APPENDIX 1

Open Report on behalf of Andrew Crookham, Executive Director - Resources

Report to:	**Councillor M J Hill, OBE, Leader of the Council (Executive Councillor for Resources, Communications and Commissioning)**
Date:	**Between 14 and 18 March 2022**
Subject:	**Treasury Management Strategy Statement and Annual Investment Strategy for Treasury Investments 2022/23**
Decision Reference:	**I025456**
Key decision?	**No**

Summary:

The Treasury Management Strategy Statement is an annual statement that sets out the expected treasury activities for the forthcoming year 2022/23. These activities include the Council's expected borrowing and treasury investments, cashflows and banking.

Annual strategies for the Council's borrowing and treasury investments are included as part of this Report, as well as the Council's Minimum Revenue Provision Policy Statement and the Annual Investment Strategy for Treasury Investments which sets out the Council's policies for investing its surplus cash for the year ahead taking into account the risks involved.

This report meets the requirements of the 2017 CIPFA Code of Practice for Treasury Management in the Public Sector, (adopted in the Council's Financial Regulations), and also the Local Governement Act 2003 and MHCLG Government Guidance. Elements of the 2021 CIPFA Code of Practice and Prudential Code, issued in December 2021, have been introduced in this report, but full adoption of these Code revisions will be included in the Strategy for 2023/24.

Approval for this Strategy Statement and Annual Investment Stategy is required by the Leader of the Council (Executive Councillor for Resources, Communications and Commissioning).

Recommendation:

That the Leader of the Council Leader of the Council (Executive Councillor for Resources, Communications and Commissioning):

Approves the Treasury Management Strategy Statement for 2022/23, including the Annual Investment Strategy Statement for Treasury Investments 2022/23 and the Minimum Reveunue Provision Policy Statement contained within the Statement for the year ahead.

Alternatives Considered:	
1.	Not to approve the strategies or to approve amended strategies.

Reasons for Recommendation:
The Council's Financial Regulations require the Council to prepare annually a Treasury Management Strategy Statement (including an Annual Investment Strategy Statement for Treasury Investments and a Minimum Revenue Provision Policy Statement). The strategies proposed in this Report have been developed with regard to relevant Guidance and in accordance with the Council's financial policies. They are aligned to the Council's Prudential Indicators. The advice of the Council's Treasury Management advisor has been taken during the course of developing the strategy and the proposals in this report are considered to be the most appropriate approach for the Council to adopt.

1. INTRODUCTION / BACKGROUND

1.1. Background

1.1.1. CIPFA defines treasury management as:

'The management of the Council's borrowing, investments and cash flows, including its banking, money market and capital market transactions, the effective control of the risks associated with those activities, and the pursuit of optimum performance consistent with those risks.'

1.1.2. The main functions of treasury management are outlined in the table below.

• Cash Flow	Cash raised during the year meets cash expenditure as part of a balanced budget. This cash flow is planned and managed to ensure cash is available when needed. (Investing surplus cash or short-term borrowing for predicted shortfalls).
• Investing Surplus Monies	Surplus monies are invested in accordance with the Council's low risk appetite and in line with its liquidity requirements. The Council outlines its investment policy and investment risk appetite within its **Annual Investment Strategy**. Risk appetite is low as security of investments is paramount over any returns made.

• Borrowing (Long Term) to fund Capital Plans.	The Council's capital plans provide a guide to the longer-term borrowing need of the Council; essentially longer term cash flow planning. Both external and internal borrowing, (using long term cash surpluses), is done to manage this long-term cash flow requirement.

1.1.3. These functions are critical to the Council, as the management of both debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due both in the short and long term for both revenue and capital projects. The minimisation of interest costs on borrowing and the maximisation of interest earned on investments, subject to the security of the sums invested, also play a significant role to the available resources of the Council.

1.2. Relevant Treasury Management Regulation / Legislation

1.2.1. The Council's treasury management activities are governed and meet the requirements of the following regulations, legislation and guidance:

- The Local Government Act 2003.
- CIPFA Prudential Code 2017/2021.
- MHCLG MRP Guidance 2018.
- CIPFA Treasury Management Code 2017/2021.
- MHCLG Investment Guidance 2018.

The Council has also adopted the key requirements of the CIPFA Treasury Management Code as part of its **Financial Regulations** within the **Constitution**.

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

- attribute all investments and investment income to one of the following three purposes: **Treasury Management**, **Service Delivery** and **Commercial Return**;
- clarify what CIPFA expects a local authority to borrow for and what they do not view as appropriate. This will include the requirement to set a **proportionate approach to commercial and service capital investment** by setting appropriate Prudential Indicators;
- create new **Investment Practices** to manage risks associated with non-treasury investment (similar to the current Treasury Management Practices);
- require implementation of a policy to review **commercial property**, with a view to divest where appropriate;
- a new requirement to clarify **reporting requirements for service and commercial investment**, (especially where supported by borrowing/leverage);
- a requirement for the Council to adopt a new **debt liability benchmark treasury indicator** to support the financing risk management of the capital financing requirement;

- ensure that any **long term treasury investment** is supported by a business model;
- a requirement to **effectively manage liquidity and longer term cash flow requirements**;
- address **Environmental, Social and Governance (ESG) issues** within the Capital Strategy;
- amendment to TMP1 to address **ESG policy** within the treasury management risk framework;
- amendment to the **knowledge and skills register** for individuals involved in the treasury management function - to be proportionate to the size and complexity of the treasury management conducted by each council.

These new implications will be developed throughout the year and reported on fully within the 2023/24 Treasury Management and Capital Strategies. The debt liability benchmark for 2022/23 will be reported in this Report for reference but developed and adhered to fully in the 2023/24 financial year.

1.3. Reporting Requirements: Treasury Management

1.3.1. The following reporting requirements of the CIPFA Treasury Management Code are met as follows:

- The Treasury Management Strategy, including the Annual Investment Strategy for Treasury Investments and the Council's Minimum Revenue Provision Policy Statement, is submitted to the **Executive Councillor for Resources, Communications and Commissioning** for approval prior to the start of the financial year. It is presented to the **Overview and Scrutiny Management Board** prior to this decision for scrutiny comment.
- **Quarterly update reports** will then be presented to the Overview and Scrutiny Management Board throughout the financial year which will monitor and report on actual treasury activity against the approved Strategy.

1.3.2. The aim of these reporting arrangements is to ensure that those with ultimate responsibility for the treasury management function appreciate fully the implications of treasury management policies and activities, and that those implementing policies and executing transactions have properly fulfilled their responsibilities regarding delegation and reporting.

1.4. Treasury Management Training

1.4.1. The importance of ensuring that all staff involved in the treasury management function are fully equipped to undertake the duties and responsibilities allocated to them are recognised by the Council and it is the responsibility of the Section 151 Officer to implement the necessary arrangements to ensure this takes place.

1.4.2. The Council seeks to appoint individuals who are both capable and suitably experienced and will provide training for staff to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills.

1.4.3. All treasury management staff are encouraged to take any suitable training in treasury management provided by CIPFA, Link Asset Services Ltd or other relevant market participant. The Treasury Manager, Treasury Officer and Corporate Head of Finance for the Council have all successfully gained the CIPFA/ACT qualification in International Treasury Management (Public Finance) (Cert ITM-PF).

1.4.4. The Section 151 Officer will ensure that elected members tasked with treasury management responsibilities, including those responsible for scrutiny have access to training relevant to their needs and those responsibilities.

1.5. External Service Providers: Treasury Management

1.5.1. The Council currently uses **Link Asset Services Ltd** as its external treasury management advisers.

1.5.2. The Council recognises that responsibility for treasury management decisions always remains with the Council and will ensure that undue reliance is not placed upon our external service providers.

1.5.3. 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, documented and subjected to regular review.

1.6. Pension Fund Cash

In line with the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009, effective from 1 April 2010, an agreement is in place for the pooling of Pension Fund cash within the surplus Council cash balances for investment. This cash can include both day to day cash balances of the Pension Fund and its Strategic Asset Allocation for Cash at any time.

1.7. Non-Treasury Investments

1.7.1. The CIPFA Codes and Government Guidance were revised in 2017/2018 to include requirements for **non-treasury investments**. In the 2021 Code non-treasury investments have been further split into investments for **Service Delivery** and investments for **Commercial Return**.

1.7.2. Non-treasury investments generally arise from capital expenditure, not from the Council's day to day cashflow activities, and comprise commercial financial assets and property, third party loans supporting service outcomes, investments in subsidiaries and investment in property portfolios.

1.7.3. Non-treasury investments held by the Council are therefore not covered within this Treasury Strategy but are reported within the Council's **Capital Strategy 2022/23**, which will be presented to Full Council for approval on 18 February 2022 along with the County Council Budget for 2022/23. The risks of holding these types of investment and how the Council manages these risks are fully explained within the Capital Strategy as they differ to the risks relating to Treasury Investments as outlined in this document.

2. TREASURY MANAGEMENT STRATEGY STATEMENT 2022/2023

2.1. Introduction

2.1.1. The Treasury Management Strategy for 2022/23 is based upon the capital and revenue expenditure plans of the Council and the Treasury Officers' current views on interest rates for the year ahead.

2.1.2. Both capital and treasury management issues are covered in the following three areas of the Strategy as detailed below:

1- Prospect For Interest Rates 2022 to 2025 and Economic Commentary	
2- Borrowing	
- Borrowing Requirement 2021/22 to 2024/25	
- Associated Prudential Indicators (PI), including:	
▪ Capital Expenditure and Financing Plans.	PI 1
▪ Capital Financing Requirement & Debt Liability Benchmark.	PI 2,9
▪ Affordable Borrowing Limit 2022/23 to 2024/25.	PI 3
▪ **Minimum Revenue Provision (MRP) Policy.**	**PI 6**
▪ Borrowing in Advance of Need Policy.	PI 13
▪ Interest Rate Exposure Re Borrowing.	PI 12
- Debt Rescheduling.	
- Borrowing Performance Benchmark.	
- Long Term Borrowing –Factors for Consideration 2022/23.	
- **Long Term Borrowing Strategy for 2022/23.**	
3- Investments	
- Annual Investment Strategy for Treasury Investments 2022/23	
- Interest Rate Exposure re Investments.	PI 12
- Short Term and Long-Term Cash Flow Management.	
▪ Liquidity of Investments.	PI 11
- Treasury Investment Performance Benchmark.	
- Treasury Investments – Factors for Consideration 2022/23.	
- Treasury Investment Strategy for 2022/23.	

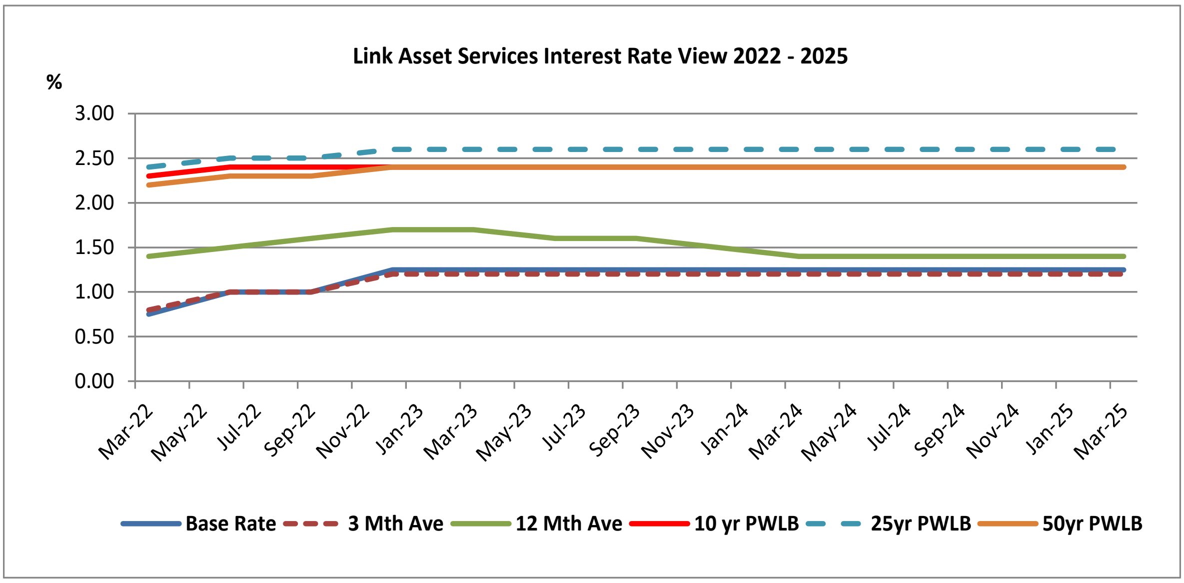
2.1.3. To place this Treasury Management Strategy in context, the table below shows the Council's net treasury portfolio position on 31 December 2021 compared to the start of the year, with associated average percentage costs/returns. It shows the net borrowing position of the Council as follows:

	1 Apr 2021		31 Dec 2021	
	Principal £m	Ave Rate %	Principal £m	Ave Rate %
PWLB Debt	(467.186)	3.75%	(456.122)	3.72%
LOBO Debt	(20.000)	4.00%	(20.000)	4.00%
Long Term Borrowing	(487.186)	3.74%	(476.122)	3.73%
Fixed Deposits	214.450	0.43%	149.870	0.29%
Bonds	0.000	0.00%	56.258	0.17%
Certificates of Deposit	27.000	0.20%	22.000	0.49%
Call & O/N	80.000	0.35%	73.100	0.41%
Money Market Funds	38.225	0.10%	52.435	0.07%
Treasury Investments*	359.675	0.52%	353.663	0.28%
Net Borrowing	(127.511)		(122.459)	

** Note this balance excludes non-treasury investments but includes Pension Fund cash.*

2.2. <u>Prospect for Interest Rates 2022 to 2025 and Economic Commentary</u>

2.2.1. Link Asset Services provided their view for both short term and longer-term interest rates for the following three years to March 2025 on 7 February 2022, considering the current outlook for the UK Economy. This is summarised in the graph below.



2.2.2. The Monetary Policy Committee (MPC) increased Bank Rate on 16 December 2021 to 0.25% and then again to 0.50% on 3 February 2022, showing that they are more focused on combating the spike in inflation than on protecting economic growth. This latter increase was nearly 0.50% but voted down to 0.25% by a narrow margin of 5 to 4. Markets are now expecting that further increases in Bank Rate will come faster now than previously forecast and the graph above shows that Link expect **further 0.25% increases in Bank Rate in March, May and November 2022 to end at 1.25% during the forecast period**. Link believe that Bank Rate will then remain flat at 1.25% to 2025, as the MPC will switch its focus to supporting economic growth, once inflation is controlled.

2.2.3. Long term rates have been highly volatile since October 2021 and rose sharply in mid-December following the increase in Bank Rate by the MPC to tackle the inflation concerns. In addition, inflation increases in the US and subsequent rise in US treasury yields have exerted upward pressure on gilt yields. Shorter dated gilts have increased with the increase in Bank Rate, whilst medium/longer dated gilts have been impacted by inflation concerns. The result is a flattening of the yield curve, as shown in the graph above. (i.e., little difference in yield for any period, long or short). Link show little overall increase in gilt yields during the forecast period out to 2025, from this recent increase, however there is a lot of unpredictable volatility during the forecast period. As part of its forward guidance on its intended monetary policy, the MPC will stop reinvesting maturing gilts as part of quantitative easing program now that Bank Rate is 0.50% and will start selling its holdings once bank rate hits 1.00%. It is yet to be seen what effect this will have on gilt prices.

2.2.4. A more detailed forecast for interest rates is shown in **Annex A** that also includes a view from Capital Economics, a leading city institution. A more detailed commentary of the path of future interest rates and economic outlook, from Link Asset Services, can be found in **Annex B**.

2.2.5. A summary of this economic outlook, that will set the backdrop to the Council's treasury management activity in 2022/23, is detailed below:

- **GDP growth** – The MPC revised down its GDP growth forecast for 2022 from 3.75% to 3.25% due to the hit to households' real incomes from higher inflation, that will impact on Consumer spending.

- **CPI inflation** – The MPC increased its forecast for inflation to reach a peak of 7.25% in April, well above its 2% target. The current energy contribution to CPI inflation of 2% to 3% is thought will fade over the next year. The MPC forecast inflation to be only 1.6% in three years' time, maybe 1.25% if energy price increases fall out sooner. This indicates therefore that the MPC's 2% target for inflation will be reached again without having to increase Bank Rate beyond 1.50% at current forecasts.
- **Labour Market/Wage Growth** – The MPC is concerned at how tight the labour market is with vacancies at near record levels and a general shortage of workers. New claims for pay increases may also help to entrench wage inflation, which is another concern.

2.2.6. The economic outlook and structure of market interest rates have several key treasury management implications for the year ahead as follows:

- **Investment returns are expected to increase in 2022/23 to around 1.25% by the financial year end.** It is advantageous to keep investments short in duration in an increasing interest rate environment to take advantage of increasing yields.
- Liquid investments such as Money Market Funds will see yields improve but there may be a time lag compared to market yield increases.
- **Borrowing interest rates** fell to historically low rates as a result of Covid and Quantitative Easing (QE) operations and have increased recently, but remain at relatively low levels with little further increase in yields expected for the following year. Yields in all periods are relatively the same with value to be found at the short end of the curve or the long end. Due to unpredictability rates will remain volatile as markets react to events as they occur.
- **There is still a gap of around 1% to 1.5%** between short term rates and long-term rates and so any external borrowing undertaken will therefore incur a **cost of carry,** i.e.) a revenue loss between borrowing costs and investment returns, in the medium term.

2.3. Borrowing

2.3.1. Borrowing Requirement Estimates 2021/22 to 2024/25

The **long term borrowing requirement** plans for the Council come from the Council's **capital expenditure and financing plans** which form part of the Council Budget each year.

The **affordability, prudence and sustainability** of the capital expenditure and financing plans are assessed / demonstrated by setting a series of **Prudential Indicators and Limits** each year, as required by the CIPFA Prudential Code. **Annex C** shows these Prudential Indicators, actuals for 2020/21 and estimated for 2021/22 through to 2024/25. These are submitted with the Council Budget 2022/23 Report, due to be considered at the meeting of the County Council on 18 February 2022. A more detailed explanation of the Prudential Indicators linked to borrowing is provided in 2.3.2 below.

2.3.2. **Prudential Indicators Associated with Borrowing**

PI 1 -Capital Expenditure and Financing Plans

The table below shows the Council's **capital expenditure plans** for the reporting period and the element of this expenditure which is not to be financed straight away from cash resource or grants, hence, to be financed at a future date by borrowing (**i.e. the borrowing requirement**). The table also shows the amount of external borrowing taken which is due to mature over the reporting period which impacts on the total indebtedness of the Council.

	Estimate 2021/22 £m	Estimate 2022/23 £m	Estimate 2023/24 £m	Estimate 2024/25 £m	Total £m
Capital Expenditure Plans (Gross)	229.688	150.364	56.042	18.154	**454.248**
New Borrowing Requirement	87.153	114.436	52.888	17.954	**272.431**
Maturing Borrowing Requirement	11.064	8.354	10.329	8.304	**38.051**

PI 2 - Capital Financing Requirement and PI 9 -Debt Liability Benchmark

The Capital Financing Requirement (CFR) is a measure of the amount of capital expenditure that the Council has already spent that has yet to be funded from cash resources, i.e., the Council's total indebtedness or **need to borrow for capital financing purposes**. Credit arrangements (finance leases and private finance initiatives) are also included in the CFR as they have the same practical impact as borrowing. The CFR is **increased** each year by the **new borrowing / credit arrangement requirement,** as highlighted in the table above, and **reduced** each year by the **Minimum Revenue Provision (MRP)**, or the Council's repayment of debt provision. The Council's current policy for MRP is outlined in **Annex D**. The Council's current CFR based on its current borrowing requirement and MRP plans can be seen on the graph in **Annex E** – This is **the purple line** on the graph. This shows that the CFR will peak in around five years as borrowing requirement exceeds MRP, then it gradually reduces from this point as MRP repayment exceeds any borrowing requirement needed. It also shows that the CFR is a long way above actual external borrowing taken (shown by the **blue** and **orange** bars), which highlights the level of borrowing requirement the Council has chosen to **finance internally** from its cash resource (Internal Borrowing).

The **Debt Liability Benchmark** is a new Treasury Indicator introduced in the revised 2021 CIPFA Code, and it introduces the concept of focusing on **net indebtedness** when making decisions on how much external borrowing to undertake to meet the borrowing requirement plans of the Council. Net indebtedness is the level of the Council's cash resource and reserves net of its borrowing liabilities. This is shown on the graph in **Annex E** as the **green dashed line**. Add to this, the level of cash the Council is comfortable with for ongoing cash flow liquidity, and this results in the Debt Liability benchmark (the **red line** on the graph), i.e., the level of debt you need to keep investments at the **chosen Liquidity Investment Benchmark** level which is shown as the yellow line on the graph, and has been set at £100m for the current time.

As indicated on the graph, the areas covered by the red boxes indicate where the level of the Council's external debt exceeds the Liability Benchmark and hence the Code is advising that no further external borrowing is needed in these periods. This should have the effect of bringing cash resources down to the £100m investment benchmark, by increasing the internal borrowing level.

The above outcome bears similarities to the existing plans for external borrowing in 2021/22, where it has been decided that no external borrowing is required, and internal borrowing is forecast to rise to £198m for the year.

It is worth noting that this new Debt Liability Benchmark will be developed and refined over the forthcoming year, including development of cashflow and reserves information that the benchmark relies on. For this initial year therefore the Debt Liability Benchmark is shown for reporting purposes only.

PI 3 - Affordable Borrowing Limit for 2022/2023 to 2024/2025

The Council has a statutory duty to determine and keep under review how much it can afford to borrow i.e., to determine its "**Affordable Borrowing Limit**" or the **Authorised Limit for External Borrowing** which is another Prudential Indicator.

The Borrowing Limit set must be affordable, prudent and sustainable so that the borrowing impact upon future council tax levels is acceptable and affordable to sustain a balanced budget. The limit includes both external borrowing and credit arrangements (finance leasing and PFI) and is set on a rolling basis for the forthcoming financial year and two successive financial years. Once set this limit should not be breached.

The Executive Director of Resources has responsibility to set the Authorised Borrowing Limit, to monitor the limit and to report to the **Executive Councillor for Resources, Communications and Commissioning**, if he is of the view that the limit is likely to be breached. The Executive Councillor has then to decide to take appropriate action for the limit not to be breached or to raise the limit if prudent to do so.

The Council's **Authorised Limit for External Debt for 2022/23 to 2024/25** is shown in the table below. The Council's actual external debt forecast, as shown in the graph in **Annex E**, falls well within these limits set.

	2022/23 £million	2023/24 £million	2024/25 £million
Borrowing	659.512	676.682	671.335
Other Long Term Liabilities	11.017	9.718	8.543
TOTAL	**670.529**	**686.400**	**679.878**

PI 6 – Minimum Revenue Provision (MRP) Policy

Financing capital expenditure by borrowing allows the Council to incur capital expenditure that it does not immediately fund from cash resources. Instead, the Council sets cash resource aside from the Revenue Budget each year to repay the borrowing. This practice is referred to as making **minimum revenue provision (or MRP) for the repayment of debt.**

Regulation and Statutory Guidance requires the Council to produce a **Minimum Revenue Provision (MRP) Policy Statement** in advance of each year, which sets out options followed to calculate, as a minimum, a **prudent MRP charge.** Voluntary Revenue Provision (VRP), over and above the statutory MRP can be made if desired and this can be reclaimed if deemed necessary or prudent.

The Council's MRP Policy Statement for 2022/23 is detailed in **Annex D**. This policy uses the **average life** and **straight-line repayment methods** to calculate the MRP charge, in accordance with the latest Guidance.

Following this policy, the MRP and VRP charge calculated for 2021/22 to 2024/25, based on the borrowing requirement above, is shown in the table below:

	Estimate 2021/22 £m	Estimate 2022/23 £m	Estimate 2023/24 £m	Estimate 2024/25 £m
Minimum Revenue Provision (MRP)	12.854*	25.009	30.107	32.969
Voluntary Revenue Provision (VRP)	0.000	0.000	0.000	0.000

**Note: Following a review of the current MRP Policy undertaken by Link Asset Services in 2021/22, the MRP provision in 2021/22 has been corrected by £7.6m to account for some MRP calculation errors dating back to 2009/10. This saving will be taken in the 2021/22 year.*

The Council's policy at present is to **actually repay** external debt at the MRP level, (not just make a provision against revenue balances), and as a measure of **affordability** the following voluntary Prudential Indicator (No 6) has been set:

MRP and Interest as a percentage of the Council's Income will not exceed 10%

Annex C shows that projected MRP and Interest to 2024/25 is well under this 10% limit – see PI 6.

In future this policy may have to change to adapt to the new Liability Benchmark as a method of managing future debt levels.

PI 13 – Policy for Borrowing in Advance of Need

The Council has set a Voluntary Prudential Indicator (No 13) which sets an upper limit for borrowing in advance of need to 25% of the expected increase in CFR over a three year budget period as shown in Annex C.

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 considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds. In determining whether borrowing will be undertaken in advance of need the Council will:

- ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need, including adherence to the Debt Liability Benchmark indicator.
- ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered.
- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow.
- consider the merits and demerits of alternative forms of funding.
- consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use.

PI 12 - Interest Rate Exposure –Borrowing

Long term loans are usually secured at fixed rates of interest, to provide certainty over the cost of maintaining the loans over their lifetime. However up to **30%** of all borrowing could alternatively be secured at **variable rates of interest**. This is a voluntary Prudential Indicator - Number 12 as shown in **Annex C**. This may be appropriate if, for example, funding is required for a relatively short period, or if the Council wishes to defer locking into fixed rate loans because the interest rate forecast indicates that interest rates will be lower than the prevailing rate in the near term.

2.3.3. **Debt Rescheduling**

Debt rescheduling involves repaying existing loans and replacing these with new loans at different terms for the prime objective of generating financial savings on interest paid.

The Council’s Financial Strategy states that **‘the Council will actively pursue debt rescheduling to the extent that it will generate financial savings without adding significantly to the overall debt burden**’.

Repaying debt early does incur a premium[1] or discount[2] depending on the current level of interest rates compared to the rate of interest on the debt repaid. The following strategy will be followed when undertaking any debt rescheduling:

- The timing of any rescheduling during the year will take place to minimise premium or maximise the discount available. This is achieved by repaying loans at a peak in current interest rate levels to reduce the amount of premium due and locking into replacement loans at a trough in current interest rates. This strategy can incur an interest cost due to the delay in replacing debt repaid or interest can be made by borrowing in advance of repaying debt. There is also a level of interest rate risk of any timing decision.
- Suitable loans will be selected for rescheduling that match out both premium and discounts, thereby eliminating the cash impact to the Council.
- Any positions taken via rescheduling will be in accordance with the borrowing strategy position outlined in 2.3.6 below.
- The appropriate timing of any rescheduling will be monitored throughout 2022/23 by the Council and Link Asset Services Ltd.

To date interest savings have been made by rescheduling existing PWLB EIP[3] loans into PWLB maturity[4] loans and some existing LOBO[5] debt has also been rescheduled into PWLB debt, at the request of the LOBO holder, to generate savings over the remaining term of the loan.

However, PWLB to PWLB debt restructuring is now much less attractive because of the large premiums that would be incurred due to the introduction by the PWLB in 2007 of a spread between the rates applied to new borrowing and repayment of debt.

---

[1] A premium is incurred on repaying a loan early when the interest rate of the loan to be repaid is higher than the current rate available for the remaining duration of the existing loan.

[2] A discount is incurred on repaying a loan early when the interest rate of the loan to be repaid is lower than the current rate available for the remaining duration of the existing loan.

[3] With EIP loans, an equal amount of principal is repaid on a half yearly basis throughout the term of the loan with interest calculated on the reducing balance, hence total payments reduce over the lifetime of the loan.

[4] With Maturity loans, only interest repayments are made during the life of the loan and repayment of principal is made in full at the end of the loan period.

[5] A LOBO is a ‘Lender’s Option, Borrowers Option’ money market loan, whereby the Lender has the option to change the rate of a loan after a designated fixed period of time and the Borrower (LCC) has the option to accept this new rate or repay the loan. The fixed period of time is typically for 1 to 20 years and the total length of the LOBO is typically for 50 to 70 years.

2.3.4. **Borrowing Performance Benchmarks**

The performance of long-term borrowing undertaken will be assessed against the relevant **PWLB rate for the year** for the relevant loan type and interest rate banding. **CIPFA Treasury Management benchmarking** will also be considered to compare with other Councils average borrowing rates for the year. **Reducing or keeping increases to the average rate of the debt portfolio to a minimum** will also be a target indicator.

Short term borrowing will be assessed against the average **Sterling Overnight Index Average (SONIA),** or relevant equivalent, for the year. Short-term borrowing for cash flow purposes will be measured against the current **average yields on Money Market Fund investments.**

2.3.5. **Long Term Borrowing – Factors for Consideration for 2022/23**

- **Forecast for Long Term Interest Rates during 2022/23** – Very little increase in long term rates (of no more than 0.20%) is expected out to 2025 with a flat yield curve over all periods. Significant volatility over the period is expected. (See 2.2.3 and **Annex A and B**).

- **Target Rates for Borrowing (Source: Link Asset Services Ltd 8/2/2022) –** see below:

Period	Target Rate
50 Years	2.20%
25 Years	2.40%
10 Years	2.30%
5 Years	2.20%

- **The Council's Debt Liability Benchmark for 2022/23** can be seen at **Annex E**. This indicates that existing debt in 2022/23 already exceeds the Debt Liability Benchmark, where the Investment Liquidity benchmark is set at £100m. This will be taken into consideration as the Liability Benchmark is refined during the year. If any external borrowing is taken during 2022/23, this will fill gaps in the Council's existing maturity profile at prevailing rates of interest.

- **Type of Debt**: An appropriate balance between PWLB and other types of fixed period debt from the market should be maintained in the debt portfolio. As such the following limits for **type of debt** against the total debt portfolio, should be followed:

Type of Debt	Limit
PWLB Debt	100%
Market Debt (Fixed term market institution debt).	20%
LOBO Debt	10%
Short Term (up to 10 years) Local Authority Debt	100%

2.3.6. **Long Term Borrowing Strategy 2022/23**

Given the factors detailed above, the following **borrowing strategy** will be adopted for 2022/23:

- **Regard will be made to the Debt Liability Benchmark, as it is refined during 2022/23, before any new borrowing is undertaken, taking into consideration the cash balance of the Council.**
- **Any new borrowing taken from the PWLB will be taken in all periods with the aim of achieving an even spread of maturity profile and keeping an increase in the average cost of the Council's debt to a minimum.**
- **Target levels will be monitored, and timing of borrowing taken will coincide with any reduced rate opportunity below the target levels identified.**
- **Consideration will be given to borrowing market loans or LOBOs, to fit into the above maturity strategy and limits, in order to take advantage of the lower rates offered on these loans.**
- **Short-term borrowing from the money markets or other local authorities will be considered if appropriate.**
- **Borrowing in advance of need will be undertaken during the year if considered appropriate in accordance with the Council's policy as detailed in 2.3.2, PI 13 above.**

2.3.7. To support the above strategy, prevailing interest rates and market forecasts will be continually monitored throughout the year and appropriate borrowing actions, including debt rescheduling if appropriate, will be taken in response to any sharp rise or fall in long- and short-term interest rates occurring throughout the year.

2.4. Investments

2.4.1. Annual Investment Strategy for Treasury Investments 2022/23

Regulation and Statutory Guidance requires the Council to produce an **Annual Investment Strategy** in advance of each year which indicates the type of treasury and non-treasury investments permitted against a given level of risk adopted for each type. This is shown in **Annex F**.

(Note: The Investment Strategy for Non-Treasury Investments is reported separately within the Capital Strategy Report 2022/23, as Non-Treasury Investments have a different risk profile to that of Treasury Investments).

The Council's **risk level** adopted for its Treasury Investments is **low** to achieve the following investment priorities:

- **the security of capital and**
- **the liquidity of its investments**

The Council will aim to achieve the optimum return on its treasury investments commensurate with proper levels of security and liquidity.

The Treasury Investment Strategy outlines the **Specified** and **Non-Specified Investments** that the Council deems acceptable given the level of risk it has adopted. Authorised counterparties, lending limits and maturity limits are set using credit worthiness methodology from Link Asset Services Ltd and an approved **Counterparty Investment Lending List** is formulated from this methodology. (See **Annex G**). These limits increase depending on the level of average Investment Balance at any time. All treasury investments will be made in accordance with the Annual Investment Strategy and Approved Lending List and any breaches during the year will be reported to the Executive Director of Resources.

2.4.2. Interest Rate Exposure re Investments PI 12

As a general guide, term deposits are usually at a **fixed rate** of interest, whereas amounts invested on call (to maintain sufficient liquidity in the investment portfolio) are usually at **variable rates** of interest. Fixed investments of up to two years are considered acceptable to good quality counterparties, limits permitting, where above market rates are achievable and sufficient liquidity is available, as a way of enhancing investment return. In a forecast rising interest rate scenario, fixed deposits should be pegged to coincide with the forecast increase periods at market levels. **There are no upper limits set to variable rate investments.**

2.4.3. **Short Term and Long-Term Cash Flow Management**

Liquidity of Investments – PI 11

Liquidity is defined as having adequate, but not excessive cash resources, borrowing arrangements and overdraft or standby facilities to ensure that funds are available, always, for the achievement of the Council's objectives.

The Council's investment level is forecast to be around **£250 million** net of Pension Fund cash in 2022/23, of which around **£150 million** can be identified as 'core' balances which will be available to invest for longer periods of investment. The remaining balance of cash is cash-flow driven.

If no external borrowing is undertaken in 2022/23 in accordance with the new Debt Liability Benchmark, then the level of investment should drop to the cash flow driven level of around £100 million.

The following measures and limits have been put in place to manage the liquidity of the Council:

- The Council will seek to maintain **liquid short-term deposits** of at least **£25m** available within a week's notice.
- **Prudential Indicator Number 11** has been set to place an upper limit to investments made over 365 days to **£40m.** (See **Annex C**).
- **Temporary Borrowing for Liquidity Purposes -** Temporary short-term borrowing will be taken instead of drawing on investments, when cheaper to do so, in order to minimise the loss of interest from withdrawing funds at higher rate from call or deposit accounts to maintain liquidity.

2.4.4. **Treasury Investment Performance Benchmark**

The target investment return for investments for 2022/23 is the Sterling Overnight Index Average or SONIA rate. This rate has replaced the LIBOR/LIBID reference rate that ceased on 31 December 2021. SONIA is the risk-free rate for sterling markets administered by the Bank of England. It represents the average overnight rate that banks and financial institutions will lend overnight to each other during Sterling Clearing Operations. This is a relative benchmark which moves with the markets, however the rate is not representative of what general Money Market participants, such as the Council, can achieve, due to size and available counterparties. It is also just an average rate with no Bid/Offer spread. (The LIBOR/LIBID spread was around 0.12%).

To make the SONIA rate into a relevant benchmark to use therefore will require some adjustment. The initial benchmark rate that will be used therefore will be **SONIA less 0.10%,** but this will be reviewed during the year as more data becomes available with help from Link Asset Services.

Investment performance will also be compared against **benchmarking data provided by both CIPFA and Link Asset Services.**

2.4.5. **Investments –Factors for Consideration for 2022/23**

- **Forecast for Short Term Interest Rates during 2022/23** - A series of 0.25% increases in Bank Rate are expected in the year to reach 1.25% by November 2022, at which point Bank Rate is expected to remain flat to 2025. (**See 2.21 and Annex A and B**).
- **Reduced Investment Level -** Cash available for Investment may be reduced to the target Investment Benchmark of £100m, if the Debt Liability Benchmark is followed during the year and no external borrowing is undertaken.
- **Enhanced Money Market Funds** – A review of Enhanced Money Market Funds (VNAV) will be undertaken during 2022/23. These funds are Non-Specified Investments within our Annual Investment Strategy and offer slightly higher yields than existing funds but have different risk parameters and access restrictions. The results of the review will be reported to members during the year accordingly, with approval sought from the Executive Councillor for Resources, Communications and Commissioning to open any new Funds if appropriate.
- **Annual Investment Strategy for Treasury Investments** – permitted counterparties, types of investments and all limits, as detailed in the Annual Investment Strategy, and amended, when necessary, should be adhered to throughout the year.
- **ESG Investments** – Any Economic, Social and Governance (ESG) Investments will be considered, provided they meet the counterparty criteria and risk parameters as set out in the Annual Investment Strategy.

2.4.6. **Treasury Investment Strategy for 2022/23**

Given these factors above, the following **investment strategy** will be adopted for 2022/23:

- **For the element of the Council's investment portfolio that represents 'core' balances, investments will be made in all periods of three months to two years, to acceptable counterparties, to lock into rates in excess of the predicted base rate level.**

- **The Council will avoid locking into longer term deals (beyond one year) while investment rates are down at historically low levels and forecast to rise, unless exceptionally attractive rates are available which make longer term deals worthwhile.**

- **Extensive use of Bank Business Reserve Accounts and Money Market Funds[6] will be made, that offer returns close to or in excess of base rate level, for the Council's 'core' cash and cash flow generated balances.**

- **Investment in Certificates of Deposit[7], Treasury/LA Bills[8], Dated Bonds held to maturity[9] and Repo[10] will also be considered where appropriate.**

- **Short dated deposits (overnight to one month) will also be made for the Council's cash-flow generated balances in order to benefit from compounding of interest.**

In addition to the above strategy, prevailing interest rates and market forecasts will be continually monitored throughout the year and appropriate investment actions will be taken in response to any sharp rise or fall in long and short-term interest rates occurring throughout the year.

---

[6] Pooled investment vehicles offering returns equivalent of up to 1 month cash deposits whose assets comprise of cash type investments such as Certificates of Deposit, Commercial Paper and Cash Deposits.

[7] A bearer instrument which certifies that a sum of money has been deposited with the bank issuing the certificate at a fixed yield and on the stated maturity date the deposit is repaid with interest. The maturity length is typically from 1 month to 1 year.

[8] Short term securities issued by HM Treasury on a discounted basis i.e. issued below 100, with 100 being received on maturity with the difference equalling the interest return.

[9] A debt security instrument that governments, supranationals, and companies sell to investors (issue) to finance a variety of projects and activities. The investor buys the bond and receives fixed or variable coupons (interest) in return. Bonds can be dated (mature/repayable on a certain date) or non-dated (never mature). Bonds are tradeable (can be bought and sold) and hence the price of a bond fluctuates over its life. The total yield (return) on a bond for investor equals the npv of the cashflows (e.g. price paid, coupons received, nominal value received on maturity).

[10] A Repo is a form of securitised lending based on a Global Master Repo Agreement (GMRA 2000). Collateral is pledged against each loan made under a Repo Agreement, usually consisting of Gilts or Treasury Bills or acceptable Corporate Bonds. This collateral passes to the Lender in the case of a default of the loan with the original Counterparty.

3. Legal Issues:

Equality Act 2010

Under section 149 of the Equality Act 2010, the Council must, in the exercise of its functions, have due regard to the need to:

- Eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by or under the Act.
- Advance equality of opportunity between persons who share a relevant protected characteristic and persons who do not share it.
- Foster good relations between persons who share a relevant protected characteristic and persons who do not share it.

The relevant protected characteristics are age; disability; gender reassignment; pregnancy and maternity; race; religion or belief; sex; and sexual orientation.

Having due regard to the need to advance equality of opportunity involves having due regard, in particular, to the need to:

- Remove or minimise disadvantages suffered by persons who share a relevant protected characteristic that are connected to that characteristic.
- Take steps to meet the needs of persons who share a relevant protected characteristic that are different from the needs of persons who do not share it.
- Encourage persons who share a relevant protected characteristic to participate in public life or in any other activity in which participation by such persons is disproportionately low.

The steps involved in meeting the needs of disabled persons that are different from the needs of persons who are not disabled include, in particular, steps to take account of disabled persons' disabilities.

Having due regard to the need to foster good relations between persons who share a relevant protected characteristic and persons who do not share it involves having due regard, in particular, to the need to tackle prejudice, and promote understanding.

Compliance with the duties in section 149 may involve treating some persons more favourably than others.

The duty cannot be delegated and must be discharged by the decision-maker. To discharge the statutory duty the decision-maker must analyse all the relevant material with the specific statutory obligations in mind. If a risk of adverse impact is identified consideration must be given to measures to avoid that impact as part of the decision making process.

The report details the Treasury Management Strategy for treasury investments and borrowing and the Council's policy for investing surplus cash for the year 2022/23. There are no equalities implications that need to be taken into account by the Executive Councillor.

Joint Strategic Needs Analysis (JSNA) and the Joint Health and Wellbeing Strategy (JHWS)

The Council must have regard to the Joint Strategic Needs Assessment (JSNA) and the Joint Health and Wellbeing Strategy (JHWS) in coming to a decision.

The report details the Treasury Management Strategy for treasury investments and borrowing and the Council's policy for investing surplus cash for the year 2022/23. There are no JSNA or JHWS implications that need to be taken into account by the Executive Councillor.

Crime and Disorder

Under section 17 of the Crime and Disorder Act 1998, the Council must exercise its various functions with due regard to the likely effect of the exercise of those functions on, and the need to do all that it reasonably can to prevent crime and disorder in its area (including anti-social and other behaviour adversely affecting the local environment), the misuse of drugs, alcohol and other substances in its area and re-offending in its area.

The report details the Treasury Management Strategy for treasury investments and borrowing and the Council's policy for investing surplus cash for the year 2022/23. There are no Crime and Disorder implications that need to be taken into account by the Executive Councillor.

4. Conclusion

The Treasury Management Strategy, determining appropriate borrowing and treasury investment decisions, and the Annual Investment Strategy, outlining the Council’s policy for treasury investments, has been set for 2022/23 considering the anticipated economic environment and movement of interest rates for the year ahead. These strategies reflect the requirements of the CIPFA Code of Treasury Management, the CIPFA Prudential Code and the MHCLG Guidance on Local Government Investments. Some elements of the revised CIPFA Codes issued in December 2021 have been included in the Treasury Management Strategy under a soft launch, such as the Debt Liability Benchmark Indicator, and full adoption of the new requirements will be made in the 2023/24 Treasury Management Strategy, as advised by CIPFA. A review of the use of Enhanced Money Market Funds will be undertaken in 2022/23. Based on officer recommendation, this report is presented to the Leader of the Council (Executive Councillor for Resources, Communications and Commissioning) for approval in order to comply with Financial Regulations.

5. Legal Comments:

The Council's Financial Regulations require the Council to annually produce a Treasury Management Strategy setting out expected treasury activities in accordance with the requirements of the CIPFA Code of Practice. CIPFA published revised Treasury Management and Prudential Codes on 20 December 2021 and has stated that formal adoption is not required until the 2023/24 financial year, but the implications of these revisions have been set out in this report. The strategy statement must be submitted to the Leader of the Council (Executive Councillor for Resources, Communications and Commissioning) for approval prior to the commencement of each financial year.

The Financial Regulations also require the production of an Annual Investment Strategy to ensure that Section 15 (1) of the Local Government Act 2003 is complied with, that is that all authorities must "have regard to guidance on investment issued by the Secretary of State" when investing their surplus cash. The strategy also must also be approved by the Leader of the Council (Executive Councillor for Resources, Communications and Commissioning).

This report enables the Council to meet its legal obligations in accordance with the Financial Regulations. The recommendations are lawful and within the remit of the Leader of the Council (Executive Councillor for Resources, Communications and Commissioning).

6. Resource Comments:

This report sets out the Council's Treasury Management Strategy and Investment Strategy for Treasury Investments for the year ahead. The Council requires a Treasury Management Strategy and Investment Strategy for Treasury Investments for the year ahead in order to comply with Financial Regulations.

7. Consultation

a) Has Local Member Been Consulted?

n/a

b) Has Executive Councillor Been Consulted?

Yes

c) Scrutiny Comments

The Overview and Scrutiny Management Board is responsibile for monitoring and scrutiny of the operation of the treasury management policies and practices and as such will consider this report at its meeting on 24 February 2022 and pass any comments to the Executive Councillor for Resources, Communications and Commissioning prior to making a decision.

d) Risks and Impact Analysis

Risk and Impact Analysis for Treasury Management forms TMP1 of the Treasury Management Practices, as required by the CIPFA Code of Practice 2017. A Risk Register which details the main risks for Treasury Management has been completed and is reviewed annually. Both the TMPs and the Risk Register are held in the Treasury Files held on IMP at County Offices.

8. Appendices

These are listed below and attached at the back of the report	
Appendix A	Interest Rate Forecasts 2022/2025
Appendix B	Economic Background - Link Asset Services Ltd
Appendix C	Prudential Indicator Table 2020/21 to 2024/25
Appendix D	Minimum Revenue Provision Policy Statement for Repayment of Debt 2022/23
Appendix E	Liability Benchmark 2022/23
Appendix F	Annual Investment Strategy for Treasury Investments 2022/23
Appendix G	Authorised Lending List Effective 1 April 2022 and Definition of Credit Ratings and Credit Default Swaps

9. Background Papers

The following background papers as defined in the Local Government Act 1972 were relied upon in the writing of this report.

Document title	Where the document can be viewed
County Council Budget 2022/23 – 18 February 2022	https://lincolnshire.moderngov.co.uk/ieListDocuments.aspx?CId=120&MId=6140&Ver=4
LCC Treasury Management Policy Statement and Treasury Management Practices.	Lincolnshire County Council, Resources

This report was written by Karen Tonge, who can be contacted on 01522 553639 or karen.tonge@lincolnshire.gov.uk.