Treasury Management Strategy Statement

Minimum Revenue Provision Policy Statement & Annual Investment Strategy 2023/24

East Staffordshire Borough Council

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1.0 Introduction

1.1 Background

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

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

The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

CIPFA defines treasury management as:

> *"The management of the local authority's 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."*

This authority has not engaged in any commercial investments under the Localism Act. Whilst we retain some historical income generating investment properties these were originally acquired for economic regeneration and in many cases funded from external funding.

Full details of the policies and objectives of the Council's treasury management activities can be seen in Schedule 1.

1.2 Reporting Requirements

The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of polices, estimates and actuals. These reports are required to be adequately scrutinised by committee before being recommended to the Council. This role is currently undertaken by the Audit Committee.

Prudential and Treasury Indicators and **Treasury Strategy** (This report) - The first, and most important report covers:

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

A **Mid Year Treasury Management Report** – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision. In addition Cabinet and Audit Committee will receive quarterly updates.

An **Annual Treasury Report** – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Quarterly Reports – In addition to the three major reports detailed above, from 2023/24 quarterly reporting (end of June/end of December) is also required. However, these additional reports do not have to be reported to Full Council but are required to be adequately scrutinised. This role is undertaken by the Audit Committee. The reports, specifically, should comprise updated Treasury/Prudential Indicators.

The CIPFA 2021 Prudential and Treasury Management Codes require, all local authorities to prepare an a **Capital Strategy report**, which will provide the following:

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

The aim of this capital strategy is to ensure that all elected members on the full council fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite. This report is contained within Appendix D to the Medium Term Financial Strategy.

1.3 Treasury Management Strategy for 2023/24

The strategy for 2023/24 covers two main areas:

Capital Issues

* the capital expenditure plans and the prudential indicators;
* the Minimum Revenue Provision (MRP) policy.

Treasury Management Issues

* the current treasury position;

* treasury indicators which will limit the treasury risk and activities of the Council;
* prospects for interest rates;
* the borrowing strategy;
* policy on borrowing in advance of need;
* debt rescheduling;
* the investment strategy;
* creditworthiness policy; and
* policy on use of external service providers.

These elements cover the requirements of the Local Government Act 2003, the CIFPA Prudential Code, the DLUHC MRP Guidance, the CIPFA Treasury Management Code and the DLUHC Investment Guidance.

2.0 Risk Management

The Council recognises that any investment has an element of risk and it is therefore imperative that such risks are controlled. Good risk management with regard to treasury management is essential. The authority therefore aims to both minimise where possible the probability of a detrimental event occurring; and at the same time reduce the impact of said event. This section highlights the primary risks where the Council has to make informed judgements as to their potential impact.

2.1 Interest Rate Risk

2.1.1 Interest rate risk, in the context of a Treasury Management Strategy, is the risk that fluctuations in the levels of interest rates create an unexpected or unbudgeted burden on the Council's finances, against which the Council has failed to protect itself adequately.

2.1.2 Section 4.3 sets out detailed advice from the Council's treasury management advisor (Link) on the predicted level of interest rates and the factors that influence them.

2.1.3 Choices need to be made about the institutions with whom the Council invests its cash surpluses. In doing so, the Council's priorities are the security of capital and the liquidity of its investments.

2.1.4 An assessment that has to be made is the length of time over which investments are made. Where investments are made for longer than one year, factors that need to be considered include:

- rates in 1+ years' time could increase above the rate for the investment;
- Strategically, in line with areas such as the Capital Programme, the authority has to assess whether it can afford for money to be tied up long term.

2.2 Inflation Risk

2.2.1 Inflation risk is the risk that prevailing levels of inflation cause an unexpected or unbudgeted burden on the Council's finances against which sufficient provision has not been made. The effect of this is twofold:

- generally as inflation falls so do interest rates; and
- as inflation rises it can impact upon the Council's revenue and capital budgets thus reducing cash balances available to invest.

2.3 Market and Credit Risks

2.3.1 Market risk is defined as the risk that, through adverse market fluctuations in the value of the principal sums the Council invests, its stated treasury management policies and objectives are compromised, against which effects it has failed to protect itself adequately.

2.3.2 The Council therefore needs to maintain an approved lending (counterparty) list that specifies institutions with which the Council will invest and the maximum maturity period of investments held with these institutions. The Investment Strategy also specifies the limit that can be invested with individual counterparties and counterparty categories (section 4.8).

2.3.3 The institutions contained on the list need to meet the credit worthiness policy set out at section 4.8.2, which follows the model provided by our Treasury Advisors (Link Asset Services). By undertaking this approach the risk of failure of a third party to meet its investment obligations and the detrimental effect that would ensue on the Council's capital or revenue resources (known as credit and counterparty risk) will be limited.

2.4 Liquidity (Cash flow) Risk

2.4.1 Liquidity risk is defined as the risk that cash will not be available when it is needed and that ineffective management of liquidity creates additional unbudgeted costs.

2.4.2 This risk is minimised by spreading the maturities of investments throughout the year, but cash flow can be affected by delays in the capital programme and/or capital receipts not being received as forecast.

The Treasury Management Strategy seeks to take into account these risks when specifying activity for the financial year. However, although the actions contained within the Strategy will limit the risks, some risk will still remain. These will be monitored closely by the finance team.

3. The Capital Prudential Indicators 2023/24 – 2025/26

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

3.1 Capital Expenditure. This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Estimates have been made in terms of the timing of various expenditure projects.

£'000	2021/22 Actual £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000	2025/26 Estimate £000
Service Related Capital Expenditure	5,026	8,896	22,805*	11,998	1,844

*Includes estimated carry forward (£7.9m) from 2022/23.

The table below summarises how the above capital expenditure plans are being financed.

Capital Financing £'000	2021/22 Actual £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000	2025/26 Estimate £000
Financed by:					
Capital Receipts	126	508	59	-	-
Capital Grants	1,328	7,494	16,974	11,669	1,806
Revenue / Reserves	238	542	5,772	38	38
Borrowing *	3,334	352	-	291	-
Total	**5,026**	**8,896**	**22,805**	**11,998**	**1,844**

3.2 The Council's Borrowing Need (the Capital Financing Requirement)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and so its' underlying borrowing need. Any capital expenditure in the table above which has not immediately been paid for from revenue or capital resource (i.e. borrowing) will increase the CFR. The forecast CFR is set out in the table below.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge to the General Fund which broadly reduces indebtedness in line with each assets life, and so charges the economic consumption of capital assets as they are used.

The CFR includes any other long term liabilities (e.g., finance leases) brought onto the balance sheet. Whilst this increases the CFR, and therefore the Council's borrowing requirement, these types of schemes include a borrowing facility and so the Council is not required to separately borrow for these schemes. As at 31st March 2022, the Council did not have any schemes within the CFR.

	2021/22 Actual £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000	2025/26 Estimate £000
Capital Financing Requirement	15,791	14,358	12,217	11,721	10,935
(Reduction)/ Increase in CFR	2,721	(1,433)	(2,141)	(496)	(786)
Movement in CFR represented by:					
New Borrowing*	3,334	352	-	291	-
MRP	(497)	(845)	(791)	(787)	(786)
Voluntary Repayment	(116)	(940)	(1,350)	-	-
Movement in CFR	**2,721**	**(1,433)**	**(2,141)**	**(496)**	**(786)**

**All new borrowing relates to service requirements (Replacement of Waste Fleet and other vehicles)*

The CFR forecasts show a reduction in the CFR across all forward looking periods. This includes plans to earmark capital receipts to make voluntary repayments, which reduces the underlying debt requirement and reduces the borrowing costs to the revenue budget.

2.1 3.3 Liability Benchmark

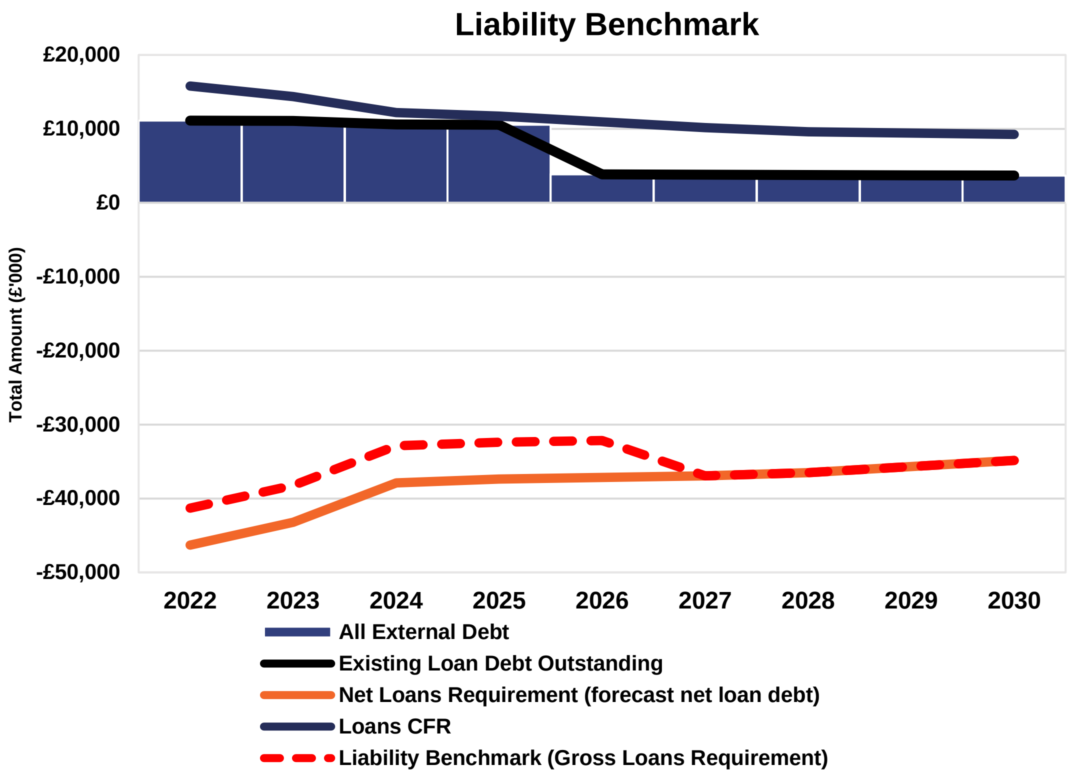
A third and new mandatory prudential indicator for 2023/24 is the Liability Benchmark (LB). The Liability benchmark is the process which should help determine the appropriate structure of the external loans profile.

The Authority is required to estimate and measure the LB for the forthcoming financial year and the following two financial years, as a minimum.

There are four components to the LB: -

1. **Existing loan debt outstanding**: the Council's existing loans that are still outstanding in future years.
2. **Loans CFR**: this is calculated in accordance with the loans CFR definition in the Prudential Code and projected into the future based on approved prudential borrowing and planned MRP.
3. **Net loans requirement**: this shows the Council's gross loan debt less treasury management investments at the last financial year-end, projected into the future and based on its approved prudential borrowing, planned MRP and any other major cash flows forecast.
4. **Liability benchmark** (or gross loans requirement): this equals net loans requirement plus short-term liquidity allowance.

The graph demonstrates that based on the current capital proposals with the MTFS there is no requirement for new external borrowing during the period.



3.4 MRP Policy Statement

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

DLUHC Regulations have been issued which require the full Council to approve **an MRP Statement** in advance of each year. The Council is recommended to approve the following MRP Statement:

For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:

- **Existing practice** - MRP will follow the existing practice outlined in former DLUHC regulations (option 1); these options provide for an approximate 4% reduction in the borrowing need (CFR) each year.

From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be*:*

- **Asset Life Method** – MRP will be based on the estimated life of the assets, in accordance with the proposed regulations, net of estimated residual balances (this option must be applied for any expenditure capitalised under a Capitalisation Direction) (option 3);

This option provides for a reduction in the borrowing need over approximately the asset's life.

Repayments included in finance leases are applied as MRP.

The Council Medium Term Financial Strategy Plans continue to utilise Capital Receipts in order to reduce the underlying need to borrowing (through Voluntary Repayment) and generate revenue budget savings.

DLUHC have been consulting on revised MRP guidance which is specifically aimed at closing any loopholes that have been utilised in order to avoid charging MRP in relation to certain activities, mainly those associated with Commercial activities. However, there are some potentially unintended consequences from the proposal which could impact on the Council. Should any short term consequences arise, it is intended to utilise either the Capital or debt repayment reserve (revenue monies) in order to mitigate the impact on the revenue budget (should that be necessary).

3.4 Affordability Prudential Indicators

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

3.5 Actual and estimates of the ratio of financing costs to net revenue stream.

Actual and estimates of the ratio of financing costs to net revenue stream. This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

%	2021/12 Actual	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Ratio	8.68%	0.69%	-2.53%	-0.53%	1.67%

The estimates of financing costs include current commitments and the proposals in the medium term financial strategy. The table above shows that the percentage ratios fluctuate over the period which reflects a combination of factors:-the increasing forecast investment returns, the inclusion of the borrowing costs associated with the fleet replacement set out within the capital programme and the forecast increases to the base budget.

This demonstrates that in the short term, investment income is expected to exceed borrowing costs as a direct result if rising interest rates.

4. Treasury Management Strategy

The capital expenditure plans set out in Section 3 provide details of the capital activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the the relevant professional codes, so that sufficient cash is available to meet this capital activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

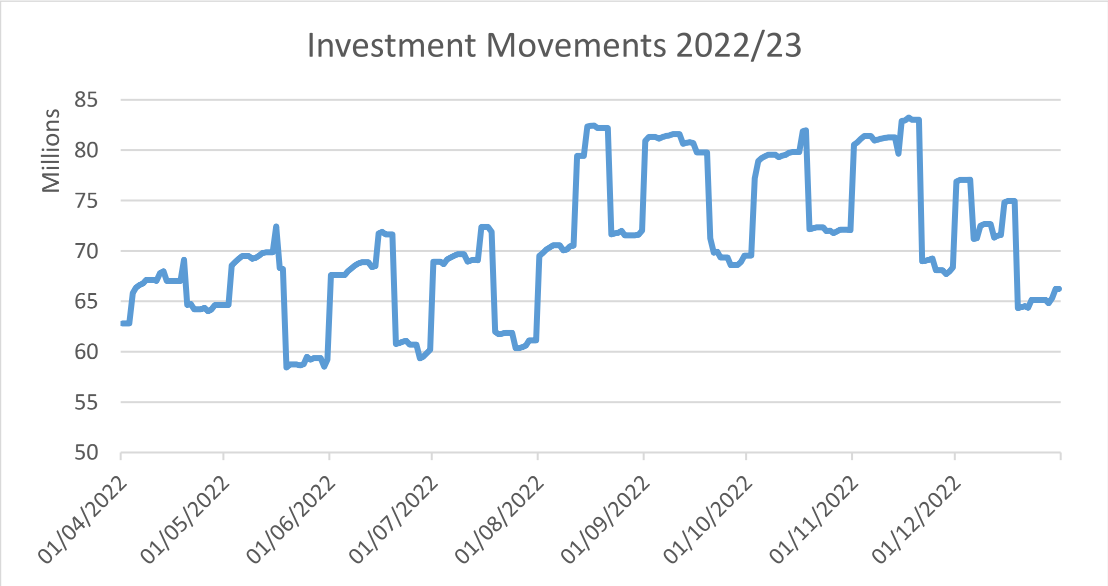
4.1 Current Portfolio Position

The Council's treasury portfolio position at 31 March 2022 and the end of December 2022, are summarised below.

Investments	**31st March 2022**		**31st December 2022**	
	£'000	**%**	**£'000**	**%**
Banks	3,560	6%	1,644	3%
Certificate of Deposit	13,000	22%	24,000	36%
Money Market Funds	7,925	13%	19,300	29%
UK Treasury Bills	5,500	9%	12,500	19%
UK Debt Management	19,400	33%	8,800	13%
Other Local Authorities	10,000	17%	-	-
Total	**59,385**	**100%**	**66,244**	**100%**

The investment balances at 31 December reflects a combination of factors:

- The Council's cashflows routinely peak each year around December and then significantly reduce in subsequent months (Jan – March) as taxation receipts reduce and payments to precetors and Government continue;
- some of the increased cash flows into and out of the Council from the Government to support realting to Covid 19 and other support packages; and also
- The timing of receipts and payments in relation to Towns Fund.



The table below shows the external borrowing position against the capital borrowing need (the Capital Financing Requirement - CFR), highlighting that the Council is maintaining an under borrowing position. As mentioned earlier the CFR is planned to reduce over the medium term as a result of future capital receipts which are earmarked to reduce the underlying borrowing requirement; however, it is not currently anticipated that any new external borrowing will be undertaken by the Council in the medium term. The CFR reflects the statutory and voluntary repayments, consistent with the MTFS.

	2021/22 Actual £000	2022/23 Estimate £000	2023/24 Estimate £000	2024/25 Estimate £000	2025/26 Estimate £000
Total external borrowing at 31 March	11,115	11,056	10,617	10,555	3,863
CFR – the borrowing need	15,791	14,358	12,217	11,721	10,935
(Under) / over borrowing	**(4,676)**	**(3,302)**	**(1,600)**	**(1,166)**	**(7,072)**

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its total external borrowing, does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes. As shown in the table above, total external debt is anticipated to remain lower than the CFR over the medium term.

4.2. Treasury Indicators: Limits to Borrowing Activity

The Operational Boundary.

This is the limit beyond which external borrowing is not normally expected to exceed. The limits have been revised to take into account current proposals within the MTFS in relation to the financing of the capital programme and commitments to reducing the capital financing requirement. The future implementation of the new accounting standard regarding leases will most likely bring additional liabilities onto the balance sheet associated with leasing arrangements. These limits will be reviewed and updated accordingly.

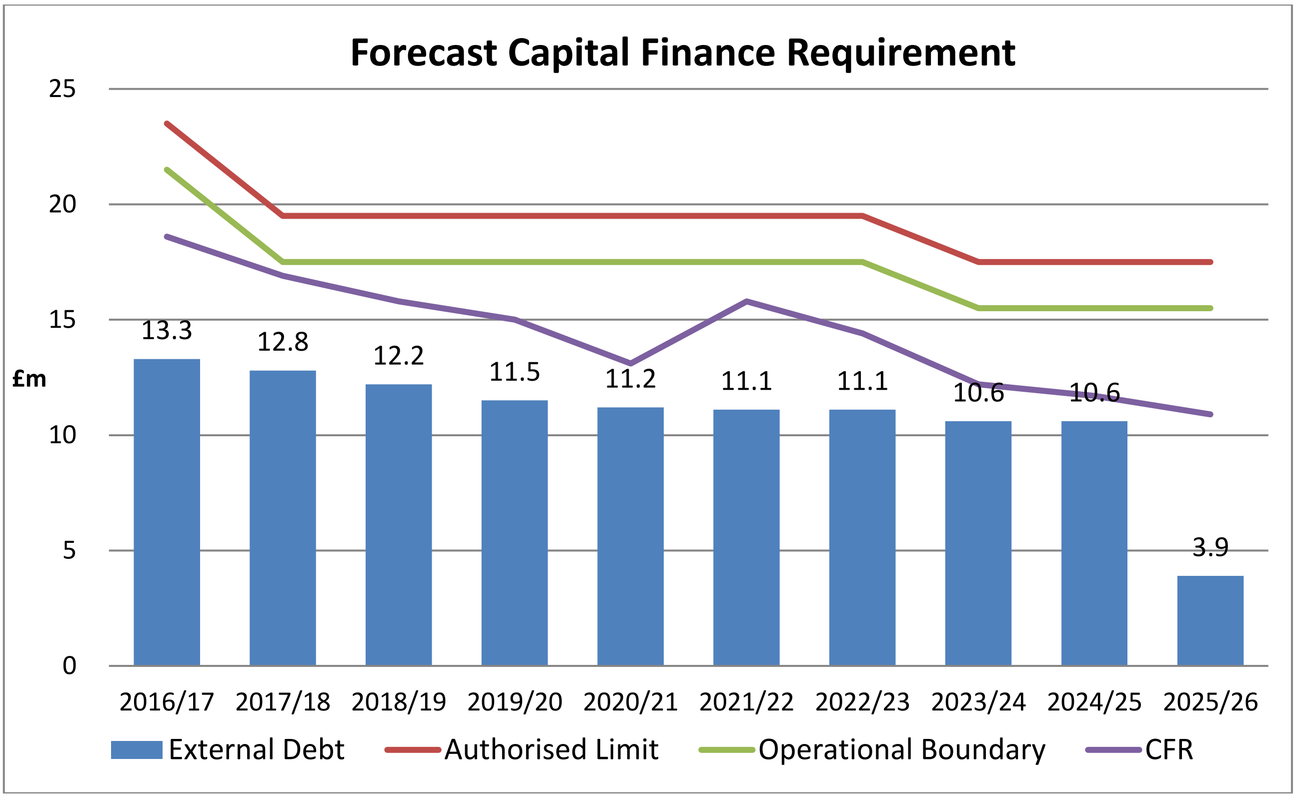
Operational boundary £'000	2022/23	2023/24	2024/25	2025/26
Borrowing	17,000	15,000	15,000	15,000
Other long term liabilities	500	500	500	500
Total	17,500	15,500	15,500	15,500

The authorised limit for external debt. A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. Any increase in debt levels above those already approved will be subject to a business case that clearly demonstrates that the proposal is prudent and sustainable in the long term.

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

Authorised limit £'000	2022/23	2023/24	2024/25	2025/26
Borrowing	18,000	16,000	16,000	16,000
Other long term liabilities	1,500	1,500	1,500	1,500
Total	19,500	17,500	17,500	17,500

The graph below brings together all this information and compares the external borrowing forecasts with both the capital financing requirement and borrowing limits, based on current capital plans:



4.3 Prospects for Interest Rates

The Authority has appointed Link Group as its treasury advisor and part of their service is to assist the Authority to formulate a view on interest rates. Link provided the following forecasts on 19th December 2022. These are forecasts for certainty rates, gilt yields plus 80 bps.

Link Group Interest Rate View	19.12.22												
	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
BANK RATE	3.50	4.25	4.50	4.50	4.50	4.00	3.75	3.50	3.25	3.00	2.75	2.50	2.50
3 month ave earnings	3.60	4.30	4.50	4.50	4.50	4.00	3.80	3.30	3.00	3.00	2.80	2.50	2.50
6 month ave earnings	4.20	4.50	4.60	4.50	4.20	4.10	3.90	3.40	3.10	3.00	2.90	2.60	2.60
12 month ave earnings	4.70	4.70	4.70	4.50	4.30	4.20	4.00	3.50	3.20	3.10	3.00	2.70	2.70
5 yr PWLB	4.20	4.20	4.20	4.10	4.00	3.90	3.80	3.60	3.50	3.40	3.30	3.20	3.10
10 yr PWLB	4.30	4.40	4.40	4.30	4.10	4.00	3.90	3.80	3.60	3.50	3.40	3.30	3.30
25 yr PWLB	4.60	4.60	4.60	4.50	4.40	4.20	4.10	4.00	3.90	3.70	3.60	3.50	3.50
50 yr PWLB	4.30	4.30	4.30	4.20	4.10	3.90	3.80	3.70	3.60	3.50	3.30	3.20	3.20

PWLB RATES

- The yield curve movements have become less volatile of late and PWLB 5 to 50 years Certainty Rates are, generally, in the range of 4.10% to 4.80%.
- Their view is that the markets as having built in, already, nearly all the effects on gilt yields of the likely increases in Bank Rate and the elevated inflation outlook.

The balance of risks to the UK economy: -

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

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

- **Labour and supply shortages** prove more enduring and disruptive and depress economic activity (accepting that in the near-term this is also an upside risk to inflation and, thus, rising gilt yields).
- **The Bank of England** acts too quickly, or too far, over the next year to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- **UK / EU trade arrangements** – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.
- **Geopolitical risks,** for example in Ukraine/Russia, China/Taiwan/US, Iran, North Korea and Middle Eastern countries, which could lead to increasing safe-haven flows.

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

- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly and for a longer period within the UK economy, which then necessitates Bank Rate staying higher for longer than we currently project or even necessitates a further series of increases in Bank Rate.
- **The Government** acts too quickly to cut taxes and/or increases expenditure in light of the cost-of-living squeeze.
- **The pound weakens** because of a lack of confidence in the UK Government's fiscal policies, resulting in investors pricing in a risk premium for holding UK sovereign debt.

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

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

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

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

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

4.4 Borrowing Strategy

The Authority is currently maintaining an under-borrowed position. This means that the capital borrowing need, (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Authority's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as medium and longer dated borrowing rates are expected to fall from their current levels once prevailing inflation concerns are addressed by tighter near-term monetary policy. That is, Bank Rate increases over the remainder of 2022 and the first half of 2023.

Against this background and the risks within the economic forecast, caution will be adopted with the 2023/24 treasury operations. The Chief Finance Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

Given that the MTFS adopts the approach of utilising one-off resources to reduce the underlying borrowing requirement and generate savings to the revenue budget, it is at present unlikely that any new external borrowing (with the exception of any finance leases brought onto the balance sheet, will be undertaken in the short to medium term.

4.5 Borrowing in Advance of Need

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

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism. However it is not anticpated that any such need will arise in 2023/24.

4.6. Debt Rescheduling

Rescheduling of current borrowing in relation to our PWLB debt portfolio is unlikely to occur as there is still generally a large difference between premature redemption rates and new borrowing rates. However the Council, in conjunction with our treasury advisors, is currently exploring options in relation to early repayment of the Market Loans.

Opportunties for rescheduling will be monitored closely and in the event that this offers value for money, suitable action will be taken and any rescheduling will be reported to Cabinet and Scrutiny (Audit Committee) at the earliest meeting following its action.

4.7 Financial institutions as a source of borrowing and / or types of borrowing

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

- Local authorities (primarily shorter dated maturities)
- Financial institutions (primarily insurance companies and pension funds but also some banks, out of spot or forward dates)
- Municipal Bonds Agency

In the unlikely event that external borrowing is required, our advisors will keep us informed as to the relative merits of each of these alternative funding sources.

Approved Sources of Long and Short term Borrowing

On Balance Sheet	Fixed	Variable
PWLB	●	●
Municipal bond agency	●	●
Local authorities	●	●
Banks	●	●
Market (long-term)	●	●
Market (temporary)	●	●
Market (LOBOs)	●	●
Local temporary	●	●
Local authority bills	●	●
Overdraft		●
Internal (capital receipts & revenue balances)	●	●
Finance leases	●	●

4.8. Annual Investment Strategy

4.8.1 Investment Policy

The Department of Levelling Up, Housing and Communities (DLUHC - this was formerly the Ministry of Housing, Communities and Local Government (MHCLG)) and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with treasury (financial) investments, (as managed by the treasury management team). Any non-financial investments are covered in the Capital Strategy.

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

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

The Council's investment priorities will be security first, liquidity second, then return. The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the Council's risk appetite. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs. However, where appropriate, the Council will also consider the value available in periods up to 12 months with high credit rated financial institutions, as well as wider range fund options.

The 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: -

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

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

3. **Other information sources** used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

4. This authority has defined the list of **types of investment instruments** that the treasury management team are authorised to use. There are two lists in schedule 4 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.

- **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.

5. **Non-specified investments limit.** The Council has determined that it will limit the maximum total exposure to non-specified investments at £5m.

6. **Lending limits**:
Investments, whether specified or non-specified, will conform to the following limits that are set out in the Council's Treasury Management Practices Schedules document:

	Limit
Maximum Amount deposited with an individual counterparty	£3.5m
Maximum Amount deposited with a part nationalised counterparty	£5.0m
Maximum Amount held with each counterparty group	£6.0m
Maximum Amount held with a part nationalised counterparty group	£7.5m
Maximum Amount deposited with an individual Local Authority	£5.0m
Maximum proportion of portfolio deposited with Building Societies	£3.5m
Maximum Amount deposited using forward dealing	£3.5m
Maximum Amount held in an individual MMF (CNAV/LVNAV)	£6.0m
UK Government / DMADF	unlimited

*These limits set the maximum amount authorised by the Council, the Chief Finance Officer will use discretion during the year to impose lower limits as and when appropriate.

7. This authority will set a limit for the amount of its investments which are invested for **longer than 365 days**, (see paragraph 4.8.4).

8. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating**, (see paragraph 4.8.3).

9. This authority has engaged **external consultants**, 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.

10. All investments will be denominated in **sterling**.

11. As a result of the change in accounting standards for 2018/19 onwards under **IFRS 9,** this 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 31.3.23.) . At the current juncture it has not been determined whether a further extension to the override will be agreed by Government.

However, this authority will also pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance. Regular monitoring of investment performance will be carried out during the year.

Changes in risk management policy from last year.
The above criteria remain unchanged from last year.

4.8.2 Creditworthiness policy

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

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

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 Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:

- Yellow 5 years
- Dark pink 5 years
- Light pink 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

Y	Pi1	Pi2	P	B	O	R	G	N/C
1	1.25	1.5	2	3	4	5	6	7
Up to 5yrs	Up to 5yrs	Up to 5yrs	Up to 2yrs	Up to 1yr	Up to 1yr	Up to 6mths	Up to 100days	No Colour

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

Typically the minimum credit ratings criteria the Council use will be a Short Term rating (Fitch or equivalents) of F1 and a Long Term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

All credit ratings will be monitored on a regular basis. The Council is alerted to changes to ratings of all three agencies through its use of the Link Asset Services' creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

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

The Council currently has a contract for its banking arrangements with Royal Bank of Scotland (RBS). In the event that regulatory changes take place that result in our banking service transfering to another provider, it is proposed that in order to maintain operational activities, that Chief Finance Officer be authorised to incorporate onto the lending list any new provider should they fall outside the scope of the criteria outlined above, but with a reduced overnight limit of £0.5m.

Creditworthiness.
Significant levels of downgrades to Short and Long-Term credit ratings have not materialised since the crisis in March 2020. In the main, where they did change, any alterations were limited to Outlooks. However, more recently the UK sovereign debt rating has been placed on Negative Outlook by the three major rating agencies in the wake of the Truss/Kwarteng unfunded tax-cuts policy. Although the Sunak/Hunt government has calmed markets, the outcome of the rating agency reviews is unknown at present, but it is possible the UK sovereign debt rating will be downgraded. Accordingly, when setting minimum sovereign debt ratings, this Authority will not set a minimum rating for the UK.

CDS prices

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

4.8.3 Other limits

Due care will be taken to consider the exposure of the Council's total investment portfolio to non-specified investments, countries, groups and sectors.

Country Limts

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of *AA* from Fitch. The list of countries that qualify using this credit criteria as at the date of this report are shown in Schedule 5. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy. The exception to this relates to funds held within AAA rated Money Market Funds and also the United Kingdom.

Non-specified treasury management investment limit. The Council has determined that it will limit the maximum total exposure of treasury management investments to non-specified treasury management investments as being £5m of the total treasury management investment portfolio.

4.8.4 Investment Strategy

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

Accordingly, while most cash balances are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer-term investments will be carefully assessed.

Investment returns expectations. The current forecast shown in paragraph 3.3, includes a forecast for Bank Rate to reach 4.5% in Q2 2023. As there are so many variables at this time, caution must be exercised in respect of all interest rate forecasts.

For its cash flow generated balances, the Council 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.

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

Maximum principal sums invested in excess of 1 Year			
	2023/24	2024/25	2025/26
Principal sums invested for longer than 1 year	£m 5.0	£m 5.0	£m 5.0

4.8.5 Property Funds - The strategy continues to provide scope to place treasury investments with property funds at an appropriate time. However, any such investment would continue to be subject to appropriate due diligence being undertaken and subject to approval by the Chair of Audit Committee, the Cabinet Member with responsibility for finance and the Chief Finance Officer.

4.9 Investment Risk Benchmarking

This Council will use an investment benchmark to assess the investment performance of its investment portfolio of 3 month compounded / SONIA

4.10 End of year investment report

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

4.11 ESG Policy and Approach

The Council aims to be a responsible investor and will consider environmental, social and Governance (ESG) issues when investing. Whilst environmental, social and governance considerations are increasingly a factor in global investors decision making, the framework for evaluating investment opportunities is still developing. As such, the authority's investment approach does not currently include ESG scoring or other real-time ESG criteria at an individual assessment level. Our Treasury Management Advisors continue to look at ways to incorporate such factors into the creditworthiness assessment criteria, however the lack of consistency of approach across the sector means this is difficult at the present time.

4.12 Training

Officers with responsibility for treasury management activities regularly undertake training both in-house and external. The Audit Committee receive training in respect of treasury management as part of a rolling programme of training for Audit Committee members each electoral cycle.

4.12 Policy on the use of external service providers

The Council uses Link Asset Services, Treasury Solutions as its external treasury management advisors.

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

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

Schedule 1 Treasury Management Policy Statement

In accordance with the CIPFA Code of Practice on Treasury Management, East Staffordshire Borough Council defines the policies and objectives of its treasury management activities as follows:-

1. The Council defines its treasury management activities as: "*The management of the 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".*

2. The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organization, and any financial instruments entered into to manage these risks.

3. The Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management."

Schedule 2 Economic Background

Against a backdrop of stubborn inflationary pressures, the easing of Covid restrictions in most developed economies, the Russian invasion of Ukraine, and a range of different UK Government policies, it is no surprise that UK interest rates have been volatile right across the curve, from Bank Rate through to 50-year gilt yields, for all of 2022.

Market commentators' misplaced optimism around inflation has been the root cause of the rout in the bond markets with, for example, UK, EZ and US 10-year yields all rising by over 200bps since the turn of the year. The table below provides a snapshot of the conundrum facing central banks: inflation is elevated but labour markets are extra-ordinarily tight, making it an issue of fine judgment as to how far monetary policy needs to tighten.

	UK	**Eurozone**	**US**
Bank Rate	3.5%	2.0%	4.25%-4.50%
GDP	-0.2%q/q Q3 (2.4%y/y)	+0.2%q/q Q3 (2.1%y/y)	2.6% Q3 Annualised
Inflation	10.7%y/y (Nov)	10.1%y/y (Nov)	7.1%y/y (Nov)
Unemployment Rate	3.7% (Oct)	6.5% (Oct)	3.7% (Nov)

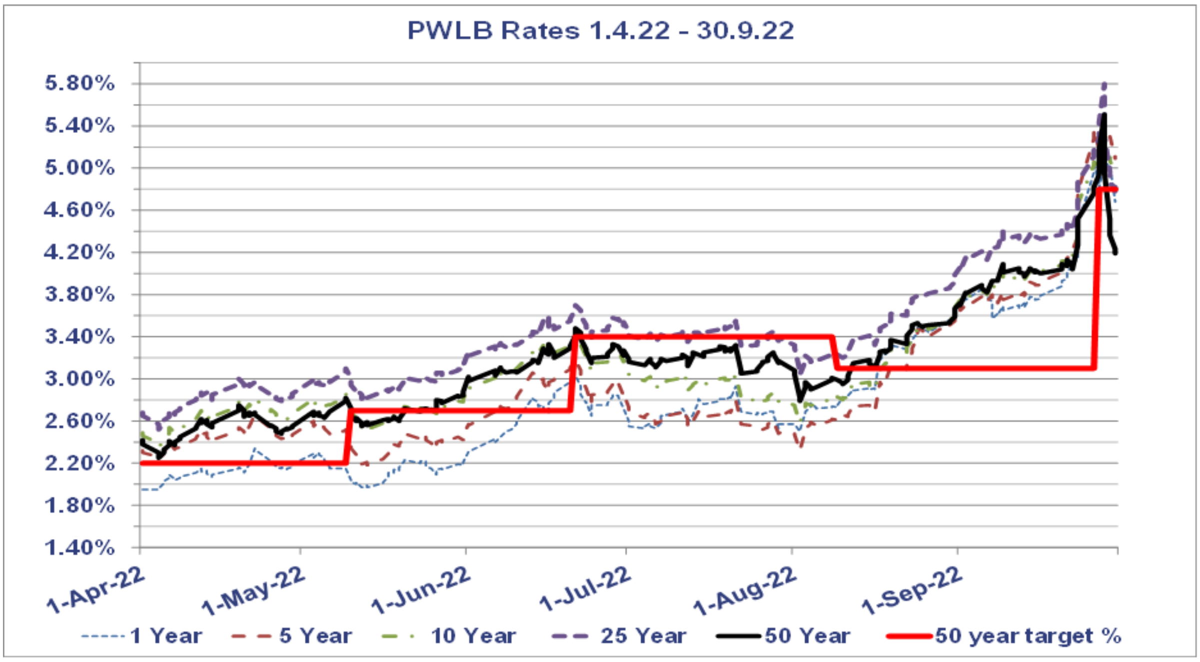
Q2 of 2022 saw UK GDP revised upwards to +0.2% q/q, but this was quickly reversed in the third quarter, albeit some of the fall in GDP can be placed at the foot of the extra Bank Holiday in the wake of the Queen's passing. Nevertheless, CPI inflation has picked up to what should be a peak reading of 11.1% in October, although with further increases in the gas and electricity price caps pencilled in for April 2023, and the cap potentially rising from an average of £2,500 to £3,000 per household, there is still a possibility that inflation will spike higher again before dropping back slowly through 2023.

The UK unemployment rate fell to a 48-year low of 3.6%, and this despite a net migration increase of c500k. The fact is that with many economic participants registered as long-term sick, the UK labour force actually shrunk by c500k in the year to June. Without an increase in the labour force participation rate, it is hard to see how the UK economy will be able to grow its way to prosperity, and with average wage increases running at over 6% the MPC will be concerned that wage inflation will prove just as sticky as major supply-side shocks to food and energy that have endured since Russia's invasion of Ukraine on 22nd February 2022.

Throughout Q3 Bank Rate increased, finishing the quarter at 2.25% (an increase of 1%). Q4 has seen rates rise to 3.5% in December and the market expects Bank Rate to hit 4.5% by May 2023. Following a Conservative Party leadership contest, Liz Truss became Prime Minister for a tumultuous seven weeks that ran through September and October. Put simply, the markets did not like the unfunded tax-cutting and heavy spending policies put forward by her Chancellor, Kwasi Kwarteng, and their reign lasted barely seven weeks before being replaced by Prime Minister Rishi Sunak and Chancellor Jeremy Hunt. Their Autumn Statement of 17th November gave rise to a net £55bn fiscal tightening, although much of the "heavy lifting" has been left for the next Parliament to deliver. However, the markets liked what they heard, and UK gilt yields have almost completely reversed the increases seen under the previous tenants of No10/11 Downing Street.

Globally, though, all the major economies are expected to struggle in the near term. The fall below 50 in the composite Purchasing Manager Indices for the UK, US, EZ and China all point to at least one, if not more, quarters of GDP contraction. In November, the MPC projected eight quarters of negative growth for the UK lasting throughout 2023 and 2024, but with Bank Rate set to peak at lower levels than previously priced in by the markets and the fiscal tightening deferred to some extent, it is not clear that things will be as bad as first anticipated by the Bank.

The £ has strengthened of late, recovering from a record low of $1.035, on the Monday following the Truss government's "fiscal event", to $1.22. Notwithstanding the £'s better run of late, 2023 is likely to see a housing correction of some magnitude as fixed-rate mortgages have moved above 5% and affordability has been squeezed despite proposed Stamp Duty cuts remaining in place.
In the table below, the rise in gilt yields, and therein PWLB rates, through the first half of 2022/23 is clear to see.



However, the peak in rates on 28th September as illustrated in the table covering April to September 2022 below, has been followed by the whole curve shifting lower. PWLB rates at the front end of the curve are generally over 1% lower now whilst the 50 years is over 1.75% lower.

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.95%	2.18%	2.36%	2.52%	2.25%
Date	01/04/2022	13/05/2022	04/04/2022	04/04/2022	04/04/2022
High	5.11%	5.44%	5.35%	5.80%	5.51%
Date	28/09/2022	28/09/2022	28/09/2022	28/09/2022	28/09/2022
Average	2.81%	2.92%	3.13%	3.44%	3.17%
Spread	3.16%	3.26%	2.99%	3.28%	3.26%

After a shaky start to the year, the S&P 500 and FTSE 100 have climbed in recent weeks, albeit the former is still 17% down and the FTSE 2% up. The German DAX is 9% down for the year.

CENTRAL BANK CONCERNS – DECEMBER 2022

In December, the Fed decided to push up US rates by 0.5% to a range of 4.25% to 4.5%, whilst the MPC followed by raising Bank Rate from 3% to 3.5%, in line with market expectations. EZ rates have also increased to 2% with further tightening in the pipeline.

Having said that, the sentiment expressed in the press conferences in the US and the UK were very different. In the US, Fed Chair, Jerome Powell, stated that rates will be elevated and stay higher for longer than markets had expected. Governor Bailey, here in the UK, said the opposite and explained that the two economies are positioned very differently so you should not, therefore, expect the same policy or messaging.

Regarding UK market expectations, although they now expect Bank Rate to peak within a lower range of 4.5% - 4.75%, caution is advised as the Bank of England Quarterly Monetary Policy Reports have carried a dovish message over the course of the last year, only for the Bank to have to play catch-up as the inflationary data has proven stronger than expected.

In addition, the Bank's central message that GDP will fall for eight quarters starting with Q3 2022 may prove to be a little pessimistic. Will the £160bn excess savings accumulated by households through the Covid lockdowns provide a spending buffer for the economy – at least to a degree? Ultimately, however, it will not only be inflation data but also employment data that will mostly impact the decision-making process, although any softening in the interest rate outlook in the US may also have an effect (just as, conversely, greater tightening may also).

SCHEDULE 3 - Specified and Non-Specified Investments and Limits

SPECIFIED INVESTMENTS: All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum 'high' quality criteria where applicable. Non-specified investments which would be specified investments apart from originally being for a period longer than 12 months, will be classified as being specified once the remaining period to maturity falls to under twelve months.)

NON-SPECIFIED INVESTMENTS: These are any investments which do not meet the Specified Investment criteria. A maximum of £5m will be held in aggregate in non-specified investment

A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the above categories.

The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

SPECIFIED INVESTMENTS:
(All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum 'high' rating criteria where applicable)

	*** Minimum credit criteria / colour band**	**Max. maturity period**
DMADF – UK Government	Yellow	Up to 1 Year (max. is set by the DMO*)
UK Government gilts	Yellow	Up to 1 year
UK Government Treasury bills	Yellow	364 days (max. is set by the DMO*)
Bonds issued by multilateral development banks	Yellow	Up to 1 year
Money market funds: CNAV, LVNAV & VNAV	AAA	Liquid
Local authorities	Yellow	Up to 1 year
Term deposits with banks and building societies	Blue Orange Red Green No Colour	12 months 12 months 6 months 100 days Not for use
CDs or corporate bonds with banks and building societies	Blue Orange Red Green No Colour	12 months 12 months 6 months 100 days Not for use
*DMO – is the Debt Management Office of H. M. Treasury – current maximum maturity is 6 months		

NON-SPECIFIED INVESTMENTS: A maximum of £5m will be held in aggregate in non-specified investment.

From 1 April 2004 all Councils were given the freedom to invest for periods greater than 365 days, based on criteria set out in their Annual Investment Strategy. These investments are defined as "Non-Specified Investments" and the Council is required to set out in this Investment Strategy the following:

(i) The procedures for determining which categories of such investments may be prudently used:

Investments will only be made with Banks or Building Societies in accordance with the credit worthiness methodology outlined at 4.8.2.

(ii) The categories of investments identified as prudent to be used during the year:

Investment	**Why Use it?**	**Associated Risks**
Sterling Term deposits with maturities greater than 365 days.	(i) Certainty over period invested. (ii) No movement in capital value of deposit despite changes of rate of return in interest rate environment.	(i) Liquid: as a general rule, cannot be traded or repaid prior to maturity. (ii) Return will be lower if interest rates rise after making the investment. (iii) Credit risk: potential for greater deterioration in credit quality over longer period.
Callable deposits with maturities greater than 365 days.	Enhanced income - potentially higher return than using a term deposit with similar maturity.	(i) Liquid – only borrower has the right to pay back deposit; the lender does not have a similar call. (ii) Period over which investment will actually be held is not known at the outset. (iii) Interest rate risk: borrower will not pay back deposit early if interest rates rise after deposit is made.
Forward deposits for periods greater than 365 days.	Known rate of return over period the monies are invested - aids forward planning.	(i) Credit risk is over the whole period, not just when monies are actually invested. (ii) Cannot renege on making the investment if credit rating falls or interest rates rise in the interim period.
Property Funds *(note 1 below)*	(i) Diversification of investment portfolio; (ii) Enhanced income	(i) liquidity – property funds are a long term investment due to the entry and exit fees (ii) exposure of capital to loss in values

Note 1: The property fund instruments can be deemed capital expenditure, and as such will be an application (spending) of capital resources. This Authority will seek guidance on the status of any fund it may consider using. Appropriate due diligence will also be undertaken before investment of this type is undertaken.

The maximum maturity of investment will be 5 years for all categories, with the exception of property funds. For forward deposits, this is the negotiated deal period plus period of deposit.

Schedule 4: Approved Countries for Investments

This list is based on those countries which have sovereign ratings of AA- or higher, (we show the lowest rating from Fitch, Moody's and S&P) and also, (except - at the time of writing - for Hong Kong, Norway and Luxembourg), have banks operating in sterling markets which have credit ratings of green or above in the Link credit worthiness service.

AAA

- Australia
- Denmark
- Germany
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Canada
- Finland
- U.S.A.

AA

- Abu Dhabi (UAE)
- France

AA-

- U.K. (the UK being the exception per section 4.8.3)

This list was compiled on 19-12-22