

## TREASURY MANAGEMENT AND INVESTMENT STRATEGY 2022/23

### Report of the Director of Finance and Public Value

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

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#### 1) Recommendation

That the Committee be asked to:

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.

#### 2) Introduction

- 2.1 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) was agreed by the Council in February 2022. No changes are proposed to these policies for 2023/24.
- 2.2 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 2023/24 is set out at Appendix 1.

#### 3) Treasury Management Strategy

- 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 2023/24 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 inclusion of external borrowing to fund the proposed South Devon Freeport development.
- c) The pressure on the Council's cash resources and continued uncertainty around the Safety Valve in relation to Special Education Needs and Disability (SEND), which may result in a further requirement for external borrowing.
- d) The potential for higher investment income resulting from the increased level of interest rates.

3.3 In general, the investment strategy remains broadly similar to that for 2022/23, with no changes, for example, to the approved counterparty criteria.

3.4 The MRP policy with respect to the Vehicle and Equipment Loans Pool has been amended such that the amount charged reflects the loan repayments. No other changes have been made to the MRP policy.

#### **4) Conclusion**

4.1 The Treasury Management and Investment Strategy will be considered by Cabinet along with the draft budget for 2023/24 on 10 February, and will become part of the budget book to be approved by Council at its budget meeting on 16 February.

4.2 The Committee is invited to make observations on these proposals prior to their consideration by the Cabinet on 10 February.

#### **Angie Sinclair**

Director of Finance and Public Value

**Electoral Divisions:** All

#### **Local Government Act 1972: List of background papers**

Nil

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# Treasury Management Strategy 2023/24 – 2026/27 and Prudential Indicators 2023/24 - 2027/28

## 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). No changes are proposed to these policies for 2023/24

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 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 2023/24 – 2027/28, 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 have been funded from corporate capital receipts and internal borrowing over the capital programme timescale.

The capital programme for 2023/24 requires borrowing of £7.1 million, which will be internal borrowing. This is offset by the MRP figure of £11.9 million which will leave the Council with total internal borrowing of £72.7 million, i.e. the Council will have borrowed £72.7 million from its cash balances, in addition to the external debt of £507.85 million, to fund the capital programme.

With the current financial pressures on the Council, it is projected that the balances available for internal borrowing will be significantly reduced as a result of:

- Budgeted use of earmarked reserves during 2022/23 and 2023/24.
- Continued unbudgeted expenditure on Special Educational Needs and Disability (SEND), charged to an unusable reserve.
- Spending of accumulated capital grants, for example Section 106 provision of infrastructure and major projects such as the North Devon Link Road.
- Spending of approved carry-forwards.

As a result the ability to use internal borrowing, as opposed to external borrowing, to fund the capital programme will become more limited.

The liability benchmark shown in table 6 and the following graph within the prudential indicators section of the Treasury Management Strategy show that the benchmark requirement for external debt from 2024/25 until around 2030 is higher than the current level of external debt, which indicates that further external borrowing may be required.

In April 2022, the Cabinet agreed to support proposals for the creation of the Plymouth and South Devon Freeport. The Business Case includes the requirement for the Council to externally borrow up to £15 million for the capital works needed. The borrowing will not be required until 2024/25, but at that point the Council's total external debt will increase. The additional external borrowing will be ringfenced to the Freeport, and all the associated capital financing costs will be funded by the excess business rate income derived from the scheme.

The Council continues to await the outcome of the Safety Valve Intervention programme with the Department for Education in relation to the deficit position on Special Educational Needs. At the end of 2021/22 the Dedicated Schools Grant High Needs Block reported a cumulative deficit of £86.5 million which was carried forward as a deficit reserve as per government guidance. When combined with the current year forecast the deficit is expected to be around £127 million by the end of 2022/23. The conclusion of the discussions with the Department of Education and any resulting agreement will be

crucial to determining whether the Council requires further external borrowing to meet its capital priorities.

The current expectation is that while interest rates will rise further during the first half of 2023, they will then reduce in late 2023 and into 2024. Therefore the requirement for new external borrowing will be kept under review with the intention that loans will only be accessed as and when they are required.

### **Target Rates for Investment**

For the 2023/24 financial year it has been assumed that the average interest rate earned on lending to banks and building societies will be **3.0%** p.a. The target rate takes into account the significant increases in the Bank of England's base rate during 2022, but also reflects existing investments at lower rates that will continue into the 2023/24 financial year and the forecast lower availability of cash to invest at higher rates.

The yield from investment in the CCLA Property Fund is assumed to be **3.8%**. The property market yield has dropped below the 4% achievable at the inception of the investment as a result of the current economic downturn. It is not proposed to make use of short-dated bond funds and multi-asset income funds during 2023/24, so these types of funds are not factored into the budget for investment income.

### **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 also 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 asset life annuity method, an appropriate annuity rate needs to be selected. The percentage chosen corresponded with the Bank of England Monetary Policy Committee's inflation target rate in 2018/19 of 2.1%. MRP will increase by this percentage each year.

Any unsupported (internal) borrowing post 1 April 2008 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. In respect of the Schools Vehicle and Equipment Loans Pool, MRP is derived as equal to the loan repayment.

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

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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**

	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000	2026/27 Estimate £'000	2027/28 Estimate £'000
<b>Total Capital programme</b>	<b>172,483</b>	<b>125,171</b>	<b>83,222</b>	<b>80,273</b>	<b>67,806</b>
Funded by:					
Gross borrowing	7,066	11,809	7,362	6,640	0
Other capital resources	165,417	113,362	75,860	73,633	67,806
<b>Total capital programme funding</b>	<b>172,483</b>	<b>125,171</b>	<b>83,222</b>	<b>80,273</b>	<b>67,806</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 2023/24 and the following four years are shown in table 2 below.

**Table 2 – Capital Financing Requirement**

	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000	2026/27 Estimate £'000	2027/28 Estimate £'000
Underlying borrowing requirement	580,556	579,663	574,026	567,478	554,079
Other long-term liabilities	129,456	124,175	119,117	114,637	109,443
<b>Capital financing requirement</b>	<b>710,012</b>	<b>703,838</b>	<b>693,143</b>	<b>682,115</b>	<b>663,522</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 2023/24 – 2027/28.

**Table 3 – Authorised Limits**

	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000	2026/27 Estimate £'000	2027/28 Estimate £'000
Authorised Limits:					
Borrowing	740,979	658,929	647,851	640,294	626,148
Other long-term liabilities	129,456	124,175	119,117	114,637	109,443
<b>Authorised limit for external debt</b>	<b>870,435</b>	<b>783,104</b>	<b>766,968</b>	<b>754,931</b>	<b>735,591</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 2023/24 and following years.

**Table 4 - Operational Limits**

	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000	2026/27 Estimate £'000	2027/28 Estimate £'000
Operational Limits:					
Borrowing	645,979	633,929	622,851	615,294	601,148
Other long-term liabilities	129,456	124,175	119,117	114,637	109,443
<b>Operational limit for external debt</b>	<b>775,435</b>	<b>758,104</b>	<b>741,968</b>	<b>729,931</b>	<b>710,591</b>

The forecast opening balance for External Borrowing at 1 April 2023 is £507.85 million and remains unchanged at 31 March 2024.

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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**

	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000	2026/27 Estimate £'000	2027/28 Estimate £'000
Capital financing requirement	710,012	703,838	693,143	682,115	663,522
Gross borrowing and other long-term liabilities	637,306	639,695	636,967	603,657	592,683
<b>Under/ (over) borrowing</b>	<b>72,706</b>	<b>64,143</b>	<b>56,176</b>	<b>78,458</b>	<b>70,839</b>

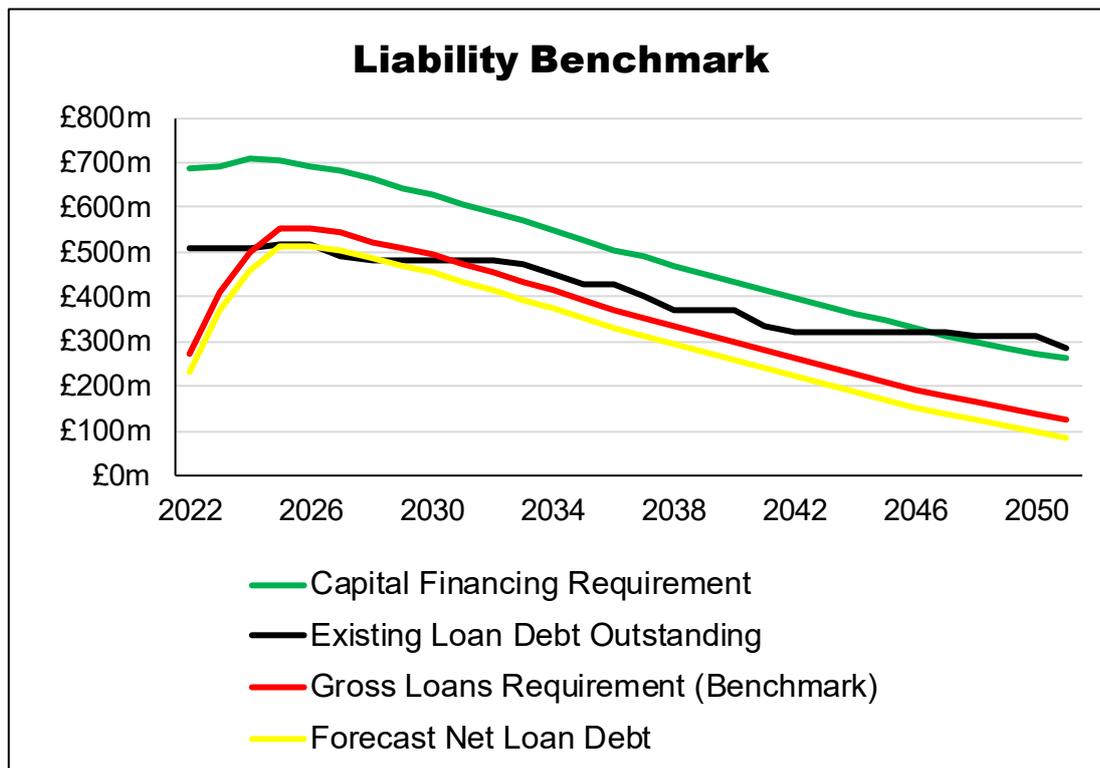
The debt management strategy and borrowing limits for the period 2023/24 to 2027/28 have been set to ensure that over the medium-term net borrowing will only be for capital purposes.

### 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**

	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000	2026/27 Estimate £'000	2027/28 Estimate £'000
Capital financing requirement	710,012	703,838	693,143	682,115	663,522
Less: total reserves and provisions	(252,518)	(192,728)	(180,742)	(179,816)	(179,617)
Plus: minimum liquidity requirement	40,000	40,000	40,000	40,000	40,000
<b>Liability Benchmark</b>	<b>497,494</b>	<b>551,110</b>	<b>552,401</b>	<b>542,299</b>	<b>523,905</b>
External Debt Maturity Profile	507,849	515,518	517,849	489,020	483,239
<b>Net Requirement for additional External Debt</b>	<b>(10,355)</b>	<b>35,592</b>	<b>34,552</b>	<b>53,279</b>	<b>40,666</b>



The increase in the gross loans requirement at the beginning of the period shown is a result of the reduction in the Council's reserves and balances available for internal borrowing.

For periods beyond the current extent of the Council's capital programme, there is no further planned capital expenditure and the budgeted MRP for the repayment of debt therefore reduces the gross loans requirement resulting in the downward trajectory shown in the graph from 2026 onwards.

### Ratio of Financing Cost to Net Revenue Stream

Table 7 below shows the relationship between Capital Financing Costs and the Net Revenue Stream for 2023/24 and future years. Financing cost is affected by Minimum Revenue Provision (MRP), interest receivable and payable and reductions in other long term liabilities.

Table 7 – Ratio of Financing Costs to Net Revenue Stream

	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000	2026/27 Estimate £'000	2027/28 Estimate £'000
Minimum revenue provision	11,948	12,701	12,999	13,187	13,399
Interest payable	26,017	26,017	26,017	26,017	26,017
Recharges and other adjustments	646	630	605	642	632
Interest receivable	(3,500)	(3,500)	(3,500)	(3,500)	(3,500)
Capital financing cost (excluding other long-term liabilities)	35,111	35,848	36,121	36,346	36,548
Capital financing costs of other long-term liabilities	14,428	13,262	12,427	12,523	12,723
Capital financing costs including other long-term liabilities	49,539	49,110	48,548	48,869	49,271
<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>6.70%</b>	<b>6.75%</b>	<b>6.65%</b>	<b>6.69%</b>	<b>6.72%</b>
Ratio of financing costs (including other long-term liabilities) to net revenue stream	9.45%	9.25%	8.93%	8.99%	9.06%

### 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 2023/24 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 three of the Council's four 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 2022 and 31 December 2022 (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 31.03.22 £'m</b>	<b>Interest Rate %</b>	<b>Current 31.12.22 £'m</b>	<b>Interest Rate %</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 2022 and as at 31 December 2022 (current).

Table 10 – Schedule of Investments

Maturing in:	<b>Actual 31.03.22 £'m</b>	<b>Interest Rate %</b>	<b>Current 31.12.22 £'m</b>	<b>Interest Rate %</b>
<b>Bank, Building Society and MMF Deposits</b>				
<b>Fixed Rates</b>				
Term Deposits < 365 days	127.50	0.48	126.00	2.34
365 days & >	31.00	0.86	10.00	0.57
Callable Deposits				
<b>Variable Rate</b>				
Call Accounts	49.01	0.58	0.00	
Notice Accounts	40.00	0.32	10.00	3.09
Money Market Funds	16.86	0.55	4.01	3.25
<b>Property Fund</b>	<b>10.00</b>	<b>3.72</b>	<b>10.00</b>	<b>3.66</b>
<b>All Investments</b>	<b>274.36</b>	<b>0.64</b>	<b>160.01</b>	<b>2.38</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 2022 is lower than at the start of the year. It was anticipated that the cash balance would reduce by 31 March 2023, as a result of:

- The growing deficit on the provision for Special Educational Needs (SEND).
- Expenditure of balances carried forward from 2021/22.
- Use of reserves during 2022/23.
- Internal borrowing to fund the capital programme in excess of MRP.

The recent investment performance of the County Council's cash has improved as a result of rising interest rates, as the Bank of England has sought to contain inflation. The Bank of England has raised base rates from 0.25% at the beginning of 2022 to 3.5% in December, the highest level for 14 years. This has had an impact on the rates available for investment, which have gradually increased over the period since December 2021.

The average rate achieved on investments has therefore improved during the year as Term deposits carried forward from earlier periods have matured and been reinvested at higher rates, where cashflow has allowed.

### Prospects for Interest Rates

Forecasting future interest rate movements even one year ahead is always difficult, and the current economic environment and recent volatility in rates has exacerbated this. 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.

Global instability and rising inflation has resulted in a significant increase in interest rates during 2022. The Bank of England has increased the Bank Rate on 8 occasions during 2022 taking it from 0.25% at the beginning of the year to 3.5% in December.

Market expectations are that rates will continue to increase during 2023, with the Bank of England seeking to achieve a sustainable return of inflation to target levels. The expectation is that the base rate will peak at a level of between 4.5% and 5%. The Bank of England also forecasts negative growth of -1.5% in 2023 and -1% in 2024, representing a long and deep recession. Therefore, once inflation has been brought under control the expectation is that rates will then fall to encourage growth.

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) 2022	March 2023	June 2023	Sep 2023	Dec 2023	March 2024	June 2024	Sep 2024
<b>Base Rate Forecasts</b>								
Link Asset Services	3.50%	4.25%	4.50%	4.50%	4.50%	4.00%	3.75%	3.50%
Capital Economics	3.50%	4.50%	4.50%	4.50%	4.50%	4.25%	4.00%	3.50%

	Dec (act) 2022	March 2023	June 2023	Sep 2023	Dec 2023	March 2024	June 2024	Sep 2024
<b>PWLB Rates</b>								
Link Asset Services forecast								
<b>10 Year</b>	4.30%	4.40%	4.40%	4.30%	4.10%	4.00%	3.90%	3.80%
<b>25 Year</b>	4.60%	4.60%	4.60%	4.50%	4.40%	4.20%	4.10%	4.00%
<b>50 Year</b>	4.30%	4.30%	4.30%	4.20%	4.10%	3.90%	3.80%	3.70%

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 2023/24 – 2026/27

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.

The capital programme for 2023/24 requires borrowing of £7.1 million, which will be internal borrowing. This is offset by the MRP figure of £11.9 million which will leave the Council with total internal borrowing of £72.7 million, i.e. the Council has borrowed £72.7 million from its cash balances, in addition to the external debt of £507.85 million, to fund the capital programme.

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. The Council's external borrowing level has reduced by £102 million since 2008/09, resulting in reduced Capital Financing Charges.

The ability to fund capital expenditure through internal borrowing depends on the availability of cash balances to fund the borrowing. The Council's cash balances comprise the general balance, earmarked revenue reserves, accumulated capital receipts, unspent capital grants, revenue balances carried forward from previous years and other balances.

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With the current financial pressures on the Council, it is projected that the available balances will be significantly reduced as a result of:

- Budgeted use of earmarked reserves during 2022/23 and 2023/24.
- Continued unbudgeted expenditure on Special Educational Needs and Disability (SEND), charged to an unusable reserve.
- Spending of accumulated capital grants, for example Section 106 provision of infrastructure and major projects such as the North Devon Link Road.
- Spending of approved carry-forwards.

As a result the ability to use internal borrowing, as opposed to external borrowing, to fund the capital programme may become more limited.

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 the call upon the Council's cash balances. 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 from 2024/25 until around 2030 is higher than the current level of external debt, which indicates that further external borrowing may be required.

In April 2022, the Cabinet agreed to support proposals for the creation of the Plymouth and South Devon Freeport. The Business Case includes the requirement for the Council to externally borrow up to £15 million for the capital works needed. The borrowing will not be required until 2024/25, but at that point the Council's total external debt will increase. The additional external borrowing will be ringfenced to the Freeport, and all the associated capital financing costs will be funded by the excess business rate income derived from the scheme.

The Council continues to await the outcome of the Safety Valve Intervention programme with the Department for Education in relation to the deficit position on Special Educational Needs. At the end of 2021/22 the Dedicated Schools Grant High Needs Block reported a cumulative deficit of £86.5 million which was carried forward as a deficit reserve as per government guidance. When combined with the current year forecast the deficit is expected to be around £127 million by the end of 2022/23. The conclusion of the discussions with the Department of Education and any resulting agreement will be crucial to determining whether the Council requires further external borrowing to meet its capital priorities.

The current expectation is that while interest rates will rise further during 2023, they will then reduce in late 2023 and into 2024. Therefore the requirement for new external borrowing will be kept under review with the intention that loans will only be accessed as and when they are required.

In previous years the Council has looked for opportunities to reduce external 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, which have meant that it has not been of financial benefit to repay debt before its maturity date.

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The increases in interest rates since the start of 2022 have reduced the level of premiums now payable, and for a short period during early October 2022 it would have been possible to repay a proportion of the Council's external debt without incurring premiums. But given the significant uncertainty and the potential need for new external borrowing, as set out above, it would not make sense for the Council to repay existing debt and then have to take out new external borrowing at higher rates than the loans that have been repaid.

The earliest date on which any of the Council's current 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. There will need to be careful management of capital requirements over the next four years if sufficient cash resources are to be 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.

The following table 12 sets out the expected profile of external debt, based on the approved borrowing for the South Devon Freeport and the loans maturing in 2027.

**Table 12 – Current Approved External Debt Profile**

	<b>Opening Balance £'m</b>	<b>New Borrowing £'m</b>	<b>Debt Repayment £'m</b>	<b>Closing Balance £'m</b>
2023/24	507.85			507.85
2024/25	507.85	7.67		515.52
2025/26	515.52	2.33		517.85
2026/27	517.85	5.00	(33.83)	489.02
2027/28	489.02		(5.78)	483.24

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 **3.5%**.

### **Investment Strategy 2023/24 – 2026/27**

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.**

Under the Markets in Financial Instruments (MiFID II) directive, local authorities are 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 generally unaffected by the 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 13 below.

**Table 13 – 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.

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. 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.

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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 14 below summarises the current 'Approved List' criteria.

**Table 14 – 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.

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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 policy of ensuring that at least 15% of deposits will be realisable within one month.**

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 are permitted. However, given the reduced level of cash, the uncertainty around the potential need for external borrowing and the requirement for liquidity it is unlikely that they would be used during 2023/24. 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. If used, funds would 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 would 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;

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- 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.

During 2022 the Government issued a consultation on whether the statutory override should be extended beyond March 2023. The Government has yet to publish a response to the consultation but it is anticipated that the override is likely to be extended for a further time-limited period. The current value of the investment in the CCLA Property Fund is now higher than the original £10 million invested, so if the statutory override were removed the Council revenue budget would benefit from the capital gain in 2023/24, but would need to manage the risk of losses in future years.

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

**Table 15 – 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 (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 2023/24 financial year it has been assumed that the average interest rate earned on lending to banks and building societies will be **3.0%** p.a. The target rate takes into account the significant increases in the Bank of England's base rate during 2022, but also reflects existing investments at lower rates that will continue into the 2023/24 financial year and the forecast lower availability of cash to invest at higher rates.

The yield from investment in the CCLA Property Fund is assumed to be **3.8%**. The property market yield has dropped below the 4% achievable at the inception of the investment as a result of the current economic downturn. As set out above, it is not proposed to make use of short-dated bond funds and multi-asset income funds during 2023/24, so these types of funds are not factored into the budget for investment income.

The targets we have set for 2023/24 are considered to be achievable.

The expectation is that interest rates are likely to increase further during 2023, but are then likely to fall back once inflation is under control. MTFS forecasts have been based on the average rates for lending to banks and building societies continuing to be 3.0% for 2024/25 and 2025/26. However, these will be reviewed in the light of updated interest rate forecasts and changes to the rates on offer from the Council's counterparties over the MTFS period.

### **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 2022. These investments are not held with the primary intention of gaining a financial return.

**Table 16 - Service Investments**

	<b>Fair Value as at 31 March 2022 £'000</b>
Norse South West Limited	85
Exeter Science Park Limited	885
Skypark	1,401
<b>Total</b>	<b>2,371</b>

Norse South West Ltd - Norse South West Ltd (NSW) commenced on 1st May 2022. The company took on the services previously provided by NPS (SW) Ltd which became inactive on 30<sup>th</sup> April 2022. The value in the table above reflects the previous value of NPS. As NSW, the new joint venture is structured into five delivery groups; Design, Estates and Asset Management, Facilities (including cleaning), Maintenance and Minor Works and Catering. Ownership remains 80% Norse Commercial Services Ltd (whose ultimate controlling party is Norfolk County Council) and 20% Devon County Council (2 x £1 shares, so minimal risk) Risk management, decision-making and performance management is reviewed quarterly by the Liaison Board which includes two Directors representing DCC. Day to day management of the service level agreement between DCC and NSW is the responsibility of the Digital Transformation and Business Support service. 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

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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 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.