

APPENDIX 1

TREASURY MANAGEMENT STRATEGY 2022-23

INTRODUCTION

- 1.1 Cheshire Fire Authority (“the Authority”) is required to operate a balanced budget meaning that cash raised during the year from grants, council tax and other income sources will match the cash expenditure for the year. The first requirement of treasury management is to ensure that this cashflow is adequately planned with cash being available when it is needed. Surplus funds are invested in low risk counterparties or financial instruments commensurate with a low risk appetite, that offer adequate liquidity (i.e. ease of access) before considering any return on the investment. The investment strategy objectives are, in order of priority, security, liquidity and then yield (i.e. interest earned).
- 1.2 The second main function of treasury management is the funding of the capital programme. The capital programme and plans provide a guide to the Authority’s borrowing requirement which is essentially the longer-term cashflow planning to ensure that the capital programme commitments can be met. The management of longer-term cashflow may involve arranging long or short-term loans or by using cashflow surpluses. Any debt currently held may also be re-structured when favourable conditions arise and in line with risk and/or cost objectives.
- 1.3 The contribution the treasury management function makes to the organisation is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the balance on the General Reserve.
- 1.4 The Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as:
‘The management of the local authority’s investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.’

1.5 The CIPFA Prudential and Treasury Management Codes require the preparation of a Capital Strategy providing a longer-term focus to capital plans including:

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

The Capital Strategy is being reported separately as part of the annual budget report pack.

1.6 CIPFA published revised Prudential and Treasury Management Codes on 20 December 2021 and has stated that formal adoption is not required until the 2023/24 financial year.

1.7 The Authority must have regard to these codes of practice when it prepares the Treasury Management Strategy and included Annual Investment Strategy.

1.8 The following bulleted list summarises issues to be considered by public sector organisations that are raised by the revised codes. Most will have limited or no impact on the Authority which does not currently hold or plan to enter into any commercial or non-treasury investments.

- a requirement to adopt a new debt liability benchmark treasury indicator to support the financing risk management of the capital financing requirement;
- clarification of what CIPFA expects an organisation to borrow for and what they do not view as appropriate. This will include the requirement to set a proportionate approach to commercial and service capital investment;
- address environmental, social and governance issues within the Capital Strategy;
- require implementation of a policy to review commercial property, with a view to divest where appropriate;
- create new Investment Practices to manage risks associated with non-treasury investment;
- ensure that any long term treasury investment is supported by a business model;
- a requirement to effectively manage liquidity and longer-term cash flow requirements;
- amendment to address environmental, social and governance policy within the treasury management risk framework;
- amendment to the knowledge and skills register for individuals involved in the treasury management function - to be proportionate to the size and complexity of the treasury management conducted by each organisation;

- a new requirement to clarify reporting requirements for service and commercial investment.
- 1.9 In addition, all investments and investment income must be attributed to one of the following three purposes

Treasury Management

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

Service Delivery

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

Commercial Return

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

- 1.10 As this Authority has not engaged in any commercial investments and has no non-treasury investments, any changes required will be considered for adoption within the 2023-24 Treasury Management Strategy report.

2. TREASURY MANAGEMENT REPORTING REQUIREMENTS

- 2.1 The Authority is required to receive and approve, as a minimum, three main reports each year concerned with treasury management which include information about policies, estimates and actual income and expenditure.

Prudential and Treasury Indicators and Treasury Strategy (this report) – the first and most important report covering:

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy statement (how residual capital expenditure is charged to revenue over time);
- the Treasury Management Strategy (how the investments and borrowings are to be organised and includes the treasury indicators); and
- an Investment Strategy (the parameters on how investments are to be managed).

A Mid-Year Treasury Management Report – this updates the Authority on the progress of the capital position, updates prudential indicators as necessary, and whether the actual execution of treasury management is in line with the Strategy or whether any policies need revision. Should there be a particularly volatile period affecting treasury management then more frequent reports would be submitted.

An Annual Treasury Management Report – This is a backward looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

3. TREASURY MANAGEMENT STRATEGY 2022-23

3.1 The Treasury Management Strategy covers two main areas:-

Capital:

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

Treasury Management:

- The current position;
- Prudential indicators which limit the treasury risks and activities of the Authority;
- Prospects for interest rates;
- The borrowing strategy;
- The policy on borrowing in advance of need;
- Debt rescheduling;
- The investment strategy;
- The policy on creditworthiness; and
- The policy on using external service providers in relation to Treasury Management.

3.2 These elements cover the requirements of the Local Government Act 2003, the Department of Levelling Up, Housing and Communities (DLUHC - this was formerly the Ministry of Housing, Communities and Local Government) Investment Guidance, DLUHC Minimum Revenue Provision (MRP) Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code.

3.3 The CIPFA Treasury Management Code requires the responsible officer (the Fire Authority Treasurer) to ensure that anyone with responsibility for treasury management receives adequate training. The external treasury management supplier will provide suitable training during the year as appropriate.

3.4 The joint Police and Fire Finance team will manage all day to day treasury management services on behalf of the Authority, supported directly by Link Group as its external treasury management advisors. However, it is recognised that responsibility for treasury management decisions remains with the Authority at all times and overdue reliance will not be placed upon one source of advice alone. Nevertheless, it is also recognised that there is value in employing external advisors in order to gain access to specialist skills and resources.

4. CAPITAL EXPENDITURE PRUDENTIAL INDICATORS 2022-25

4.1 Capital expenditure

- 4.1.1 Capital expenditure plans are a key driver of treasury management activity. The funding of such plans impact on cash balances and borrowing requirements in the short and longer terms. The on-going consequences of these decisions have a direct impact on the annual revenue budget. As such, the following prudential indicators show the proposed capital expenditure plans, how they are to be funded, the impact on the organisation's finances and their affordability in terms of the impact on revenue budgets.
- 4.1.2 This prudential indicator is a summary of the Authority's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. These are based on actual and current forecast cash spend along with the planned future capital programme.

Table 1: Capital Expenditure

2021-22 Estimate £000	2022-23 Estimate £000	2023-24 Estimate £000	2024-25 Estimate £000
5,621	16,177	5,605	4,865

- 4.1.3 The next table shows how the above capital expenditure is to be financed. Where there is a shortfall in available funds, the shortfall is covered by an additional borrowing requirement. It is anticipated that c£16m of additional borrowing requirement will be utilised over the period to complete the financing of the new operational training centre and to finance other planned major estates projects. A review of the Fire Station modernisation programme is currently underway and due to be completed during 2022-23. This will also help to determine the way forward for Warrington Fire Station, which to-date has not been included in any plans. If significant additional capital expenditure is approved following this review it will also further increase the borrowing requirement

Table 2: Capital Financing

2021-22 Estimate £000		2022-23 Estimate £000	2023-24 Estimate £000	2024-25 Estimate £000
5,621	Forecast Spend	16,177	5,605	4,865
	<u>Financed by:</u>			
0	General capital grants	0	0	0
0	Specific capital grants	0	0	0
513	Capital Receipts	0	0	0
1,108	Capital Reserves & Revenue Contributions	6,077	4,355	4,615
4,000	Borrowing requirement	10,100	1,250	250

4.2 Capital Financing Requirement (or borrowing needs)

- 4.2.1 The second prudential indicator is the Authority's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been financed either from revenue or capital funds. It is essentially a measure of borrowing need and any capital expenditure not financed in the above table will increase the CFR.
- 4.2.2 It should be noted that the CFR increases during the period of the current MTFP, reflecting the new borrowing requirement due to planned capital expenditure, and a reduction in alternative capital funding sources.

Table 3: Capital Financing Requirement (CFR)

2021-22 Estimate £000	Capital Financing Requirement (CFR)	2022-23 Estimate £000	2023-24 Estimate £000	2024-25 Estimate £000
12,794	CFR brought forward	16,126	25,424	25,790
4,000	Net financing need for the year	10,100	1,250	250
(668)	Less MRP	(802)	(884)	(1,011)
16,126	CFR carried forward	25,424	25,790	25,029
3,332	Movement in CFR	9,298	366	(761)

- 4.2.3 The CFR is reduced every year by the minimum revenue provision (MRP). The Authority is required by statute to set aside MRP each year for the repayment of external debt. Under amendment regulation 4(1) of the 2008 Regulations, the Authority is charged with a simple duty to set aside MRP which it considers to be prudent. Guidance has been issued which sets out recommendations on the interpretation of 'prudent' and the Authority is required to prepare an annual statement on how it proposes to calculate MRP. The 2022-23 annual statement is set out in the Annex.
- 4.2.4 The DLUHC issued a "Consultation on changes to the capital framework: Minimum Revenue Provision" on 30 November 2021 which primarily covers concerns that the government has in respect of compliance with the duty to make a prudent MRP. The consultation states that DLUHC are not intending to change the current statutory guidance, but to clearly set out in legislation the practices that authorities should already be following. There are two main proposals and neither will impact upon the Authority's current MRP practices which are already consistent and fully compliant with the intent of the framework and government expectations.

4.3 Core Funds and Expected Investment Balances

- 4.3.1 The application of funds (capital receipts, reserves etc.) to finance capital expenditure or other budget decisions to support the revenue budget will have an on-going impact on the cash available for investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are the estimated year-end balances for reserves. The Capital Receipts and Unapplied Capital Grants reserves are restricted in their usage to funding capital expenditure or repaying debt and cannot be used for revenue purposes.

Table 4: Reserves

Reserves	31 March 2021 Actual £000	31 March 2022 Estimate £000	31 March 2023 Estimate £000	31 March 2024 Estimate £000	31 March 2025 Estimate £000
Earmarked Revenue Reserves					
IRMP Reserve	8,276	0	0	0	0
Resource Centre Managers Reserves	7,859	4,857	4,975	4,318	3,974
Funding Support (Covid) Reserve	2,255	2,255	2,238	1,488	988
Community Risk Reduction Reserve	333	328	328	328	328
Unitary Performance Group Reserve	162	162	146	146	146
	18,885	7,602	7,687	6,280	5,436
Capital Reserves					
Usable Capital Receipts	285	0	0	0	0
Revenue Reserve for Capital Expenditure	1,299	11,786	7,934	5,473	2,752
Unapplied Capital Grants	0	0	0	0	0
	1,584	11,786	7,934	5,473	2,752
General Reserve					
General Fund	2,210	2,210	2,210	2,210	2,210
Total Reserves	22,679	21,598	17,831	13,963	10,398

Affordability Prudential Indicators

- 4.3.2 So far the Strategy has covered the control of overall capital expenditure plans and borrowing prudential indicators. The following indicator provides an indication of the impact of the above capital expenditure plans and their financing proposals on the overall finances and precept (council tax).

Table 5: Ratio of financing costs to net revenue funding

2020-21 Actual	2021-22 Estimate	2022-23 Estimate	2023-24 Estimate	2024-25 Estimate
0.94%	1.80%	2.32%	2.66%	2.87%

- 4.3.3 This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream. The estimates of financing costs include current commitments and the proposals included in the budget/medium-term financial plan. The ratios are increasing due to the requirement to increase borrowing in order to finance the capital programme from 2018-19 onwards. Most notably new debt repayment provision (MRP) in respect of the new Operational Training Centre, the planned replacement fire station at Crewe and the potential purchase of service housing in Wilmslow to allow the Day Crewing duty system to be introduced at Wilmslow Fire Station (albeit this depends on the Fire Authority approving the 2022-23 Annual Action Plan).

5. BORROWING

- 5.1 The capital expenditure plans set out in Section 4 provide details of the capital plans of the Authority. A key function of treasury management is to ensure that the cash resources are organised in accordance with the relevant regulations and professional codes so that sufficient cash is available to meet service activity and the capital strategy. This will involve both cashflow management and where capital expenditure plans require it, the arrangement of appropriate borrowing facilities. This Strategy covers the relevant treasury and prudential indicators, the current and projected debt positions and the Annual Investment Strategy.

Current Debt Position

- 5.1.1 The current debt position, as at 31 March 2021, with forward projections, is summarised below. The table shows actual external debt against the underlying capital borrowing need, highlighting any internal borrowing or over borrowing.

Table 6: Debt Position

2020-21 Actual £000	2021-22 Estimate £000	Gross Borrowing Requirement	2022-23 Estimate £000	2023-24 Estimate £000	2024-25 Estimate £000
		External Debt			
1,012	5,012	Debt at 1 April	12,012	19,512	20,086
4,000	7,000	Expected change in Debt	7,500	574	(467)
5,012	12,012	External Debt at 31 March	19,512	20,086	19,619
0	0	Finance Lease	0	0	0
0	0	Expected change in Finance Lease	0	0	0
5,012	12,012	Actual Gross Debt at 31 March	19,512	20,086	19,619
12,794	16,126	Capital Financing Requirement	25,424	25,790	25,029
7,782	4,114	Internal / (over) borrowing	5,912	5,704	5,410

- 5.1.2 Within the prudential indicators there are a number of key indicators to ensure that the Authority operates its activities within well-defined limits. One of these is that the Authority ensures that its gross debt does not, except in the short-term, exceed the total Capital Financing Requirement in the preceding year plus the estimates for any additional Capital Financing Requirement for 2022-23 and the following two financial years. This allows some flexibility for limited early borrowing for future plans but ensures that borrowing is not undertaken for revenue or speculative purposes.
- 5.1.3 The Treasurer confirms that the Authority complied with this prudential indicator in the current year and does not envisage any issues for the immediate future. This view takes into account current commitments, existing plans and the proposals included in the budget report and Medium Term Financial Plan for 2022-27 to be considered by the Fire Authority on 9th February 2022.

5.2 Treasury Indicators – limits to borrowing activities

- 5.2.1 There are two limits to borrowing, the operational boundary and the authorised limit for external debt. These are the current debt position as shown in 5.1.1 above plus the forecast requirement for external financing over the next three years.
- 5.2.2 **The operational boundary** is the limit which external debt and long-term liabilities is not normally expected to exceed. In most cases this would be a similar figure to the Capital Financing Requirement but may be higher or lower depending on the level of actual debt and repayment schedules. Temporary breach of the operational boundary is not in itself cause for concern but an indicator that such liabilities should be reviewed. If there was a sustained breach, (such as an increase in long-term borrowing), then this would need to be investigated and action taken.
- 5.2.3 The operational boundaries below are based on estimating the Authority's most likely level of borrowing and leasing each year. It includes long-term borrowing to fund capital expenditure plans, short-term temporary borrowing for cashflow purposes and the impact of any finance leases.

Table 7: Operational Boundary

Operational Boundary	2022-23 Estimate £000	2023-24 Estimate £000	2024-25 Estimate £000
Debt	22,012	22,586	22,586
Other long term liabilities	200	200	200
Total	22,212	22,786	22,786

- 5.2.4 As Table 7 shows, the Operational Boundary over the period 2022-25 is increasing to around £23m by 2024-25 from around £12m in 2021-22 because of the planned borrowing to support the capital programme.

- 5.2.5 The **authorised limit for external debt** is a further key prudential indicator representing a control on the maximum level of borrowing. This represents a limit beyond which external debt and finance leases are prohibited and is set or revised by the Authority. It reflects the level of such debt which, while not desired, could be afforded in the short term but is not sustainable in the longer-term.
- 5.2.6 This is a statutory limit determined under section 3(1) of the Local Government Act 2003. The Government retains an option to control either the total of all local authorities' plans or those of any specific public body; although this power has yet to be exercised.
- 5.2.7 There is a statutory requirement for the Authority to confirm the authorised limit. This is set out in the table below:

Table 8: Authorised Limit

Authorised limit for external debt	2022-23 Estimate £000	2023-24 Estimate £000	2024-25 Estimate £000
Borrowing	24,012	24,586	24,586
Other Long Term Liabilities	200	200	200
Total Authorised Limit	24,212	24,786	24,786

5.3 Prospects for Interest Rates

- 5.3.1 Link Group have been appointed as external treasury advisor and part of their service is to assist the Authority to formulate a view on interest rates. The following table gives our current view.

Link Group Interest Rate View 20.12.21														
	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
BANK RATE	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25
3 month ave earnings	0.20	0.30	0.50	0.50	0.60	0.70	0.80	0.90	0.90	1.00	1.00	1.00	1.00	1.00
6 month ave earnings	0.40	0.50	0.60	0.60	0.70	0.80	0.90	1.00	1.00	1.10	1.10	1.10	1.10	1.10
12 month ave earnings	0.70	0.70	0.70	0.70	0.80	0.90	1.00	1.10	1.10	1.20	1.20	1.20	1.20	1.20
5 yr PWLB	1.40	1.50	1.50	1.60	1.60	1.70	1.80	1.80	1.80	1.90	1.90	1.90	2.00	2.00
10 yr PWLB	1.60	1.70	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10	2.20	2.30
25 yr PWLB	1.80	1.90	2.00	2.10	2.10	2.20	2.20	2.20	2.30	2.40	2.40	2.50	2.50	2.50
50 yr PWLB	1.50	1.70	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.20	2.20	2.30	2.30

Source: Link Group

- 5.3.2 Over the last two years, the coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March 2020 to cut the Bank Rate to first 0.25%, and then to 0.10%, it left the Bank Rate unchanged at its subsequent meetings until raising it to 0.25% at its meeting on 16 December 2021.

Forecasts for Bank Rate

5.3.3 It is not expected that the Bank Rate will go up fast after this initial December 2021 rate rise as the supply potential of the economy is not likely to have taken a major hit during the pandemic. It should, therefore, be able to cope well with meeting demand after supply shortages subside over the next year, without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the MPC's 2% target after the spike up to around 5%. The forecast includes four increases in Bank Rate over the three-year forecast period to March 2025, ending at 1.25%. However, it is likely that these forecasts will need amending within a relatively short timeframe due to significant continuing uncertainties including:

- There were already increasing grounds for viewing the economic recovery as running out of steam during the autumn and now into the winter. And then along came Omicron to pose a significant downside threat to economic activity. This could lead into stagflation, or even into recession, which would then pose a dilemma for the MPC as to whether to focus on combating inflation or supporting economic growth through keeping interest rates low.
- Will some current key supply shortages spill over into causing economic activity in some sectors to take a significant hit?
- Rising gas and electricity prices in October and next April and increases in other prices caused by supply shortages and increases in taxation next April, are already going to deflate consumer spending power without the MPC having to take any action on the Bank Rate to cool inflation.
- On the other hand, consumers are sitting on over £160bn of excess savings left over from the pandemic so when will they spend this sum, in part or in total?
- It looks as if the economy coped well with the end of furlough on 30 September. It is estimated that there were around one million people who came off furlough then and there was not a huge spike in unemployment. The other side of the coin is that vacancies have been hitting record levels so there is a continuing acute shortage of workers. This is a potential danger area if this shortage drives up wages which then feed through into producer prices and the prices of services i.e., a second-round effect that the MPC would have to act against if it looked like gaining significant momentum.

5.3.4 We also recognise there could be further nasty surprises on the Covid front beyond the Omicron mutation.

5.3.5 If the UK invokes article 16 of the Brexit deal over the dislocation in trading arrangements with Northern Ireland, this has the potential to end up in a no-deal Brexit.

- 5.3.6 In summary, with the high level of uncertainty prevailing on several different fronts, we expect to have to revise our forecasts again - in line with whatever the latest situation is.
- 5.3.7 It should also be borne in mind that the Bank Rate being cut to 0.25% and then to 0.10%, were emergency measures to deal with the Covid crisis hitting the UK in March 2020. At any time, the MPC could decide to simply take away such emergency cuts on no other grounds than they are no longer warranted and as a step forward in the return to normalisation. In addition, any Bank Rate under 1% is both highly unusual and highly supportive of economic growth.

Forecasts for PWLB rates and gilt and treasury yields

- 5.3.8 Since the start of 2021, we have seen a lot of volatility in gilt yields, and hence PWLB rates. As the interest forecast table for PWLB certainty rates above shows, there is forecast to be a steady, but slow, rise in both the Bank Rate and gilt yields during the forecast period to March 2025, though there will doubtless be a lot of unpredictable volatility during this forecast period.
- 5.3.9 While monetary policy in the UK will have a major impact on gilt yields, there is also a need to consider the potential impact that rising treasury yields in America could have on our gilt yields. As an average since 2011, there has been a 75% correlation between movements in US 10-year treasury yields and UK 10-year gilt yields. This is a significant 'Upward Risk' exposure to our forecasts for longer term PWLB rates. However, gilt yields and treasury yields do not always move in unison.
- 5.3.10 There are also possible 'Downside Risks' from the huge sums of cash that the UK public have saved during the pandemic; when savings accounts earn little interest. It is likely that some of this cash could end up being invested in bonds and so push up demand for bonds and support their prices. How this will interplay with the Bank of England eventually getting round to not reinvesting maturing gilts and then later selling gilts, will be interesting to monitor.
- 5.3.11 Overall there is a balance of upside risks to forecasts for medium to long term PWLB rates.

A new era for local authority investing

- 5.3.12 One of the key results of the pandemic has been a fundamental rethinking and shift in monetary policy by major central banks like the Fed, the Bank of England and the European Central Bank (ECB), to tolerate a higher level of inflation than in the previous two decades when inflation was the prime target to bear down on so as to stop it going above a target rate. There is now also a greater emphasis on other targets for monetary policy than just inflation, especially on 'achieving broad and inclusive "maximum" employment in its entirety' in the US, before consideration would be given to increasing rates.

- 5.3.13 The Fed in America has gone furthest in adopting a monetary policy based on a clear goal of allowing the inflation target to be symmetrical, (rather than a ceiling to keep under), so that inflation averages out the dips down and surges above the target rate, over an unspecified period of time.
- 5.3.14 The Bank of England has also amended its target for monetary policy so that inflation should be 'sustainably over 2%' before starting on raising Bank Rate and the ECB now has a similar policy.
- 5.3.15 For local authorities and other public sector organisations, this means that investment interest rates and very short term PWLB rates will not be rising as quickly or as high as in previous decades when the economy recovers from a downturn and the recovery eventually runs out of spare capacity to fuel continuing expansion.
- 5.3.16 Governments will also be concerned to see interest rates stay lower as every rise in central rates will add to the cost of vastly expanded levels of national debt; (in the UK this is £21bn for each 1% rise in rates). On the other hand, higher levels of inflation will help to erode the real value of total public debt.

Investment and borrowing rates

- 5.3.17 Investment returns are expected to improve in 2022-23. However, while markets are pricing in a series of Bank Rate increases, actual economic circumstances may see the MPC fall short of these elevated expectations.
- 5.3.18 Borrowing interest rates fell to historically very low rates as a result of the coronavirus crisis and the quantitative easing operations of the Bank of England and still remain at historically low levels. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years.
- 5.3.19 On 25 November 2020, the Chancellor announced the conclusion to a review of margins over gilt yields for PWLB rates; the standard and certainty margins were reduced by 1% but a prohibition was introduced to prevent borrowing from the PWLB by any local authority that had the purchase of assets for yield in its three-year capital programme.
- 5.3.20 While the Authority will not be able to avoid borrowing to finance new capital expenditure, to replace maturing debt and the rundown of reserves, there will be a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new short or medium-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.
- 5.3.21 As Link's long-term (beyond 10 years) forecast for Bank Rate is 2.00% and some PWLB rates are currently below 2.00%, there remains value in considering long-term borrowing from the PWLB, where appropriate. The Authority will assess its borrowing requirement in conjunction with budgetary pressures to reduce total interest costs and long-term borrowing will be undertaken for the purpose of certainty, and to secure long term favourable interest rates at the appropriate time.

5.4 Borrowing Strategy

- 5.4.1 As shown in Table 6, the Authority is currently utilising internal borrowing and forecast to remain so for the period covered by this Strategy. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with external loan debt as cash supporting reserves, balances and cash flow has been used as a temporary measure. This approach is appropriate for the current economic scenario and prudent given that limited investment return on surplus cash flow and counter-party risk are still issues that need to be considered.
- 5.4.2 This strategy plans to maintain internal borrowing over the period of major Estates projects delivery at around £5m to £6m, through careful cashflow management, in order to minimise new long term external borrowing over this period. At this point, a temporary increase to the target level of internal borrowing over this period, supported by short periods of temporary external borrowing if required, is considered to be manageable and a sensible position in view of almost non-existent returns that can be achieved on cash balances invested.
- 5.4.3 Against this background and the risks within the economic forecast, caution will be adopted with the 2022-23 treasury operations. The Treasurer will keep interest rates and the cashflow under continual review in order to adopt a pragmatic approach to changing circumstances, supported by advice from the external Treasury Management advisers. It may at some point be necessary to reduce internal borrowing further, if cash reserves continue to reduce due to ongoing budget pressures and planned capital expenditure, by securing additional new external borrowing above that forecast to fund the ongoing capital programme in Table 2 although this is not anticipated in the short term.
- 5.4.4 A key aim of the borrowing strategy is to minimise the cost of the loan portfolio whilst ensuring that the obligation to repay the loans is spread out over a period of time. This reduces the impact of such loans on the revenue budget. The profile of the repayment of the debt portfolio is shown below at 5.6.3.
- 5.4.5 New long term borrowing is currently planned during the life of this strategy. Where short term borrowing arrangements are required to support a temporary low general fund bank balance, the Authority will engage with Treasury Advisors to understand if there are any Local Authority counterparties available to lend from. The offer will then be considered and terms of loans agreed between the Chief Accountant and nominated officer from the lending organisation.

5.5 Policy on borrowing in advance of need

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

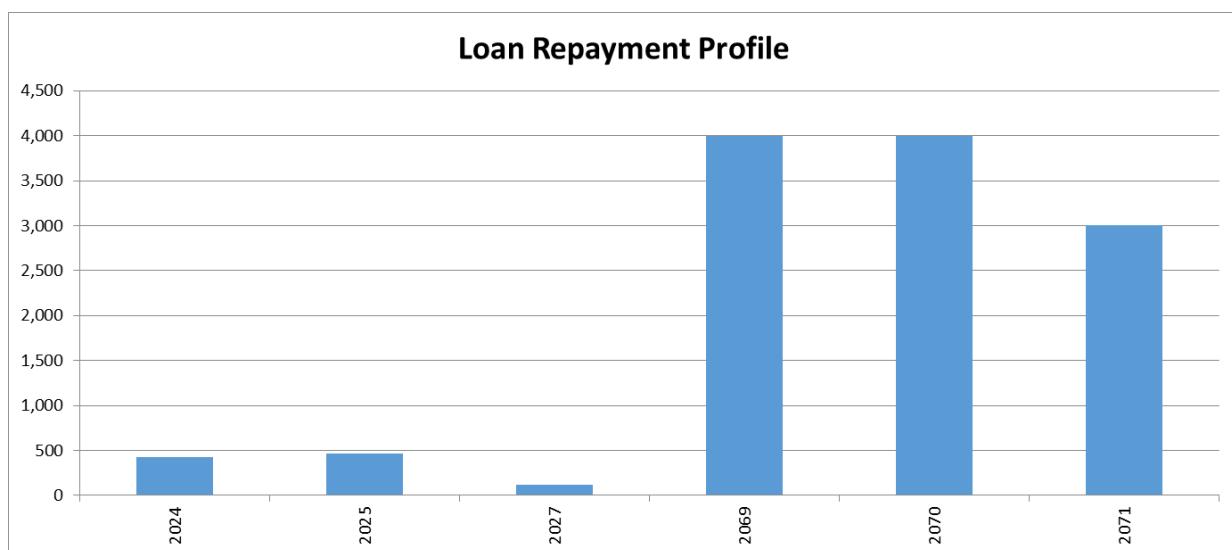
5.6 Debt Rescheduling

5.6.1 Rescheduling of current borrowing in the debt portfolio is unlikely to occur as there is still a very large difference between premature redemption rates and new borrowing rates, even though the general margin of PWLB rates over gilt yields was reduced by 1% in November 2020.

5.6.2 The reasons for any rescheduling to take place will include:

- The generation of cash savings and/or discounted cash flow savings
- Helping to fulfil the treasury strategy
- Enhancing the balance of the portfolio (amending the maturity profile and/or the balance of volatility).

5.6.3 Any potential rescheduling will be very carefully considered. A table showing the current profile of the debt portfolio, highlighting years in which debt matures, is shown below:



5.6.4 All current borrowing is on a fixed rate basis with a current overall weighted average 2.01%, reduced from 4.65% in February 2021 because of new external borrowing of £11m to finance the Training Centre project. This has been secured from PWLB at favourably low fixed rates in March 2021 (£4m at 1.99%), July 2021 (£4m at 1.65%) and November 2021 (£3m at 1.63%). Any new loans taken out for future capital expenditure plans or the repayment of maturing debt will be subject to the rates applicable at that time. Any early repayment of debt would also be subject to the expense of early pay-back premiums.

5.6.5 Key sensitivities of the interest rate forecast are likely to be:

- if it was felt that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity, or a sudden increase in inflation risks, then the portfolio position will be reviewed with the potential action of increasing borrowing to cover the internal borrowing position or future known commitments or repayments while rates were still relatively low; and
- If it were felt that there was a significant risk of a sharp fall in short and long-term interest rates due to a weakening of economic factors; then longer-term borrowing will be postponed until rates were deemed at their lowest and a review of current debt would be undertaken to ascertain the benefit of rescheduling to more competitive short term loans.

5.7 Treasury Management limits on activity

- #### 5.7.1 There are three debt-related treasury activity limits. Their purpose is to restrain borrowing activity within certain limits to manage risk and reduce the impact of adverse movement in interest rates. However, if these are set too restrictively they will impair the opportunity to reduce costs or maximise value for money.

Table 9: Interest Rate Limits

	2022-23	2023-24	2024-25
	Upper	Upper	Upper
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	25%	25%	25%

Table 10: Maturity structure of fixed interest rate borrowing 2022-23

Maturity Structure of Authority Borrowing	Lower Limit %	Upper Limit %
Under 12 months	0%	15%
12 months to 2 years	0%	15%
2 years to 5 years	0%	25%
5 years to 10 years	0%	25%
10 years and above	50%	100%

6. ANNUAL INVESTMENT STRATEGY

6.1 Investment Policy

- #### 6.1.1 The Department of Levelling Up, Housing and Communities (DLUHC - this was formerly the Ministry of Housing, Communities and Local Government) and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This Strategy deals solely with treasury (financial) investments. The

Authority does not hold any non-financial investments, essentially the purchase of income yielding assets, but if it did these would now be covered in the separate Capital Strategy.

6.1.2 The Authority's investment policy has regard to the following:

- DLUHC's Guidance on Local Government Investments ("the Guidance")
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the Code")
- CIPFA Treasury Management Guidance Notes 2018

6.1.3 The Authority's principal objectives for investments are security first, liquidity next and finally yield (return). The Authority will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity. In the current economic climate, it is considered appropriate to keep investments short term to cover cash flow needs. However, where appropriate, the Authority will also consider the value available in periods up to 12 months with high credit rated financial institutions.

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

- a) Minimum acceptable credit criteria are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.
- b) Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Authority will engage with its external advisors to monitor market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.
- c) Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.
- d) The Authority has defined the list of types of investment instruments that the treasury management team are authorised to use. There are two lists in table 11 below under the categories of 'specified' and 'non-specified' investments.
 - **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year or have less than a year left to run to maturity if originally they were classified as being non-specified investments solely due to the maturity period exceeding one year.

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

Table 11: Approved Investment Instruments

Specified Investments (maturities up to one year) <ul style="list-style-type: none"> <input type="checkbox"/> Bank & Building Societies Term Deposits <input type="checkbox"/> Other Local Authority Term Deposits <input type="checkbox"/> Debt Management Agency Deposit Facility <input type="checkbox"/> AAA Money Market Funds (CNAV/LVNAV/VNAV)
Non-Specified Investments (maturities over one year) <ul style="list-style-type: none"> <input type="checkbox"/> Bank & Building Societies Term Deposits <input type="checkbox"/> Other Local Authority Term Deposits
Other Non-Specified Investments <ul style="list-style-type: none"> <input type="checkbox"/> Fixed term deposits with variable rates & maturities

- e) Non-specified investments limit. The Authority has determined that it will limit the maximum total exposure to non-specified investments as being 20% of the total investment portfolio.
- f) Lending limits, the maximum amount for each counterparty will be set at £10m per organisation/group. The maximum investment duration for each counterparty will be set in line with the creditworthiness service provided by Link Asset Services as set out in paragraph 6.2.
- g) The Authority will set a limit for the amount of its investments which are invested for longer than 365 days, (see paragraph 6.4.7).
- h) Investments will only be placed with counterparties from countries with a specified minimum sovereign rating, (see paragraph 6.3).
- i) The Authority has engaged external consultants, (see paragraph 3.4), to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.
- j) All investments will be denominated in sterling.
- k) As a result of the change in accounting standards for 2022-23 under IFRS 9, the Authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, the Ministry of Housing, Communities and Local Government, [MHCLG], concluded a consultation

for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years ending 31 March 2023).

6.1.5 The above criteria are unchanged from last year.

6.2 Creditworthiness Policy and Exposure to Risk

6.2.1 The Authority utilises the creditworthiness service provided by Link Group as its Treasury Management advisers. This service employs a sophisticated modelling approach incorporating credit ratings from the three main credit rating agencies – Fitch, Moody's and Standard & Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- Credit watches and credit outlooks from credit rating agencies;
- Credit Default Swaps (CDS) to give early warning of likely changes in credit ratings; and
- Sovereign ratings to select counterparties from only the most creditworthy countries.

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

- | | |
|-------------|---|
| • Yellow | 5 years |
| • Purple | 2 years |
| • Blue | 1 year (only applies to nationalised or semi nationalised UK banks) |
| • Orange | 1 year |
| • Red | 6 months |
| • Green | 100 days |
| • No Colour | Not to be used |

6.2.3 As this methodology uses a wide range of information beyond basic credit ratings, it ensures that no one source of information is given undue credence. All ratings and colour codes are monitored weekly via Link's credit listings and in-between via business press. The Authority is alerted to changes to any ratings via email from Link. If a downgrade results in the counterparty / investment scheme no longer meeting the Authority's minimum criteria, its further use as a new investment will be withdrawn immediately and any current investments reviewed for potential movement.

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

6.3 Country Limits

- 6.3.1 The Authority has determined that it will only use approved counterparties from the UK and from countries outside of the UK with a minimum sovereign credit rating of AAA from Fitch (or equivalent). The list will be added to, or deducted from, should ratings change.

6.4 Investment Strategy

- 6.4.1 Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. While most of the Authority's cash balances are required in order to manage the 'ups and downs' of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.
- 6.4.2 The Authority would seek to maintain at all times a core liquid balance of £4m, and maintain a liquid balances vs longer term balances ratio of 50:50.
- 6.4.3 For its cash flow generated balances, the Authority will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated deposits, (overnight to 100 days), in order to benefit from the compounding of interest.
- 6.4.4 The current forecast shown in paragraph 5.3, includes a forecast for a first increase in Bank Rate in May 2022, though it could come sooner. Bank Rate forecasts for financial year ends (March) are:

2021/22 – 0.25%	2022/23 – 0.75%	2023/24 – 1.00%	2024/25 – 1.25%
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- 6.4.5 If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.
- 6.4.6 Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

Investment treasury indicator and limit

- 6.4.7 This indicator limits the total funds which the Authority is willing to invest for periods greater than 365 days. This limit is set with regard to the Authority's liquidity requirements and to reduce the need for early sale of an investment. It is based on the forecast availability of funds after each year-end. The Authority will avoid locking into long term investments whilst interest rates remain at their current low levels, and will not enter into investments that are over one year duration.

Table 12: Investment Treasury Limit:

	2022-23	2023-24	2023-24
	Upper	Upper	Upper
Principal sums invested for longer than 365 days	Nil	Nil	Nil

6.5 End of Year Investment Report

- 6.5.1 At the end of the financial year, the Treasurer will report on the Authority's investment activity as part of the Annual Treasury Report.

Minimum Revenue Provision (MRP) Statement

1. The Authority is required to make an annual provision from revenue to contribute towards the repayment of borrowing. This requirement arises under the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008, which simplifies earlier MRP requirements by placing a duty on the Authority to determine each year an amount of minimum revenue provision, which it considers to be prudent. In order to assist the Authority with this determination, guidance for assessing what would represent a prudent provision has been issued under Section 21 (1A) of the Local Government Act 2003 (the Guidance). The Authority is required to have regard to the Guidance when considering the amount of their annual “prudent” MRP.
2. It is proposed that the Authority continues to set the MRP at 6.7% of the opening Capital Financing Requirement (CFR) relating to the balance of historic debt liability. This is considered to be a prudent and sustainable approach, however the 6.7% level remains subject to review.
3. Any post 2017-18 new borrowing will be subject to MRP under option 3 of the Government Guidance. It will be charged over a period which is reasonably commensurate with the estimated useful life applicable to the nature of expenditure, using the equal annual instalment method. For example, borrowing in respect of capital expenditure on the new Training Centre Project will be related to the estimated life of that asset.
4. The use of this option for certain schemes will also result in a nil MRP charge until the year after that in which all expenditure on the scheme, project or other item of capital expenditure has been fully accrued under proper accounting practices, regardless of the extent of such expenditure that has not been accrued at the end of the previous financial year. Estimated life periods will be determined using appropriately qualified professional judgement.
5. Based on the current projected capital outturn position for 2021-22 and this statement, it is expected that the resulting MRP charge will be approximately £802k for 2022-23.
6. The policy will be reviewed on an annual basis. If it is proposed to vary the strategy during the year, a revised statement will be submitted to the Authority.