland or a parish or community council; and
- the making of which is not defined as capital expenditure under section 25(1)(d) in SI 2003 No 3146 (i.e. the investment is not loan capital or share capital in a body corporate).

Specified Investments will include bank and building society deposits. Security is achieved by the creation of an ‘Approved List of Counterparties’. These are the banks, building societies, money market funds and other public bodies with whom we are prepared to deposit funds. In preparing the list, a number of criteria will be used not only to determine who is on the list, but also to set limits as to how much money can be placed with them, and how long that money can be placed for.

## Appendix 2

Banks are expected to have a high credit rating. The Council uses the ratings issued by all three of the major credit rating agencies, Fitch, Moody's and Standard & Poor's, made available to the Council through its external Treasury Advisors. These are monitored daily.

The lowest rating published by any of the agencies is used to decide whether an institution is eligible for inclusion. Where the counterparty is only rated by two of the major ratings agencies the lowest rating published by either of the two is used. This rating also determines the maximum amount which can be loaned to an individual counterparty. Overseas banks that meet the criteria are included from countries with an 'AAA' Sovereign rating.

The time length of all deposits with financial institutions will be managed prudently, taking account of the latest advice from the Council's external advisors.

Money Market Funds have a portfolio comprised of short-term (less than one year) securities representing high-quality, liquid debt and monetary instruments. Following the financial crisis these funds were seen as higher risk and were therefore not used by the Council. However, the new regulatory environment around the concept of "bail-in" means that many money market funds are now regarded as a more secure form of investment than bank deposits, as they diversify their investments across a range of financial institutions to spread the risk, and will therefore be used where appropriate.

Money market funds must have an 'AAA' rating to be included on the counterparty list. They may be CNAV (Constant Net Asset Value), LVNAV (Low Volatility Net Asset Value) or VNAV (Variable Net Asset Value). Yields and prices will be monitored on a daily basis to ensure that there is minimal risk of loss of capital.

Other public sector bodies are principally arms of Government, or other local authorities, and although not rated are deemed suitable counterparties because of their inherent low risk.

The 'Approved List of Counterparties' specifies individual institutions and is formally reviewed at least monthly. Notification of credit rating downgrades (or other market intelligence) is acted upon immediately, resulting in any further lending being suspended.

Table 13 below summarises the current 'Approved List' criteria.

Table 13 – Specified Investments Counterparty Approved List Criteria

| Counterparty Type                    | Fitch     | Moody's   | Standard & Poor's | Credit Limit |
|--------------------------------------|-----------|-----------|-------------------|--------------|
| <b>UK Banks</b>                      |           |           |                   |              |
| not below                            | AA- & F1+ | Aa3 & P-1 | AA- & A-1+        | £50 million  |
| not below                            | A- & F1   | A3 & P-1  | A- & A-1          | £30 million  |
| <b>UK Building Societies</b>         |           |           |                   |              |
| not below                            | AA- & F1+ | Aa3 & P-1 | AA- & A-1+        | £50 million  |
| not below                            | A- & F1   | A3 & P-1  | A- & A-1          | £30 million  |
| <b>Overseas Banks</b>                |           |           |                   |              |
| Sovereign Rating of                  | AAA       | Aaa       | AAA               |              |
| and not below                        | AA- & F1+ | Aa3 & P-1 | AA- & A-1+        | £50 million  |
| and not below                        | A- & F1   | A3 & P-1  | A- & A-1          | £30 million  |
| <b>UK Public Bodies</b>              |           |           |                   |              |
| <b>Central Government</b>            |           |           |                   |              |
| – Debt Management Office             |           |           |                   | Unlimited    |
| <b>Local Government</b>              |           |           |                   |              |
| – County Councils                    |           |           |                   | £10 million  |
| – Metropolitan Authorities           |           |           |                   | £10 million  |
| – London Boroughs                    |           |           |                   | £10 million  |
| – English Unitaries                  |           |           |                   | £10 million  |
| – Scottish Authorities               |           |           |                   | £10 million  |
| – English Districts                  |           |           |                   | £5 million   |
| – Welsh Authorities                  |           |           |                   | £5 million   |
| <b>Fire &amp; Police Authorities</b> |           |           |                   |              |
|                                      |           |           |                   | £5 million   |
| <b>Money Market Funds</b>            | AAA       | Aaa       | AAA               | £30 million  |

Where the short term rating of a counterparty is one notch below the stated criteria, but the counterparty meets the long term rating criteria, they may still be used subject to the advice of our external advisors (Link Asset Services) who will take into account a range of other metrics in arriving at their advice.

The counterparty limits shown in the table also apply at a banking group level. This ensures that the Council is not exposed to the risk of having maximum sums invested in multiple institutions owned by a group that encounters financial difficulties.

The credit ratings shown in the table for banks and building societies allow for greater sensitivity in recognising counterparty risk. Liquidity in investments is the second key factor in determining our strategy. Funds may be earmarked for specific purposes or may be general balances, and this will be a consideration in determining the period over which the investment will be made.

**The Council has a self-imposed limit of ensuring that at least 15% of deposits will be realisable within one month.**

## Appendix 2

The Council will look to invest in specified investments for a range of durations up to one year to ensure sufficient liquidity for cashflow purposes. Our treasury advisors, Link Asset Services, provide advice on the recommended maximum length of deposit for each of the counterparties that the Council uses, and their recommendations will be taken into account when determining the length of time that any deposit is placed for.

### Non-Specified Investments

Non-specified investments are those that do not meet the criteria described above, but are intended to be a longer term investment, generating a higher yield, but with a slightly higher degree of risk.

**The limit on non-specified investments will be set at no more than 25% of the total treasury investments at any time or £40m whichever is the lower.**

The Council has previously decided that investment in a commercial property fund would be a prudent way to diversify risk and achieve a higher yield, as it would benefit from forecast growth in GDP. The CCLA Property Fund is therefore included as an approved counterparty, and an initial investment of £10 million was made in 2015. The counterparty limit for the Fund (as set out below) is £30 million, and further investments may be made up to that limit, subject to the approval of the Cabinet Member for Finance.

In addition, short-dated bond funds and multi-asset income funds may be used. Short dated bond funds will invest in high quality short dated government or corporate bonds. Multi-asset income funds will invest in a wider range of investments designed to produce a higher income yield, but will have a higher level of risk. In both cases, funds will be targeted where the total return is likely to be higher than the income yield, to reduce the risk of capital loss should the investment need to be realised.

The Council's policy has been to only use funds that are subject to a statutory override to IFRS9. Under the IFRS9 accounting standard unrealised gains and losses arising from funds previously measured as Available for Sale will now be classified as Fair Value through Profit and Loss and taken to the Comprehensive Income and Expenditure Account in the year they arise. As a result, any capital loss would impact on the yield gained from the investment.

Currently, Parliament has put in a statutory override for investments that fall under the following definitions:

- A money market fund;
- A collective investment scheme as defined in section 235 (1) of the Financial Services and Markets Act 2000;
- An investment scheme approved by the Treasury under section 11(1) of the Trustee Investments Act 1961 (local authority schemes)

The regulation (override) makes it clear that the revenue account should not be charged in respect of that fair value gain or loss and instead that amount should be charged to an account established, charged and used solely for the purpose of recognising fair value gains and losses in accordance with this regulation.

The statutory override applies from 1st April 2018 to 31st March 2023. This has reduced the risk to the Council of capital losses impacting on investment income, as any capital loss would only impact on the Council at the point that the investment is realised, or after the statutory override ends in March 2023.

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However, from 2023/24 capital gains and losses will need to be recognised. A further investment in the CCLA Property Fund, which is being considered for 2022/23 will result in an initial capital loss, as the investment will have to be valued at the bid price (the value at which the asset could be sold) which is lower than the offer price (the price at which the asset is purchased). This initial capital loss would be offset to some extent by the capital appreciation on the current investment since its inception in 2015, but any net deficit would need to be funded from the budget management reserve in 2023/24. The expectation would be that the capital value would increase in the longer term, and the reserve could be replenished in future years. Volatility in the capital value of fund investments means that they should be seen as longer-term investments.

Non-specified investments can also include bank and building society deposits of over a year, in line with the criteria set out in the section on Specified Investments.

Table 14 below summarises the 'Approved List' criteria for non-specified investments.

**Table 14 – Non-Specified Investments Counterparty Approved List Criteria**

| <b>Counterparty Type</b>                                                                                        | <b>Credit Limit</b> |
|-----------------------------------------------------------------------------------------------------------------|---------------------|
| CCLA Property Fund                                                                                              | £30 million         |
| Short-dated bond funds                                                                                          | £20 million         |
| Multi-asset income funds                                                                                        | £20 million         |
| Bank and Building Society Deposits over 1 year<br>(meeting credit rating criteria as per Specified Investments) | £30 million         |

Where a bank or building society is considered for an investment of over one year, the credit limit will be applied to the total investments with that institution, including specified and non-specified investments, i.e. deposits above and below one year.

### Interest Rate Targets

For the 2022/23 financial year it has been assumed that the average interest rate earned on lending to banks and building societies will be **0.35%** p.a. The target rate takes into account the increase in the Bank of England's base rate announced in December 2021, but on the basis that it will only gradually feed into the rates achievable on the Council's investments.

The yield from investment in the CCLA Property Fund is assumed to be **4.0%**. The property market has recovered to some extent from the impact of the pandemic, and the projected yield is therefore a small improvement on the target yield for 2021/22. Further analysis would be required to identify short-dated bond funds and multi-asset income funds that would meet the Council's requirements, should it be decided to utilise the provision for those type of funds. The targeted yield from those funds would be **2.00%** for short-dated bond funds and **3.50%** for multi-asset income funds. Currently these are not factored into the budget for investment income.

The targets we have set for 2022/23 are considered to be achievable.

Given the degree of uncertainty about future economic prospects and the future level of interest rates, MTFS forecasts have been based on the average rates for lending to banks and building societies continuing to be 0.35% for 2023/24 and 2024/25. However, these will be reviewed in the light of changes to the rates on offer from the Council's counterparties over the MTFS period. It may be possible to increase the target rate should the Bank of England agree further increases to the base rate that then filter through to the rates on offer to the Council.

### **Performance Targets**

The primary targets of the Treasury Management Strategy are to minimise interest payments and maximise interest receipts over the long term whilst achieving annual budgets, without taking undue risk. Where there are comparative statistics available for individual aspects of the Strategy these will be used to monitor performance. The Council will continue to review best practice at other authorities and work with its treasury advisors (Link Asset Services) to assess performance.

### **Investments that are not part of treasury management**

The revised Treasury Management Code also requires the authority to report on investments in financial assets and property that are not part of treasury management activity. This includes commercial investments, which are made primarily to achieve a financial return, and service investments which are made to support the provision of services to the community.

#### **Commercial Investments**

The Council's policy is not to make commercial investments outside of its treasury management activity for mainly financial reasons. All capital investments outside of treasury management activities are held explicitly for the purposes of operational services, including regeneration, and are monitored through existing control frameworks.

This will be important if at any stage the council decides to take out new external borrowing to fund its capital programme. The Government has been concerned for some time about the risk involved in local authorities taking out external debt to fund investments in commercial property to generate income. In November 2020, they announced a change in the PWLB's lending terms. This introduced a prohibition to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three year capital programme. Given the Council's policy, this should have no impact on our treasury management strategy.

#### **Service Investments**

The following table sets out the Council's current financial investments held for purposes related to the Council's provision of services to the local community, at the values included in the Statement of Accounts as at 31<sup>st</sup> March 2021. These investments are not held with the primary intention of gaining a financial return.

Table 15 - Service Investments

|                             | Fair Value as<br>at 31 March 2021<br>£'000 |
|-----------------------------|--------------------------------------------|
| NPS South West Limited      | 85                                         |
| Exeter Science Park Limited | 885                                        |
| Skypark                     | 1,401                                      |
| <b>Total</b>                | <b>2,371</b>                               |

- NPS (SW) Ltd - The investment in NPS (SW) Ltd was made in order to set up an outsourced service provider for the Council's facilities management service. The initial investment was 2 x £1 shares, so minimal risk. The company is due to become inactive as at 31<sup>st</sup> March 2022, but will be replaced by a new joint venture company to provide property services and facilities management functions, in which the Council will retain a 20% stake. Risk management, decision-making and performance management are the responsibility of the Digital Transformation and Business Support team. Performance reports will be made to Cabinet, and to the Corporate Infrastructure and Regulatory Services Scrutiny Committee as appropriate.
- Exeter Science Park Ltd - The Council purchased shares in Exeter Science Park Ltd. at a cost of £1.965 million. The value of the shares has subsequently been revised to a value of £885,000, which is included as a financial asset in the Council's Statement of Accounts. The investment was to stimulate economic development to the East of Exeter through the creation of a high-tech business park. The Council along with the University of Exeter is also a guarantor to a loan from the Local Enterprise Partnership Growing Places Fund. Risk management, decision-making and performance management responsibility is shared between the Economy, Enterprise and Skills team Finance Services. Performance reports will be made to Cabinet, and to the Corporate Infrastructure and Regulatory Services Scrutiny Committee as appropriate.
- Skypark - The investment in Skypark is made in the form of a series of loans, which are held as a long-term debtor in the Statement of Accounts. The investment was to stimulate economic development to the East of Exeter through the creation of a high-tech business park. The Council is currently in the process of buying out St Modwen, partners in the project, and returning the park to the sole ownership of the Council. Risk management, decision-making and performance management responsibility is shared between the Economy, Enterprise and Skills team Finance Services. Performance

## **Appendix 2**

reports will be made to Cabinet, and to the Corporate Infrastructure and Regulatory Services Scrutiny Committee as appropriate.

Further investments -

Any further financial investments will be subject to the approval of Cabinet. Reports to Cabinet will be required to set out the investment objectives, investment criteria, and the risk management, decision-making, reporting, performance measurement and management arrangements.