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| **Report for:** | **Cabinet** |

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| Date of Meeting: | 6 February 2024 |
| Subject: | **Treasury Management Strategy Statement, Minimum Revenue Provision Policy Statement and Annual Investment Strategy 2024/25** |
| Cabinet Member: | Cllr James Buczkowski, Cabinet Member for Finance |
| Responsible Officer: | Andrew Jarrett, Deputy Chief Executive (S151) |
| Exempt: | N/A |
| Wards Affected: | All |
| Enclosures: | Appendix 1 – Prudential and treasury indicators and MRP statement<br>Appendix 2 – Interest rate forecasts<br>Appendix 3 – Economic background<br>Appendix 4 – Treasury management practice 1 – credit and counterparty risk management<br>Appendix 5 – Approved countries for investments<br>Appendix 6 – Treasury management scheme of delegation<br>Appendix 7 – The treasury management role of the Section 151 Officer |

## Section 1 – Summary and Recommendation(s)

To agree the proposed Treasury Management Strategy, Minimum Revenue Provision Policy and Annual Investment Strategy for 2024/25.

### Recommendation(s):

**That Cabinet recommends to Full Council that the proposed Treasury Management Strategy and Annual Investment Strategy for 2024/25, including the prudential indicators for the next 3 years and the Minimum Revenue Provision Statement (Appendix 1), be approved.**

## Section 2 – Report

## 1.0 Background

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

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

**1.3** 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.

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

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

**1.6** In the latest Devon Audit Partnership audit (December 2022), a Substantial Assurance opinion was given, meaning the Council has "a sound system of governance, risk management and control exists, with internal controls operating effectively and being consistently applied to support the achievement of objectives in the area audited".

## 2.0 Reporting requirements

### 2.1 Treasury Strategy

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

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

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

### 2.2 Treasury Management reporting

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

a. **Prudential and treasury indicators and treasury strategy** (this report) **-** The first, and most important report is forward looking and covers:

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy (how the investments and borrowings are to be organised), including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

b. **A mid-year treasury management report** – This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision. In addition, members will receive quarterly treasury updates as part of the financial monitoring.

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

2.2.2 **Scrutiny.** The above reports are required to be adequately scrutinised before being recommended to the Council. The Cabinet undertakes this role.

### 2.3 Treasury Management Strategy for 2024/25

2.3.1 The strategy for 2024/25 covers two main areas:

2.3.2 **Capital issues**

- The capital expenditure plans and the associated prudential indicators; and

- The minimum revenue provision (MRP) policy.

2.3.3 **Treasury management issues**

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

2.3.4 These elements cover the requirements of the Local Government Act 2003, the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code, Department for Levelling Up, Housing and Communities (DLUHC – this was formerly the Ministry of Housing, Communities and Local Government [MHCLG]) MRP Guidance, the CIPFA Treasury Management Code and DLUHC Investment Guidance.

## 2.4 Training

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

2.4.2 Furthermore, the Code states that all organisations are expected to have a formal and comprehensive knowledge and skills or training policy for the effective acquisition and retention of treasury management knowledge and skills for those responsible for management, delivery, governance and decision making.

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

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

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

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

2.4.6 Training requirements of members are being reviewed and training will be arranged as required.

2.4.7 The training needs of treasury management officers are periodically reviewed.

2.4.8 A formal record of the training received by officers central to the Treasury function will be maintained by the S151 (Deputy Chief Executive). Similarly, a formal record of the treasury management/capital finance training received by members will be maintained by the Democratic Services Manager.

**2.5 Treasury management consultants**

2.5.1 The Council uses Link Group 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 the services of our external service providers.

2.5.2 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.

**3.0 The Capital Prudential Indicators 2024/25 – 2026/27**

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

**3.2 Capital expenditure and financing**

3.2.1 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. The below table shows planned expenditure in the 2024/25 Capital Programme of £40,701k, (£11,868k new projects plus the projected slippage from prior years of £28,833k).

*Prudential Indicator: Estimates of Capital Expenditure*

| Capital Expenditure £000 | 2022/23 Actual | 2023/24 Estimate | 2024/25 Estimate | 2025/26 Estimate | 2026/27 Estimate |
|---|---|---|---|---|---|
| General Fund | 4,910 | 4,459 | 24,676 | 21,780 | 2,580 |
| HRA | 6,957 | 7,414 | 16,025 | 16,290 | 25,236 |
| Loans to Subsidiary Company * | 5,363 | 2,639 | 0 | 0 | 0 |
| **Total** | **17,230** | **14,512** | **40,701** | **38,070** | **27,816** |

** Loans to Subsidiary Company are non-treasury investments and so not covered in detail in this report. Refer to the Capital Strategy for further information.*

For Members clarity, the NHS Hub loan is treated as General Fund.

3.2.2 Other long-term liabilities – The above financing need excludes other long-term liabilities, such as PFI and leasing arrangements that already include borrowing instruments.

3.2.3 The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

| Financing of capital expenditure £000 | 2022/23 Actual | 2023/24 Estimate | 2024/25 Estimate | 2025/26 Estimate | 2026/27 Estimate |
|---|---|---|---|---|---|
| Capital receipts | 865 | 1,306 | 1,394 | 1,855 | 1,097 |
| Capital grants | 4,967 | 4,665 | 15,943 | 21,240 | 12,295 |
| Capital reserves | 0 | 0 | 0 | 0 | 0 |
| Revenue | 4,018 | 4,593 | 5,120 | 3,799 | 2,746 |
| **Net financing need for the year** | **7,380** | **3,948** | **18,244** | **11,176** | **11,678** |

3.2.4 The net financing need for Loans to Subsidiary Company included in the above table against expenditure is shown below:

| Loans to Subsidiary Company £000 | 2022/23 Actual | 2023/24 Estimate | 2024/25 Estimate | 2025/26 Estimate | 2026/27 Estimate |
|---|---|---|---|---|---|
| Capital Expenditure | 5,363 | 2,639 | 0 | 0 | 0 |
| Financing costs | 0 | 0 | 0 | 0 | 0 |
| **Net financing need for the year** | **5,363** | **2,639** | **0** | **0** | **0** |
| Percentage of total net financing need % | 72.7% | 66.3% | 0.0% | 0.0% | 0.0% |

The financing costs are zero as, to date, all lending has been funded through internal borrowing. With the company now going through a soft closure, it is not expected that any external borrowing will be required to fund the lending.

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

3.3.1 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 above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

3.3.2 The CFR does not increase indefinitely, as the Minimum Revenue Provision (MRP) is a statutory annual revenue charge which broadly reduces the indebtedness in line with each asset's life, and so charges the economic consumption of capital assets as they are used.

3.3.3 The CFR includes any other long-term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility by the PFI, PPP lease provider and so the Council is not required to separately borrow for these schemes. The Council currently has £2.092m of such schemes within the CFR.

3.3.4 **The Council is asked to approve the CFR projections below:**

*Prudential Indicator: Estimates of Capital Financing Requirement*

| Capital Financing Requirement £000 | 2022/23 Actual | 2023/24 Estimate | 2024/25 Estimate | 2025/26 Estimate | 2026/27 Estimate |
|---|---|---|---|---|---|
| CFR - General Fund | 9,623 | 9,722 | 18,657 | 21,892 | 21,880 |
| CFR - Housing | 40,552 | 40,163 | 46,949 | 52,651 | 61,719 |
| CFR - Loans to Subsidiary Company | 14,417 | 0 | 0 | 0 | 0 |
| **Total CFR** | **64,592** | **49,885** | **65,606** | **74,543** | **83,599** |
| **Movement in CFR*** | **3,464** | **-14,707** | **15,721** | **8,937** | **9,056** |

**The movement in CFR will not directly match the Net Financing Need (see 3.2.3) due to the annual MRP charge reducing the balance in line with each asset's expected life. The CFR is cumulative, so increases and decreases for scheduled loans to, and repayments from, 3 Rivers Developments Ltd.*

### 3.4 Liability Benchmark

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

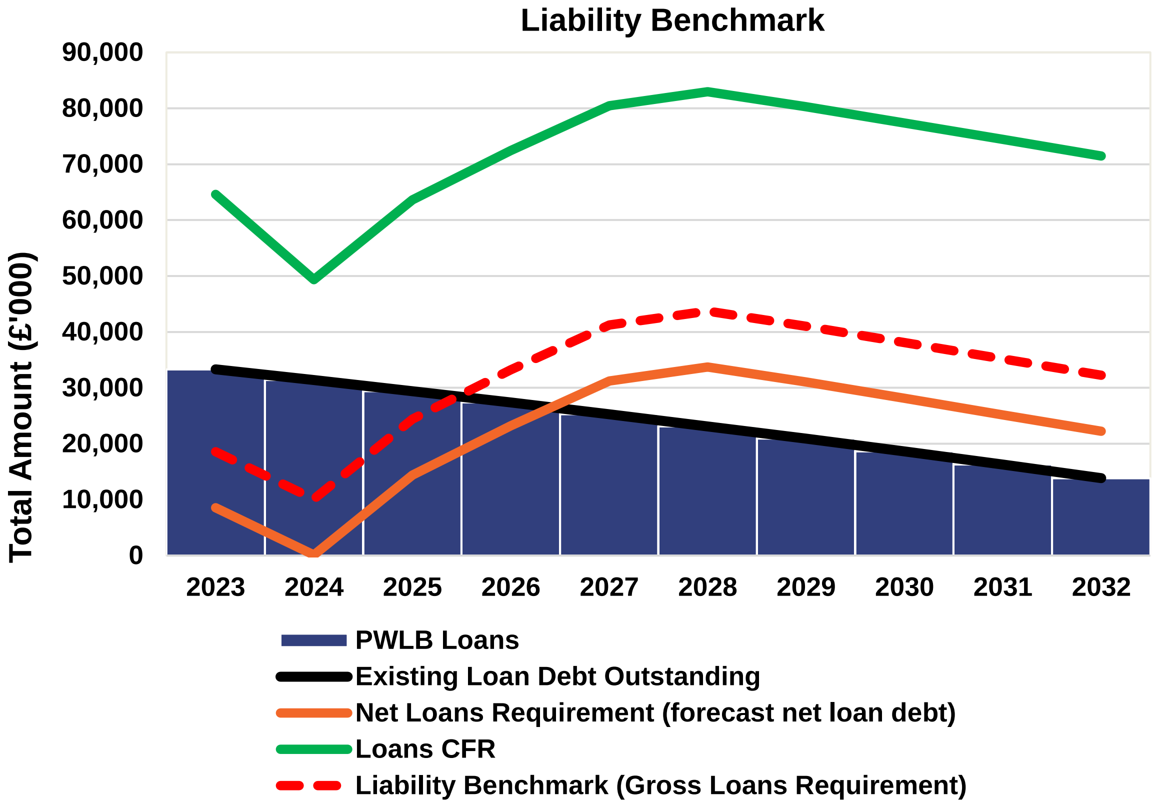
3.4.2 There are four compenents to the LB:

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 will show 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 a short-term liquidity allowance.

3.4.3 The Council's Liability Benchmark for years ending March 2023 to March 2032 is shown below:




3.4.4 The chart can be interpreted as follows:

- The liability benchmark (red dashed line) is the Council's need for external borrowing.
- Where the liability benchmark exceeds the existing loans (black line) then there is a need for new borrowing. Where the liability benchmark is below the existing loans then the Council is holding surplus cash that will be put into short-term investments.
- The area between the liability benchmark and net loans requirement (orange line) shows the cash required to manage the Council's day-to-day cash flow need, which is estimated to be £10m.
- The area between the loans CFR (green line) and liability benchmark shows the potential for internal borrowing, which currently stands at circa £40m.

## 4.0 Borrowing

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

### 4.2 Current portfolio position

4.2.1 The overall treasury management portfolio as at 31 March 2023 and the position as at 31 December 2023 are shown below for both borrowing and investments.

| TREASURY PORTFOLIO | | | | |
|---|---|---|---|---|
| | **Actual** | **Actual** | **Current** | **Current** |
| | **31/03/2023** | **31/03/2023** | **31/12/2023** | **31/12/2023** |
| **Treasury Investments** | **£000** | **%** | **£000** | **%** |
| Banks | 7,757 | 31% | 9,301 | 27% |
| Building Societies | 0 | 0% | 0 | 0% |
| Local Authorities | 12,000 | 48% | 15,000 | 44% |
| DMADF (H.M.Treasury) | 0 | 0% | 5,000 | 15% |
| Other Public Bodies | 0 | 0% | 0 | 0% |
| **Total Managed In-House** | **19,757** | **80%** | **29,301** | **85%** |
| Property Funds | 5,000 | 20% | 5,000 | 15% |
| **Total Managed Externally** | **5,000** | **20%** | **5,000** | **15%** |
| **Total Treasury Investments** | **24,757** | **100%** | **34,301** | **100%** |
| **Treasury External Borrowing** | | | | |
| Local Authorities | 0 | 0% | 0 | 0% |
| PWLB | 33,310 | 100% | 32,349 | 100% |
| **Total External Borrowing** | **33,310** | **100%** | **32,349** | **100%** |
| **Net Treasury Investments / (Borrowing)** | **-8,553** | | **1,952** | |

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

| External Debt £000 | 2022/23 Actual | 2023/24 Estimate | 2024/25 Estimate | 2025/26 Estimate | 2026/27 Estimate |
|---|---|---|---|---|---|
| Debt at 1 April | 35,234 | 33,310 | 31,373 | 37,198 | 41,966 |
| Expected Change in Debt | -1,924 | -1,937 | 5,825 | 4,767 | 7,908 |
| Other Long-Term Liabilities (OLTL) | 2,190 | 1,981 | 2,092 | 3,981 | 3,397 |
| Expected Change in OLTL | -209 | 111 | 1,889 | -584 | 355 |
| **Actual Gross Debt at 31 March** | **35,291** | **33,465** | **41,179** | **45,362** | **53,626** |
| **The Capital Financing Requirement** | **64,592** | **49,885** | **65,606** | **74,543** | **83,599** |
| **Under / (Over) Borrowing** | **29,301** | **16,420** | **24,427** | **29,181** | **29,973** |

4.2.3 Within the range of 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 gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2024/25 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes.

4.2.4 The S151 (Deputy Chief Executive) reports that the Council complied with this Prudential Indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

**4.3 Treasury Indicators: limits to borrowing activity**

4.3.1 **The operational boundary.** This is the limit which external debt is not normally expected to exceed. This is the CFR, split between debt and other long term liabilities (leases) and rounded up to the nearest million.

*Prudential Indicator: Operational Boundary*

| Operational boundary £000 | 2023/24 Estimate | 2024/25 Estimate | 2025/26 Estimate | 2026/27 Estimate |
|---|---|---|---|---|
| Debt | 48,000 | 62,000 | 72,000 | 80,000 |
| Other long term liabilities | 3,000 | 4,000 | 4,000 | 4,000 |
| **Total** | **51,000** | **66,000** | **76,000** | **84,000** |

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

4.3.3 This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised. The authorised limit is set at the CFR plus £5m for debt and £4m for other long term liabilities, to cover exceptional circumstances and borrowing ahead of need to secure interest rates.

4.3.4 **The Council is asked to approve the following authorised limit:**

*Prudential Indicator: Authorised Limit*

| Authorised limit £000 | 2023/24 Estimate | 2024/25 Estimate | 2025/26 Estimate | 2026/27 Estimate |
|---|---|---|---|---|
| Debt | 53,000 | 67,000 | 77,000 | 85,000 |
| Other long term liabilities | 7,000 | 8,000 | 8,000 | 8,000 |
| **Total** | **60,000** | **75,000** | **85,000** | **93,000** |

### 4.4 Prospects for interest rates

4.4.1 The Council has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on future interest rates. The following table gives their view as at 08 January 2024.

| Interest Rates | Mar-24 | Jun-24 | Sep-24 | Dec-24 | Mar-25 | Jun-25 | Sep-25 | Dec-25 | Mar-26 | Jun-26 | Sep-26 | Dec-26 | Mar-27 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Bank Rate View | 5.25% | 5.25% | 4.75% | 4.25% | 3.75% | 3.25% | 3.00% | 3.00% | 3.00% | 3.00% | 3.00% | 3.00% | 3.00% |
| 5yr PWLB Rate | 4.50% | 4.40% | 4.30% | 4.20% | 4.10% | 4.00% | 3.80% | 3.70% | 3.60% | 3.60% | 3.50% | 3.50% | 3.50% |
| 10yr PWLB Rate | 4.70% | 4.50% | 4.40% | 4.30% | 4.20% | 4.10% | 4.00% | 3.90% | 3.80% | 3.70% | 3.70% | 3.70% | 3.70% |
| 25yr PWLB Rate | 5.20% | 5.10% | 4.90% | 4.80% | 4.60% | 4.40% | 4.30% | 4.20% | 4.20% | 4.10% | 4.10% | 4.10% | 4.10% |
| 50yr PWLB Rate | 5.00% | 4.90% | 4.70% | 4.60% | 4.40% | 4.20% | 4.10% | 4.00% | 4.00% | 3.90% | 3.90% | 3.90% | 3.90% |

4.4.2 Although CPI inflation has seen large falls to 4.0% in December 2023, down from its high of 11.1% in October 2022, it is expected that the MPC will be keen to underpin its anti-inflation credentials by keeping Bank Rate at 5.25% until at least the second half of 2024. Rate cuts are expected to begin only when the CPI inflation and wage/employment data are unequivocally supportive of such a move.

4.4.3 A more thorough economic outlook provided by our Treasury Advisors is detailed in **Appendices 2 and 3.**

### 4.5 Borrowing strategy

4.5.1 The Council 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 Council's reserves, balances and cash flow has been used as a temporary measure. With significant levels of capital expenditure expected during 2024/25, it is recommended that the Council maximises its use of internal borrowing rather than seeking to fund projects through new external borrowing. This strategy is prudent as investment returns are lower than the cost of borrowing and counterparty risk is still an issue that needs to be considered.

4.5.2 Against this background and the risks within the economic forecast, caution will be adopted with the 2024/25 treasury operations. The S151 (Deputy Chief Executive) will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- If it was felt that there was a significant risk of a sharp FALL in borrowing rates, then borrowing will be postponed;
- If it was felt that there was a significant risk of a much sharper RISE in borrowing rates than that currently forecast, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.
- The Council will consider all external loan options available in the market including Public Works Loans Board, Banks, Other Local Authorities and the Municipal Bond Agency. The term and repayment profile of any loans will be determined by the periods financing is required. The level of borrowing will stay within the above limits.

4.5.3 Any decisions will be reported to the Cabinet at the next available opportunity.

**4.6 Policy on borrowing in advance of need**

4.6.1 The Council can 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.

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

**4.7 Debt rescheduling**

4.7.1 Rescheduling of current borrowing in our debt portfolio is unlikely to occur as the penalties currently being applied to premature repayments are prohibitive. If rescheduling is done, it will be reported to the Cabinet at the earliest meeting following its action.

**4.8 New financial institutions as a source of borrowing and / or types of borrowing**

4.8.1 Currently the PWLB Certainty Rate is set at gilts + 80 basis points. There is also a temporary HRA rate set at gilts + 40 basis points, which is currently available until June 2025. Despite these discounted rates, there are more cometitive rates available elsewhere for some durations, and so consideration will still need to be given to sourcing funding from the following sources:

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

4.8.2 The degree to which any of these options proves cheaper than PWLB Certainty Rate is constantly evolving but our advisors will keep us informed.

## 4.9 Approved Sources of Long and Short Term Borrowing

| On Balance Sheet | Fixed | Variable |
|---|---|---|
| PWLB | ● | ● |
| Municipal Bond Agency | ● | ● |
| Local Authorities | ● | |
| Banks | ● | ● |
| Finance Leases | ● | ● |

## 5.0 Annual Investment Strategy

## 5.1 Investment policy – management of risk

5.1.1 The DLUHC and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with financial investments (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy (a separate report).

5.1.2 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"); and
- CIPFA Treasury Management Guidance Notes 2021

5.1.3 The Council's investment priorities will be Security first, portfolio Liquidity second and then Yield (return) – known as the SLY Principle.

5.1.4 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:

5.1.4.1 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.

5.1.4.2 **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, which the Council will achieve through engaging with its advisors to maintain a monitor on market pricing.

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

5.1.4.4 The Council has defined the list of **types of investment instruments** that the treasury management team are authorised to use. See **Appendix 4** for a list.

5.1.4.5 **Lending and transaction limits** (amounts and maturity) for each counterparty will be set through applying the matrix table in paragraph 5.2.6.

5.1.4.6 The Council will set a limit for the amount of its investments which are invested for **longer than 365 days** (see paragraph 5.4.9).

5.1.4.7 Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating** (see paragraph 5.3.2).

5.1.5 The Council has engaged external consultants (see paragraph 2.5.1) to provide expert advice on how to optimise an appropriate balance of Security, Liquidity and Yield, given the risk appetite of the Council in the context of the expected level of cash balances and need for liquidity throughout the year.

5.1.6 All investments will be denominated in sterling.

5.1.7 As a result of the change in accounting standards for 2019/20 under IFRS 9, the Council will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. In November 2018, the then 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. This override has since been extended to 31 March 2025.

5.1.8 However, the Council will also pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance (see section 5.5). Regular monitoring of investment performance will be carried out during the year.

5.1.9 The above criteria are unchanged from last year.

## 5.2 Creditworthiness policy

5.2.1 The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and
- It has sufficient liquidity in its investments. For this purpose, it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

5.2.2 The S151 (Deputy Chief Executive) will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

5.2.3 Credit rating information is supplied by Link Group, our treasury advisors, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating Watches (notification of a likely change), rating Outlooks (notification of the longer-term bias outside the central rating view) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating Watch applying to a counterparty with the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.

5.2.4 The criteria for providing a pool of high quality investment counterparties (both specified and non-specified investments) is:

- Banks 1 - good credit quality – the Council will only use banks which:
    i. are UK banks; and/or
    ii. are non-UK and domiciled in a country which has a minimum sovereign Long Term Fitch rating of AAA; and
    iii. have, as a minimum, a credit rating of F1 (Fitch), with regard for Moody's and Standard & Poor's credit ratings (where rated).
- Banks 2 – The Council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time invested.
- Building Societies – The Council will use all societies which:
    i. Meet the Fitch rating for banks outlined above; and
    ii. Have assets in excess of £1bn;
- Money Market Funds Fitch CNAV AAAmmf/AAA
- Money Market Funds LNVAV AAAmmf/AAA
- Money Market Funds VNAV AAAmmf/AAA
- UK Government (including gilts, Treasury Bills and the DMADF)
- Local authorities, Police, Fire, parish councils and other public bodies

5.2.5 **Use of additional information other than credit ratings.** Additional requirements under the Code require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information will be applied to compare the relative security of differing investment opportunities.

5.2.6 **Time and monetary limits applying to investments.** The time and monetary limits for institutions on the Council's counterparty list are as follows (these will cover both specified and non-specified investments):

| Details | Fitch Short term Rating | Money and/or % Limit | Transaction Limit | Time Limit |
|---|---|---|---|---|
| **The Council's bank* (currently NatWest)** | F1 | £5m + balance of grant funds | n/a | n/a |
| **Banks 1 (good credit quality)** | F1 | £5m | £5m | 2yr |
| **Banks 2 (Council's banker if not meeting Banks 1)** | F2/F3 | £5m (call account) | £5m (call account) | 1 day |
| **DMADF** | UK sovereign rating | unlimited | unlimited | unlimited |
| **Local authorities & other public bodies** | N/A | unlimited | unlimited | unlimited |
| **Building Societies** | F1 | £5m | £5m | 2yr |
| **Money Market Funds - CNAV** | AAAmmf/AAA | £2m | £2m | liquid |
| **Money Market Funds - LVNAV** | AAAmmf/AAA | £2m | £2m | liquid |
| **Money Market Funds - VNAV** | AAAmmf/AAA | £2m | £2m | liquid |

**This limit was approved in the TMSS for 2021/22 to allow the continued administration of business grant funds.*

The above table relates to financial investments only – non-financial investments, such as commercial loans or purchases of income yielding assets are covered in the Capital Strategy.

5.2.7 The proposed criteria for specified and non-specified investments are shown in **Appendix 4** for approval.

5.2.8 **Creditworthiness**

5.2.9 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. Nonetheless, when setting minimum sovereign debt ratings, this Authority will not set a minimum rating for the UK.

### 5.3 Other limits

5.3.1 Due care will be taken to consider the country, group and sector exposure of the Council's investments.

5.3.2 **Country limit.** The Council has determined that it will only use approved counterparties from the UK and from countries with a minimum sovereign credit rating of AAA. The list of countries that qualify using this credit criteria as at the date of this report are shown in **Appendix 5**. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

5.3.3 **Other limits.** In addition:

- no more than 30% of overall investment balances will be placed with any non-UK country at any time;
- limits in place above will apply to a group of companies; and
- the Council will not hold more than £5m with any banking group.

### 5.4 Investment strategy

5.4.1 **In-house funds**

5.4.2 Over recent years, the Council has typically held upwards of £20m in short term investments with the objective of managing cash flows whilst earning a return at the same time. These returns remained historically low for two years after interest rates plummeted at the start of the Covid-19 pandemic in Q4 2019/20, however increases to interest rates through 2022 and 2023 have seen returns on short term investments rebound from £54k in 2021/22, to £539k in 2022/23, and a forecast £1,198k in 2023/24.

5.4.3 Retaining cash balances (short term investments + current account) of £10m would be enough to ensure a regular turnover in short term investments to manage the fluctuations in cash flows. Therefore, internal borrowing will be used to finance capital expenditure where cash balances remain above £10m, with external borrowing only sought to keep balances above this limit where necessary. Although there is currently not much difference between interest rates currently available from PWLB and rates available for short term investments, taking out new PWLB loans would expose the Council to high rates of interest for the duration of those loans. With interest rates expected to come down over the next couple of years, maximising internal borrowing is still the most prudent approach.

5.4.4 As cash balances reduce through 2024/25, there will be a need to reduce the average maturity on investments to ensure a regular turnover of maturities, which will be matched with the Council's large cash outflows. This will mean the primary consideration for investments will be the core balance and cash flow requirements, with the outlook for short-term interest rates only considered where significant changes are expected. Greater returns are usually obtainable by investing for longer periods, however this needs to be balanced with the Council's cash requirements.

- 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.
- 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.

5.4.5 **Investment returns expectations**

5.4.6 The current forecast shown in paragraph 4.4.1 includes a forecast for Bank Rate to start reducing in Q3 2024 from the current high of 5.25%.

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

| Year | % |
|---|---|
| **2024/25** | 4.55% |
| **2025/26** | 3.10% |
| **2026/27** | 3.00% |
| **2027/28** | 3.25% |
| **Later years** | 3.25% |

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

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

| Upper limit for principal sums invested for longer than 365 days | 2024/25 (£m) | 2025/26 (£m) | 2026/27 (£m) |
|---|---|---|---|
| Principal sum invested for longer than 365 days but not exceeding 2 years. | 5 | 5 | 5 |

5.4.10 For its cash flow generated balances, the Council will seek to utilise money market funds and short-dated deposits (overnight to 365 days) in order to benefit from the compounding of interest.

## 5.5 Investment performance / risk benchmarking

5.5.1 The Council will use an investment benchmark to assess the performance of its investment portfolio of 7 day SONIA (Sterling Overnight Index Average).

## 5.6 End of year investment report

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

## 5.7 Commercial and Non-Financial Investments

5.7.1 **Property Investments.** A limit of £5m will be applied to the use of non-specified investments. This principally relates to property funds, which is within the Local Authorities' Property Fund via CCLA.

5.7.2 **Non-Financial Investments.** On the 30th March 2017, Cabinet approved the establishment of a Special Purpose Vehicle – 3 Rivers Developments Limited and that the Council could lend to 3 Rivers Developments Ltd. This company is a subsidiary of Mid Devon District Council and has the sole purpose of property development.

5.7.3 There was no cap on the amount of money that can be loaned to 3 Rivers Developments Ltd. However, for each new project the company takes on, there is an individual loan agreement signed by the S151 Officer prior to any lending. All project spending / borrowing requirements are approved annually by Cabinet as part of the company's Annual Report/Business Plan, with individual Business Cases reviewed and approved by Cabinet on any development over £1m.

5.7.4 At a Full Council meeting on 06 September 2023, a soft closure of 3 Rivers was agreed. Therefore no further funding will be required apart from amounts to complete live developments.

5.7.5 Please refer to the Capital Strategy for a more detailed programme and borrowing streams.

## 6.0 Conclusion

**6.1** Treasury management is a highly complex and specialist subject. It is tightly controlled by regulation and procedures that the Council must abide by. In addition to the skilled staff in house, the Council has access to advice from its Treasury Advisors (Link Group) where we need it to ensure that we comply with these rules.

**6.2** Cabinet will consider the Treasury Management Strategy before recommending Full Council approve it at its budget meeting on 21 February.

**Financial Implications:** Good financial management and administration underpins the entire strategy. The Council's Treasury Management Strategy should attempt to maximise investment return commensurate with minimum risk to the principal sums invested**.**

**Legal Implications:** Authorities are required by regulation to have regard to the Prudential Code when carrying out their duties under Part 1 of the Local Government Act 2003.

**Risk Assessment:** The S151 Officer is responsible for the administration of the financial affairs of the Council. Implementing this strategy and the CIPFA Code of Practice on Treasury Management helps manage the risk associated with the Council's treasury management activity.

**Impact on Climate Change:** There are no Climate Change implications relating to the content of this report.

**Equality Impact Assessment:** There are no Equalities Impact implications relating to the content of this report.

**Relationship to Corporate Plan:** Maximising investment return whilst minimising risk of credit default enables the Council to finance the delivery of its Corporate Plan objectives.

**Section 3 – Statutory Officer sign-off/mandatory checks**

**Statutory Officer: Andrew Jarrett**
Agreed by or on behalf of the Section 151
**Date: 26/01/2024**

**Statutory Officer: Maria De Leiburne**
Agreed on behalf of the Monitoring Officer
**Date: 26/01/2024**

**Chief Officer: Stephen Walford**
Agreed by or on behalf of the Chief Executive/Corporate Director
**Date: 26/01/2024**

**Performance and risk: Steve Carr**
Agreed on behalf of the Corporate Performance & Improvement Manager
**Date: 26/01/2024**

**Cabinet member notified:** Yes

**Section 4 - Contact Details and Background Papers**

**Contact:** Kieran Knowles, Principal Accountant & Procurement Manager
Email: kknowles@middevon.gov.uk
Telephone: 01884 24(4624)

**Background papers**: Capital Strategy 2024/25 (Cabinet 06/02/2024)

**APPENDIX 1**

## 1.0 THE CAPITAL PRUDENTIAL AND TREASURY INDICATORS 2024/25 – 2026/27

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

### 1.1 Capital expenditure

See section 3.2 for the breakdown of capital expenditure.

### 1.2 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:**

**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.

| % | 2022/23 Actual | 2023/24 Estimate | 2024/25 Estimate | 2025/26 Estimate | 2026/27 Estimate |
|---|---|---|---|---|---|
| General Fund | 16.33% | -4.15% | 1.57% | 4.82% | 5.74% |
| HRA | 12.31% | 9.16% | 9.57% | 11.34% | 13.76% |

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

### 1.3 Minimum Revenue Provision (MRP) Policy Statement

Where the Council finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the Council to have regard to the Department of Levelling Up, Housing & Communities' *Statutory Guidance on Minimum Revenue Provision* (the DLUHC Guidance).

The broad aim of the DLUHC Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

The DLUHC Guidance requires the Council to approve an Annual MRP Statement each year, and recommends a number of options for calculating a prudent amount of MRP.

**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:

- **Based on CFR** – MRP will be based on the CFR.

This option provides 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 regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction)

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

Finance leases will have their capital financing applied on a straight-line basis over the life of the lease contract.

There is no requirement on the HRA to make a Minimum Revenue Provision but there is a requirement for a charge for depreciation to be made.

The MRP requirement for a finance lease or PFI contract is deemed to be equal to the element of the charge/rent that goes to write down the balance sheet liability.

For capital expenditure loans to third parties that are expected to be repaid in full, the Council will make nil MRP, but will instead apply the capital receipts arising from principal repayments to reduce the capital financing requirement. Where it becomes probable that a loan will not be repaid in full, MRP will be charged in accordance with the Expected Credit Loss (ECL) model outlined in IFRS 9.

MRP will not be charged against capital expenditure in the year it is incurred, but will instead commence the following year. Capital expenditure incurred during 2023/24 will not be subject to a MRP charge until 2024/25.

### 1.4 MRP Overpayments

A change introduced by the revised DLUHC MRP Guidance was the allowance that any charges made over the statutory Minimum Revenue Provision (MRP), Voluntary Revenue Provision (VRP) or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year. Up until the 31 March 2023, the total VRP overpayments were £0m.

## APPENDIX 2 – Provided by Link Group (MDDC's Treasury Advisor)

### 2.0 INTEREST RATE FORECASTS 2024-2026

Link Group Interest Rate View

| Interest Rates | Mar-24 | Jun-24 | Sep-24 | Dec-24 | Mar-25 | Jun-25 | Sep-25 | Dec-25 | Mar-26 | Jun-26 | Sep-26 | Dec-26 | Mar-27 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Bank Rate View | 5.25% | 5.25% | 4.75% | 4.25% | 3.75% | 3.25% | 3.00% | 3.00% | 3.00% | 3.00% | 3.00% | 3.00% | 3.00% |
| 5yr PWLB Rate | 4.50% | 4.40% | 4.30% | 4.20% | 4.10% | 4.00% | 3.80% | 3.70% | 3.60% | 3.60% | 3.50% | 3.50% | 3.50% |
| 10yr PWLB Rate | 4.70% | 4.50% | 4.40% | 4.30% | 4.20% | 4.10% | 4.00% | 3.90% | 3.80% | 3.70% | 3.70% | 3.70% | 3.70% |
| 25yr PWLB Rate | 5.20% | 5.10% | 4.90% | 4.80% | 4.60% | 4.40% | 4.30% | 4.20% | 4.20% | 4.10% | 4.10% | 4.10% | 4.10% |
| 50yr PWLB Rate | 5.00% | 4.90% | 4.70% | 4.60% | 4.40% | 4.20% | 4.10% | 4.00% | 4.00% | 3.90% | 3.90% | 3.90% | 3.90% |

Our central forecast for interest rates was previously updated on 8 January and reflected a view that the MPC would be keen to further demonstrate its anti-inflation credentials by keeping Bank Rate at 5.25% until at least H2 2024. We expect rate cuts to start when both the CPI inflation and wage/employment data are supportive of such a move, and when there is a likelihood of the overall economy enduring at least a slowdown or mild recession over the coming months (although most recent GDP releases have surprised with their on-going robustness).

Naturally, timing on this matter will remain one of fine judgment: cut too soon, and inflationary pressures may well build up further; cut too late and any downturn or recession may be prolonged.

In the upcoming months, our forecasts will be guided not only by economic data releases and clarifications from the MPC over its monetary policies and the Government over its fiscal policies, but also international factors such as policy development in the US and Europe, the provision of fresh support packages to support the faltering recovery in China as well as the on-going conflict between Russia and Ukraine, and Gaza and Israel.

**PWLB RATES**

The short and medium part of the gilt curve has rallied since the start of November as markets price in a quicker reduction in Bank Rate through 2024 and 2025 than held sway back then. This reflects market confidence in inflation falling back in a similar manner to that already seen in the US and the Euro-zone. At the time of writing there is c70 basis points difference between the 5 and 50 year parts of the curve.

**The balance of risks to the UK economy**

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

**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, could keep gilt yields high for longer).

- **The Bank of England** has increased Bank Rate too fast and too far over recent months, and subsequently brings about a deeper and longer UK recession than we currently anticipate.

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

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

- Despite the tightening in Bank Rate to 5.25%, the **Bank of England allows inflationary pressures to remain elevated** for a long period within the UK economy, which then necessitates Bank Rate staying higher for longer than we currently project.

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

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

**LINK GROUP FORECASTS**
We expect the MPC will keep Bank Rate at 5.25% until the second half of 2024, to combat on-going inflationary and wage pressures, even if they have dampened somewhat of late. We do not think that the MPC will increase Bank Rate above 5.25%.

**Gilt yields and PWLB rates**
The overall longer-run trend is for gilt yields and PWLB rates to fall back over the timeline of our forecasts, as inflation continues to fall through 2024.

Our target borrowing rates are set **two years forward** (as we expect rates to fall back) and the current PWLB (certainty) borrowing rates are set out below:

| PWLB debt | Current borrowing rate as at 08.01.24 p.m. | Target borrowing rate now (end of Q4 2025) | Target borrowing rate previous (end of Q3 2025) |
|---|---|---|---|
| 5 years | 4.53% | 3.70% | 3.80% |
| 10 years | 4.67% | 3.90% | 3.80% |
| 25 years | 5.19% | 4.20% | 4.20% |
| 50 years | 4.97% | 4.00% | 4.00% |

**Borrowing advice:** Our long-term (beyond 10 years) forecast for Bank Rate remains at 3% and reflects Capital Economics' research that suggests AI and general improvements in productivity will be supportive of a higher neutral interest rate. As all PWLB certainty rates are currently significantly above this level, borrowing strategies will need to be reviewed in that context. Overall, better value can be obtained at the shorter end of the curve and short-dated fixed LA to LA monies should be considered. Temporary borrowing rates will remain elevated for some time to come but may prove the best option whilst the market continues to factor in Bank Rate reductions for 2024 and later.

## APPENDIX 3 – Provided by Link Group (MDDC's Treasury Advisor)

### 3.0 ECONOMIC BACKGROUND

The third quarter of 2023/24 saw:

- A 0.3% m/m decline in real GDP in October, potentially partly due to unseasonably wet weather, but also due to the ongoing drag from higher interest rates. Growth for the second quarter, ending 30th September, was revised downwards to -0.1% and growth on an annual basis was also revised downwards, to 0.3%;
- A sharp fall in wage growth, with the headline 3myy rate declining from 8.0% in September to 7.2% in October, although the ONS "experimental" rate of unemployment has remained low at 4.2%;
- CPI inflation continuing on its downward trajectory, from 8.7% in April to 4.6% in October, then again to 3.9% in November;
- Core CPI inflation decreasing from April and May's 31 years' high of 7.1% to 5.1% in November, the lowest rate since January 2022;
- The Bank of England holding Bank Rate at 5.25% in November and December;
- A steady fall in 10-year gilt yields as investors revised their interest rate expectations lower.

The revision of GDP data in Q2 to a 0.1% q/q fall may mean the mildest of mild recessions has begun. Indeed, real GDP in October fell 0.3% m/m which does suggest that the economy may stagnate again in Q3. The weakness in October may partly be due to the unseasonably wet weather. That said, as the weakness was broad based it may also be the case that the ongoing drag from higher interest rates is more than offsetting any boost from the rise in real wages.

However, the rise in the flash composite activity Purchasing Managers Index, from 50.7 in November to 51.7 in December, did increase the chances of the economy avoiding a contraction in Q3. The improvement was entirely driven by the increase in the services activity balance from 50.9 to 52.7. (Scores above 50 point to expansion in the economy, although only tepid in this instance.) The press release noted that this was primarily driven by a revival in consumer demand in the technological and financial services sectors. This chimes with the further improvement in the GfK measure of consumer confidence in December, from -24 to -22. The services PMI is now consistent with non-retail services output growing by 0.5% q/q in Q3, but this is in stark contrast to the manufacturing sector where the output balance slumped from 49.2 to 45.9 and, at face value, the output balance is consistent with a 1.5% q/q fall in manufacturing output in Q3.

The 0.3% m/m fall in retail sales volumes in October means that after contracting by 1.0% q/q (which was downwardly revised from -0.8% q/q) in Q2, retail activity remained weak at the start of Q3. That suggests higher interest rates are taking a bigger toll on real consumer spending.

Higher interest rates have filtered through the financial channels and weakened the housing market but, overall, it remains surprisingly resilient with the Halifax house price index recently pointing to a 1.7% year on year increase whilst Nationwide's December data pointed to a -1.8% year on year decrease. However, the full weakness in real consumer spending and real business investment has yet to come as currently it is estimated that around two thirds to a half of the impact of higher interest rates on household interest payments has yet to be felt.

Overall, we expect real GDP growth to remain subdued throughout 2024 as the drag from higher interest rates is protracted but a fading of the cost-of-living crisis and interest rate cuts in the second half of 2024 will support a recovery in GDP growth in 2025.

The labour market remains tight by historical standards, but the sharp fall in wage growth seen in October will reinforce the growing belief in markets that interest rates will be cut mid-2024. Wage growth eased in October much faster than the consensus expected. Total earnings fell by 1.6% m/m, which meant the headline 3myy rate eased from 8.0% in September to 7.2% in October. This news will be welcomed by the Bank of England. Indeed, the timelier three-month annualised rate of average earnings growth fell from +2.4% to -1.2%. Excluding bonuses, it fell from 5.3% to 2.0%. Furthermore, one of the Bank's key barometers of inflation persistence, regular private sector pay growth, dropped from 7.9% 3myy to 7.3%, which leaves it comfortably on track to fall to 7.2% by December, as predicted by the Bank in November.

The fall in wage growth occurred despite labour demand being stronger in October than expected. The three-month change in employment eased only a touch from +52,000 in September to +50,000 in October. But resilient labour demand was offset by a further 63,000 rise in the supply of workers in the three months to October. That meant labour supply exceeded its pre-pandemic level for the first time, and the unemployment rate remained at 4.2% in October. In the three months to November, the number of job vacancies fell for the 17th month in a row, from around 959,000 in October to around 949,000. That has reduced the vacancy to unemployment ratio as demand for labour eases relative to supply, which may support a further easing in wage growth in the coming months.

CPI inflation fell from 6.7% in September to 4.6% in October, and then again to 3.9% in November. Both these falls were bigger than expected and there are clear signs of easing in domestic inflationary pressures. The fall in core CPI inflation from 5.7% to 5.1% in November was bigger than expected (consensus forecast 5.6%). That's the lowest rate since January 2022. Some of the decline in core inflation was due to the global influence of core goods inflation, which slowed from 4.3% to 3.3%. But some of it was due to services inflation falling from 6.6% to 6.3%. The Bank views the latter as a key barometer of the persistence of inflation and it came in further below the Bank's forecast of 6.9% in its November Monetary Policy Report. This will give the Bank more confidence that services inflation is now on a firmly downward path.

The Bank of England sprung no surprises with its December monetary policy committee (MPC) meeting, leaving interest rates at 5.25% for the third time in a row and pushing back against the prospect of near-term interest rate cuts. The Bank continued to sound hawkish, with the MPC maintaining its tightening bias saying that "further tightening in monetary policy would be required if there were evidence of more persistent inflationary pressures". And it stuck to the familiar script, saying that policy will be "sufficiently restrictive for sufficiently long" and that "monetary policy is likely to need to be restrictive for an extended period of time". In other words, the message is that the MPC is not yet willing to endorse investors' expectations that rates will be cut as soon as May 2024.

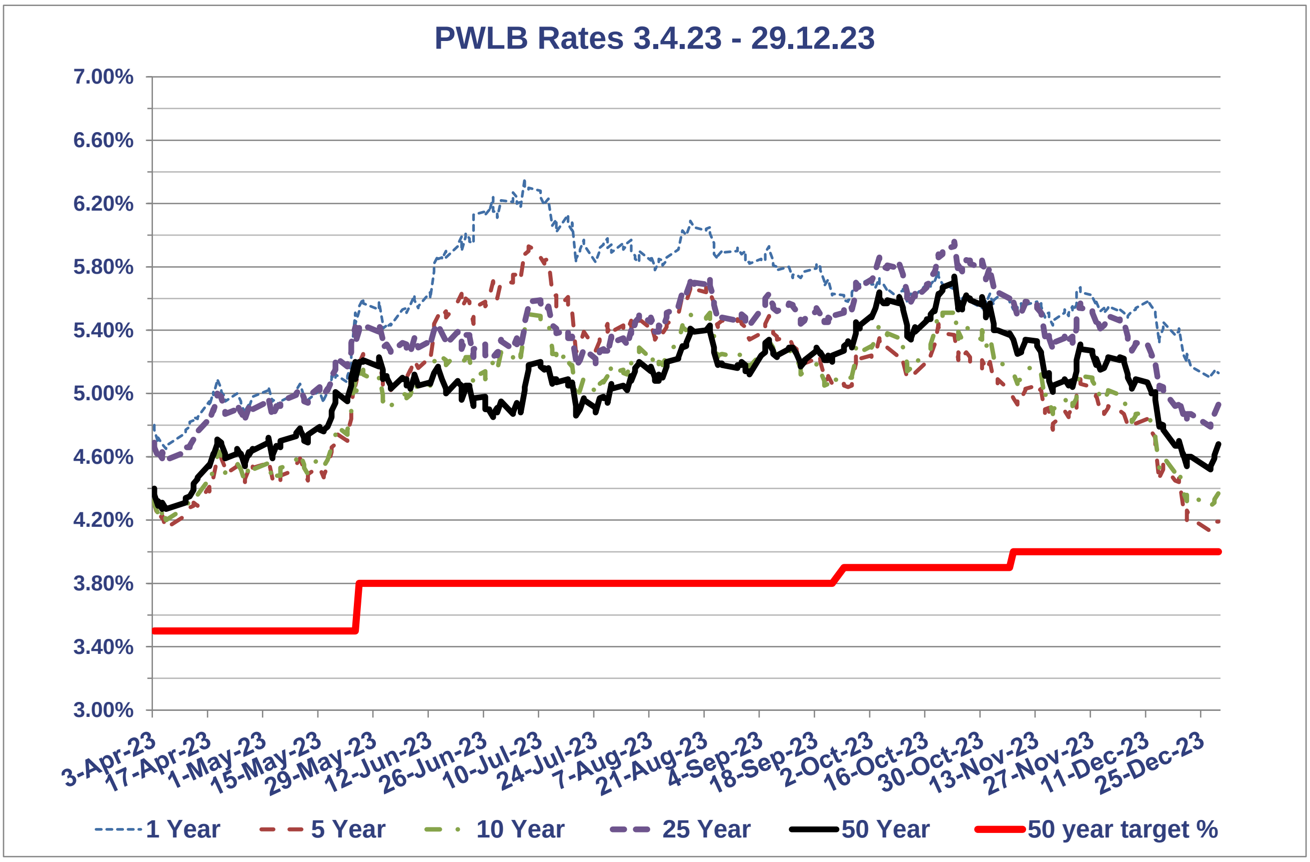
Looking ahead, our colleagues at Capital Economics forecast that the recent downward trends in CPI and core inflation will stall over the next few months before starting to decline more decisively again in February. That explains why we think the Bank of England won't feel comfortable cutting interest rates until H2 2024.
The fall in UK market interest rate expectations in December has driven most of the decline in 10-year gilt yields, which have fallen in line with 10-year US Treasury and euro-zone yields. 10-year gilt yields have fallen from 4.68% in October 2023 to around 3.70% in early January, with further declines likely if the falling inflation story is maintained.

Investors' growing expectations that the Fed will cut interest rates soon has led to an improvement in risk sentiment, which has boosted the pound and other risky assets. In addition, the rise in the pound, from $1.21 in November to $1.27 now, has also been supported by the recent relative decline in UK wholesale gas prices.

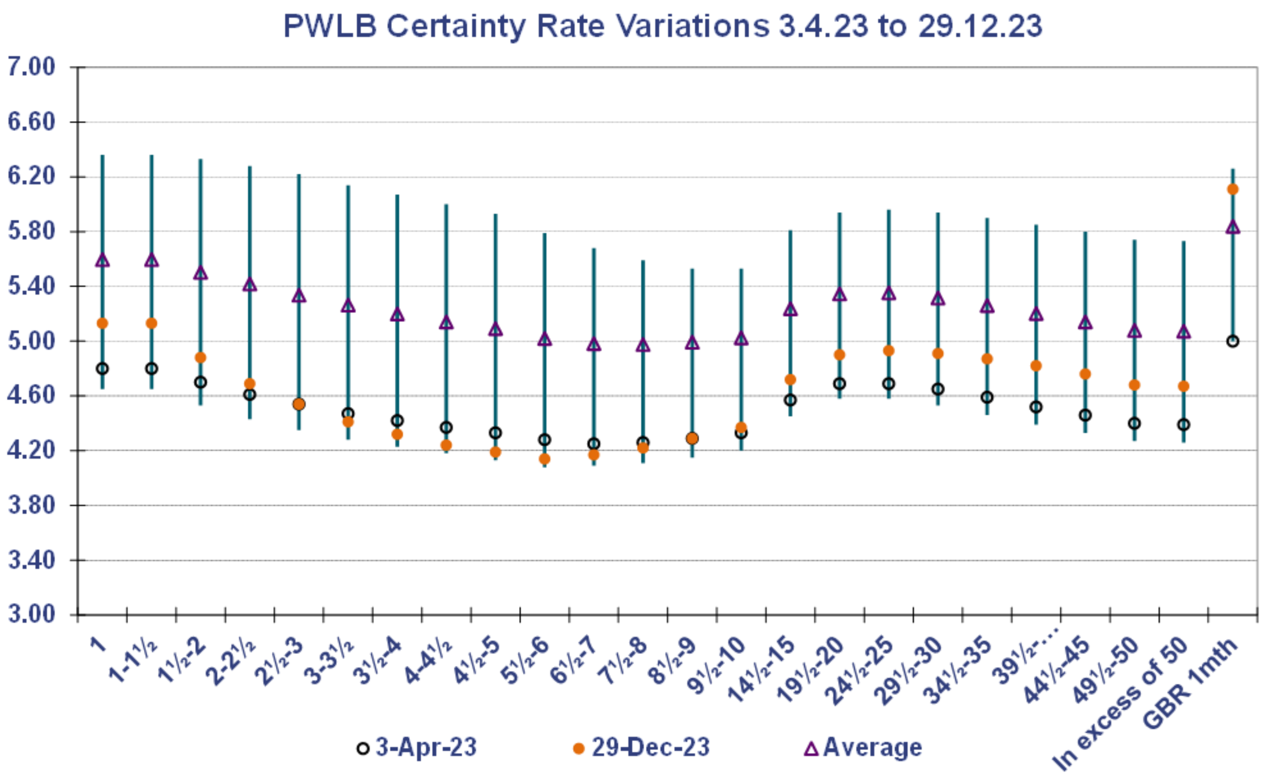
The further fall in 10-year real gilt yields in December has supported the recent rise in the FTSE 100. That said, the index remains 5% below its record high in February 2023. This modest rise in equities appears to have been mostly driven by strong performances in the industrials and rate-sensitive technology sectors. But UK equities have continued to underperform US and euro-zone equities. The FTSE 100 has risen by 2.2% in December, while the S&P 500 has risen by 3.8%. This is partly due to lower energy prices, which have been a relatively bigger drag on the FTSE 100, due to the index's high concentration of energy companies.

In the chart below, the rise in gilt yields across the curve in the first half of 2023/24, and therein PWLB rates, is clear to see, prior to the end of year rally based on a mix of supportive domestic and international factors.

**PWLB RATES 03/04/2023 – 29/12/2023**



PWLB Rates 3.4.23 - 29.12.23
7.00%
6.60%
6.20%
5.80%
5.40%
5.00%
4.60%
4.20%
3.80%
3.40%
3.00%
3-Apr-23
17-Apr-23
1-May-23
15-May-23
29-May-23
12-Jun-23
26-Jun-23
10-Jul-23
24-Jul-23
7-Aug-23
21-Aug-23
4-Sep-23
18-Sep-23
2-Oct-23
16-Oct-23
30-Oct-23
13-Nov-23
27-Nov-23
11-Dec-23
25-Dec-23
1 Year
5 Year
10 Year
25 Year
50 Year
50 year target %

PWLB Certainty Rate Variations 3.4.23 to 29.12.23
7.00
6.60
6.20
5.80
5.40
5.00
4.60
4.20
3.80
3.40
3.00
1
1-1½
1½-2
2-2½
2½-3
3-3½
3½-4
4-4½
4½-5
5½-6
6½-7
7½-8
8½-9
9½-10
14½-15
19½-20
24½-25
29½-30
34½-35
39½-…
44½-45
49½-50
In excess of 50
GBR 1mth
3-Apr-23
29-Dec-23
Average

## HIGH/LOW/AVERAGE PWLB RATES FOR 03/04/2023 – 29/12/2023

| | 1 Year | 5 Year | 10 Year | 25 Year | 50 Year |
|---|---|---|---|---|---|
| **Low** | 4.65% | 4.13% | 4.20% | 4.58% | 4.27% |
| **Date** | 06/04/2023 | 27/12/2023 | 06/04/2023 | 06/04/2023 | 05/04/2023 |
| **High** | 6.36% | 5.93% | 5.53% | 5.96% | 5.74% |
| **Date** | 06/07/2023 | 07/07/2023 | 23/10/2023 | 23/10/2023 | 23/10/2023 |
| **Average** | 5.60% | 5.09% | 5.03% | 5.35% | 5.08% |
| **Spread** | 1.71% | 1.80% | 1.33% | 1.38% | 1.47% |

**MPC meetings 2nd November and 14th December 2023**

On 2nd November, the Bank of England's Monetary Policy Committee (MPC) voted to keep Bank Rate on hold at 5.25%, and on 14th December reiterated that view. Both increases reflected a split vote, the latter by 6 votes to 3, with the minority grouping voting for an increase of 0.25% as concerns about "sticky" inflation remained in place.

Nonetheless, with UK CPI inflation now at 3.9%, and core inflating beginning to moderate (5.1%), markets are voicing a view that rate cuts should begin in Q1 2024/25, some way ahead of the indications from MPC members. Of course, the data will be the ultimate determinant, so upcoming publications of employment, wages and inflation numbers will be of particular importance, and on-going volatility in Bank Rate expectations and the gilt yield curve can be expected.

In addition, what happens outside of the UK is also critical to movement in gilt yields. The US FOMC has kept short-term rates in the range of 5.25%-5.50%, whilst the ECB has moved its Deposit rate to a probable peak of 4%. Markets currently expect both central banks to start cutting rates in 2024.

## APPENDIX 4

### 4.0 TREASURY MANAGEMENT PRACTICE (TMP1) – CREDIT AND COUNTERPARTY RISK MANAGEMENT

**Specified Investments:** All investments with a high level of credit quality subject to a maturity limit of one year.

**Non-Specified Investments:** Any investments that do not meet the specified investment criteria. These may be of a lower credit quality, for periods in excess of one year, or are more complex instruments which require a greater consideration by members and officers before being authorised for use. 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:

| | Minimum credit criteria | Max % of total investments / £ limit per institution | Max. maturity period |
|---|---|---|---|
| **DMADF – UK Government** | N/A | 100% | Any |
| **UK Government gilts** | UK sovereign rating | 100% | Any |
| **UK Government Treasury bills** | UK sovereign rating | 100% | Any |
| **Money Market Funds CNAV** | AAAmmf/AAA | £2m | Liquid |
| **Money Market Funds LNVAV** | AAAmmf/AAA | £2m | Liquid |
| **Money Market Funds VNAV** | AAAmmf/AAA | £2m | Liquid |
| **Local authorities** | N/A | 100% | Any |
| **Term deposits with banks and building societies** | F1 (Fitch) / £1bn asset base for building societies | £5m | 2 Years |
| **Term deposits with Non-UK banks and building societies** | Sovereign Fitch rating of AAA | £3m | 1 Year |
| **Gilt funds** | UK sovereign rating | 100% | Any |
| **Property funds** | LA Property Fund | £5m | Ongoing |

In addition to the minimum credit criteria outlined in the above table, all term deposits with banks and building societies will be subject to the maximum recommended duration set out by Link Group.

**Accounting treatment of investments.** The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by the Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

**Environmental, Social and Governance (ESG) factors.** Following changes to the CIPFA Treasury Management Code 2021, the Council is required to consider ESG factors as part of its investment policy. This is a new and evolving area within the short-term financial markets, so the impact on investment decisions will be limited for the coming year.

**Governance** is by far the most important part of ESG when considering treasury investments, as this is most likely to impact on the financial performance of an entity and its ability to repay deposits. Governance issues already play a role in the selection of acceptable investment counterparties, as any banks or building societies with significant governance concerns are unlikely to achieve the high credit ratings required for the Council to deposit funds.

**Environmental and Social** factors have less of an impact when considering short-term investments. This is because investments specifically for environmental or social gain are typically longer term and inherently more risky, which isn’t aligned with the Security, Liquidity and Yield (SLY) principle the Council currently follows. Only the larger banks and building societies are able to achieve the credit ratings required by the Council, all of which are likely to have environmental and social aims broadly aligned with that of the Council, so further consideration of these factors are currently unlikely to influence the Council’s investment decisions.

Further work on ESG is required by the financial markets before the Council can incorporate this into its investment policy. Trying to do this too early could result in artificially limiting potential counterparty options, thus decreasing diversification and increasing financial risk. This could then lead to the need to widen credit criteria to find more counterparties, again increasing financial risk beyond what is considered prudent and acceptable. Members will be updated on any significant advances by the financial markets that could allow the formulation of ESG criteria to include in the Council’s investment policy.

## APPENDIX 5

## 5.0 APPROVED COUNTRIES FOR INVESTMENTS

AAA

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

The sovereign ratings shown above are at 11 January 2024 from Link Group.

## APPENDIX 6

## 6.0 TREASURY MANAGEMENT SCHEME OF DELEGATION

### (i) Full Council

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.

### (ii) Cabinet

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;
- approving the selection of external service providers and agreeing terms of appointment.

### (iii) Cabinet

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

### (iv) Delegation from the S151 (Deputy Chief Executive) to the nominated post(s) for the taking of the investment decisions:

- Corporate Manager for Finance and Procurement (Deputy S151)

## APPENDIX 7

## 7.0 THE TREASURY MANAGEMENT ROLE OF THE SECTION 151 OFFICER

### The S151 (responsible) officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers;
- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe for example 25+ years;
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money;
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority;
- ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing;
- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources;
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities;
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees;
- ensuring that members are adequately informed and understand the risk exposures taken on by an authority;
- ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above;
- creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed, to include the following
    - *Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;*

    - *Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;*

- *Decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;*

- *Reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken;*

- *Training and qualifications (TMP10 and schedules), including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.*