

## Appendix 2 - Treasury Management and investment Strategy

### Contents

Part 1: Treasury Investments .....	3
Treasury Management Policy Statement .....	3
Risk Appetite Statement .....	6
Treasury Investments and Borrowing .....	7
Investment Objective .....	8
Counterparty limits .....	8
Business model for holding investments .....	13
Negative interest rates .....	13
Liquidity Management .....	13
Responsible Investing .....	13
Borrowing .....	14
Borrowing Sources .....	15
Operational Boundary for External Debt.....	15
Authorised Limit for External Debt.....	16
Treasury Management Indicators.....	17
Prudential indicator for the Liability Benchmark .....	17
Security and credit risk.....	17
Maturity Structure of Borrowing .....	18
Prudential limits for long term treasury management investments.....	18
Market and economic risk.....	18
Other Items .....	19
Policy on Use of Financial Derivatives.....	19
Investment of Money Borrowed in Advance of Need .....	20
Investment Training .....	20

Investment Advisers .....	21
Reporting.....	21
Treasury investments .....	21
Other Options Considered .....	22
Part 2 - Commercial Investments .....	23
Security.....	24
Liquidity .....	25
Proportionality – Commercial Investments.....	25
Part 3 - Service Investments .....	26
Governance and suitability .....	27
Approved Service Investments .....	28
Risk Management.....	28
Proportionality – Service investments.....	29
Part 4 - Non-Specified Investments .....	30

# Treasury Management Policy Statement, Treasury Management Strategy Statement and Annual Investment Strategy for 2023/24

## Part 1: Treasury Investments

### Treasury Management Policy Statement

Treasury management within the Council is undertaken in accordance with the CIPFA Code of Practice for Treasury Management in the Public Services and statutory guidance issued by the Department for Levelling Up, Housing and Communities.

The Council defines treasury management as:

“The management of the organisation’s borrowing, financial 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.”

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

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

The Treasury investment policy objective for this Council is the prudent investment of its treasury balances. The Council’s Treasury investment priorities are security of capital and liquidity of its investments so that funds are available for expenditure when needed. Both the Treasury Management Code and the statutory guidance require the Council to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield.

The Authority is currently debt free and its capital expenditure plans do not currently imply any need to borrow over the forecast period. This strategy has been prepared assuming that it will not need to borrow, except for short term cash flow purposes for revenue and capital commitments.

The Authority invests its money for three broad purposes:

- because it has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure (known as treasury management investments);
- to support local public services by lending to or buying shares in other organisations (service investments); and,
- to earn investment income (known as commercial investments where this is the main purpose).

## Treasury Management Strategy

The Council's priority is the security and liquidity of its treasury investments in accordance with the priorities set out in the Treasury Code and the statutory guidance. Whilst fundamentally risk averse, the Council accepts some modest degree of risk within the limits and counterparty restrictions set out in its Treasury Management and Investment Strategy and risk appetite statement

The Chartered Institute of Public Finance and Accountancy's '*Treasury Management in the Public Services: Code of Practice*' (the CIPFA Code) requires the Council to approve a Treasury Management Strategy (TMS) before the start of each financial year.

The Department for Levelling Up, Housing & Communities (DLUHC) also issues guidance on Local Authority Investments (the Guidance). Paragraph 21 of the Guidance makes it clear that, except for the requirement to prioritise Security, Liquidity and Yield in that order of importance, treasury management investments are managed within the principles set out within the CIPFA Code.

The Council's Treasury Management Statement is underpinned by Treasury Management Practices (TMPs) which provide prescriptive information as to how the treasury management function should be carried out.

In accordance with the Guidance, the Council will be asked to approve a revised Treasury Management Strategy should the assumptions on which this report is based change significantly. Such circumstances may include, for example, a large unexpected change in interest rates, or in the Council's capital programme or in the level of its investment balances.

At 30 September 2022 the Council held £115.4m of investments as set out in table 1.

*Table 1: Investment Portfolio Position*

Investments	£m	Return %*
Short term Investments (cash, call accounts, deposits)	18.0	
Money Market Funds	57.4	
<b>Total Liquid Investments</b>	<b>75.4</b>	<b>0.93</b>
External Pooled funds	40.0	3.97
<b>Total Treasury Financial Investments</b>	<b>115.4</b>	<b>1.40</b>
Carried Loss on Fair Value of External Funds	(3.5)	
<b>Current Value of Investments</b>	<b>111.9</b>	

*\*returns are based on Q1 22-23. They are not representative of future returns.*

For the purposes of the limits in this strategy, the position in table 1 is not representative of the long term stable investment position of the Council. The temporary effects of COVID funding have increased the Council’s net funds for investment by around £20m, although officers expect much of this to be settled over the next 12 months.

CIPFA’s Prudential Code for Capital Finance in Local Authorities (“the Prudential Code”) states that, as a minimum, the Council must forecast its liability benchmark for the current and future 2 financial years. This is shown in table 2 below. The Liability Benchmark is effectively the Net Borrowing Requirement of a local authority plus a liquidity allowance. In its simplest form, it is calculated by deducting the amount of investable resources available on the balance sheet (reserves, cash flow balances) from the amount of outstanding external debt and then adding the minimum level of investments required to manage day-to-day cash flow.

The Code requires any substantial mismatches between actual loan debt outstanding and the liability benchmark to be explained. As the Council’s net Treasury position is debt free across the entire forecast period, the Council’s liability benchmark (and Capital Financing Requirement, “CFR”) is also nil or negative across the forecast period, indicating that there is no present need to borrow and no further explanation is required.

From the projection in table 2 the Council has determined that its long-term investments in pooled funds are Treasury, not Commercial, investments. They are therefore managed under part 1 of this strategy. The Council accepts that, should it cease to be debt free, this classification will be reviewed in line with the requirements of the Treasury Code.

Table 2: Liability Benchmark forecast to 31 March 2027 (£m)

	2022 Actual	2023	2024	2025	2026	2027
Capital Financing Requirement	(1)	0	0	0	0	0
Less: Other debt liabilities	0	0	0	(1)	(1)	(1)
Balance sheet resources						
• Usable Reserves	84	76	76	76	76	78
• Working capital	29	6	3	3	3	6
Treasury Investments	112	82	79	78	78	83
Minimum Liquidity Allowance	(10)	(10)	(10)	(10)	(10)	(10)
(Liability)/ Investment Benchmark	102	72	69	68	68	73

The above figures are based on resource projections and include assumptions about timing of transactions that may differ from actual delivery.

An assumption that debt liabilities will increase slightly in 2024/25 due to the implementation of IFRS16 has been incorporated into these forecasts. The Council's operational boundary and authorised debt ceilings are set out in tables 5 and 6 (page 15) and are set at a level that will accommodate possible short-term working capital requirements or any financial lease liabilities that will be recognised following the adoption of IFRS16 on 1 April 2024.

The Liquidity allowance is set at £10m and is the minimum level of funds invested to maintain professional investor status under the relevant financial regulations.

## Risk Appetite Statement

Any investment made by the Council should be proportionate to its financial capacity – so that plausible losses can be absorbed in budgets or reserves without unmanageable detriment to local services

As a debt free authority the Council's highest priority in its treasury management function is the security of those investments in accordance with the priorities set out in the CIPFA Treasury Code. Whilst fundamentally risk averse the Council will however accept some modest degree of risk.

The Council mitigates Treasury investment risk by using counterparty limits based on the available resources to plausible losses, and ensures that investments are diversified across high credit quality counterparties as set out in this strategy.

When investing surplus cash, the Council will not necessarily limit itself to making deposits with the UK Government and local authorities, but may invest in other bodies including certain unrated building societies and money market funds. The Council may also invest surplus funds through tradable instruments such as gilts, treasury bills, certificates of deposit, corporate bonds and pooled funds. The duration of such investments will be carefully considered to limit that risk of them having to be sold (although they may be) prior to maturity, mitigating the risk of the capital sum being diminished through price movements.

For Commercial and Service investments, the Council uses a combination of factors that are set out in parts 2 and 3 of this document.

## **Treasury Investments and Borrowing**

In line with the Council's Treasury Management Policy Statement, treasury management includes all the activities necessary for:

1. Cash management;
2. Liquidity planning and control; and,
3. Corporate finance, including medium and long term financing and investing.

The contribution that treasury investments make to the objectives of the Authority is to support effective treasury management activities. Successfully identifying, monitoring and mitigating risk is the cornerstone of effective treasury management, although the Council acknowledges that effective treasury management also supports the achievement of business and service objectives.

The Authority typically receives its income in cash (e.g. from taxes and grants) before it pays for its expenditure in cash (e.g. through payroll and invoices). It also holds reserves for future expenditure and collects local taxes on behalf of other local authorities and central government. These activities lead to a cash surplus which is invested in accordance with the CIPFA Code.

The stable long-term balance of treasury investments is expected to fluctuate between £82m and £79m during the 2023/24 financial year (table 2, above).

The Council does not intend to borrow any monies, except for short term cash flow purposes for revenue and capital commitments.

## Investment Objective

The Council's objective when investing money is to comply with the principles stated in this strategy document, striking an appropriate balance between risk and return in line with the Council's risk appetite statement.

## Counterparty limits

The Council may invest its surplus funds with any of the counterparties in table 3 below, subject to the cash limits (per counterparty) and time limits shown.

The Authority's available reserves available to cover investment losses are forecast to be £76 million on 31st March 2024.

From this figure the following sums are excluded as they would not be available to fund any loss:

- Forecast CIL balance       £8m
- Capital receipts reserve   £1m

The Authority's expected available reserves to cover any default is therefore £67m.

The Counterparty and sector limits below are set such that no one default will incur a loss of either:

- 10% of the Council's expected average investment balance, equivalent to £8m; or,
- 15% of the Council's available reserves as defined above, equivalent to £12m.

Given the forecasts above, the strategy increases the general counterparty investment limit for 2023/24 to £7m.

The Council's investment with the CCLA property fund has a higher, separate limit. Where this counterparty limits in tables 3 and 4 fall between financial years, any new limit will only apply once existing investments as at 1 April reach the end of their present deposit period. For external pooled funds, the limit applied will be that in force on the date of the investment. Should counterparty limits fall after this date, a balanced view will be taken by the s.151 officer as to when the investment above the new limit will be redeemed.

A group of entities under the same ownership will be treated as a single organisation for counterparty limit purposes.

In addition to the limits set on individual counterparties in table 3 below, table 4 sets limits on any group of pooled funds under the same management.



*Table 3: Approved Investment Counterparties*

<b>Sector</b>	<b>Time limit</b>	<b>Counterparty limit</b>	<b>Sector limit</b>	<b>Notes</b>
The UK Government	50 years	Unlimited	n/a	
Local authorities & other government entities	10 years	£7m	Unlimited	
Secured investments	10 years	£7m	Unlimited	1
Banks (unsecured)	13 months	£3.5m	Unlimited	1,2
Building societies (unsecured)	13 months	£3.5m	£7m	1
Money market funds	n/a	£7m or 0.5% of fund value	Unlimited	1 3
Strategic pooled funds (excluding LAPF)	n/a	£7m	£50m	5
Strategic pooled funds (CCLA - LAPF)	n/a	£15m	£15m	5
Real estate investment trusts	n/a	£2m	£4m	5
Other investments	2 years	£3.5m	£7m	1, 4

*Notes:*

1. *Investments are subject to credit rating floors and/ or other criteria set out 'Minimum credit ratings' below*
2. *The limits for the Council's operational bank account are determined separately and set out in the relevant section below*
3. *Individual limits will be 0.5% of fund value or £7m, whichever is the smaller*
4. *Service and commercial investments will be subject to individual, separate risk assessment and are considered separately in this strategy. They are not covered by the Treasury limits in table 3*
5. *No maximum investment period is set for pooled funds and REITs as they are intended to be for the long term. The limit on strategic pooled funds does not apply to Money Market Fund investments.*

The Council sets limits on the totals to be invested in any one single entity, group of entities, or investment type. These are set out in table 4 and apply to all treasury investments.

Limits are also placed on fund managers, investments in brokers' nominee accounts and foreign countries as below. Investments in pooled funds (including money market funds) and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table 4: Additional investment limits

	Cash limit
Any group of pooled funds under the same management	£20m per manager
Negotiable instruments held in a broker's nominee account	£7m per broker (1)
Foreign countries	£7m per country

1. The limit for nominee accounts does not apply to investments in Money Market Funds and their nominee companies

## Counterparties

### Government

Loans to, and bonds and bills issued or guaranteed by, national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Government are deemed to be zero credit risk due to its ability to create additional currency and therefore may be made in unlimited amounts for up to 50 years

### Secured investments

Investments secured on the borrower's assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments

### Banks and building societies (unsecured)

Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

### Money market funds

Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to

money market funds, the Authority will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

### **Strategic pooled funds**

Bond, equity and property funds that offer enhanced returns over the longer term but are more volatile in the short term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly

Where investments in pooled funds or other financial assets have prices or values that can vary according to fund performance and other factors, the investment limits in table 4 will operate to regulate the initial purchase cost (total initial investment) only.

### **Real estate investment trusts (REIT)**

Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties. Investments in REIT shares cannot be withdrawn but can be sold on the stock market to another investor.

### **Operational bank accounts**

The Authority may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £2.5m in total across all operational accounts.

### **Other investments**

This category covers treasury investments not listed above, for example unsecured corporate bonds and company loans. Non-bank companies cannot be bailed-in but can become insolvent placing the Authority's investment at risk.

For corporate bonds, the limits referred to in table 3 will apply to the sum of bond principal (par value) and any premium or discount paid to acquire the bond in the secondary market. The limit will exclude the accrued interest element paid to secure a secondary bond as this is recoverable on maturity of the Bond.

## **Risk Assessment and Credit Ratings**

Credit ratings are obtained and monitored by the Council's treasury advisors, who will notify changes in the ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made;
- any existing investments that can be recalled or sold at no cost will be; and,
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

If in the case of a decision to recall or sell an investment at a cost which is over the approved virement limits, the Council's urgent action procedure in its Constitution would be invoked by officers.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn in a timely manner will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

### **Minimum credit rating**

Treasury investments in the sectors marked *Note 1* in table 3 will only be made with entities whose lowest published long-term credit rating is no lower than A-.

Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be considered.

For entities without published credit ratings, investments may be made either (a) where external advice indicates the entity to be of similar credit quality; or (b) to a maximum of £1m per counterparty; or (c) are part of a diversified pool of investments e.g. a strategic investment in an external pooled fund.

### **Other Information on the Security of Investments**

The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions, and advice from the Council's Treasury advisor. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or with other local authorities. This may will cause investment returns to fall but will protect the principal sum invested.

### **Business model for holding investments**

The Council aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash-flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

### **Negative interest rates**

In the event of negative interest rates, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

### **Liquidity Management**

The Council uses purpose-built cash flow forecasting software to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium term financial plan and cash flow forecast. To ensure adequate liquidity is maintained, 'worst case' estimates of cash flows are used when considering the Council's medium term investment position.

### **Responsible Investing**

As a responsible investor, the Council is committed to considering environmental, social, and governance (ESG) issues, and has a particular interest in taking action against climate change and pursuing activities that have a positive social impact.

The overriding priorities of treasury management must remain security, liquidity, and yield in that order. However, once these priorities are met preference will be given to placing investments with banks or institutions who have demonstrated a significant interest in sustainability by being a signatory to the UN Environment Finance Initiative's (UNEFI) Principles for Responsible Banking/ Investment. This requirement will not extend to investments with the UK public sector.

Before a direct investment is made with an institution that is not a participant in the above initiative, approval will be sought from the section 151 or deputy section 151 officer setting

out why no reasonable alternative at that particular time is available. This 'comply or explain' approach recognises that, whilst ESG is a desirable objective for treasury investing, to comply with Statutory Guidance it must be ranked behind security, liquidity and yield.

Where the Council does not have direct control over the individual investments, (for example, for investments in money market or external pooled funds), the Council will seek to understand and evaluate the Ethical, Social and Governance policies of money market and external pooled funds when considering making an initial investment. This evaluation will include a review of any reports prepared by prospective fund managers under the UK Stewardship Code issued by the Financial Reporting Council and of the institution's commitment to the UNEFI Principles for Responsible Investment.

## **Borrowing**

The strategy recognises that the following are not prudent activities for the Council to undertake.

1. Borrowing to investment for the primary purpose of return
2. Making any investment or spending decision that will increase the Council's capital financing requirement, and so may lead to new borrowing, unless directly and primarily related to the function of the Council and where any financial returns are either related to the financial viability of the project or otherwise incidental to the primary purpose

The Council is currently debt-free and has no borrowing other than that which might occur as part of routine working capital management. There are no plans to borrow to finance new capital expenditure over the medium term but this remains an option if deemed to be prudent.

If it considers it necessary to borrow money, the Council's chief objective will be to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

Short term internal borrowing (for schemes that pay back within the 5 year time frame of the capital programme) can be accommodated without incurring external interest charges, provided the resulting savings are recycled into reserves.

Longer term pay back periods will have to accommodate both the external interest and a minimum revenue provision (MRP) in accordance with the Council's MRP policy.

Borrowing would add pressure on the revenue budget as MRP and interest would become payable. The capacity to make these payments would need to be identified in advance, namely the further efficiency savings generated by the investment in the assets.

### **Borrowing Sources**

The Council may need to borrow money in the short term to cover unexpected cash flow shortages from the following approved sources:

- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
- Any institution approved for investments
- Any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds (except the West Sussex Pension Fund)
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues
- Capital market bond investors, including via community municipal bonds
- Any other UK public sector body

In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- Leasing
- Hire purchase
- Sale and leaseback

The Council will, where possible, take advantage of any reduction in borrowing costs available from the Public Works Loan Board (PWLB) for authorities who provide information on their plans for long-term borrowing and associated capital spending.

PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Authority intends to avoid this activity in order to retain its potential access to PWLB loans.

### **Operational Boundary for External Debt**

The operational boundary is based on the Authority's estimate of most likely (i.e. prudent but not worst case) scenario for external debt. It links directly to the Authority's estimates of capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring. If these limits are breached in-year, this will trigger an exception report explaining the circumstances of the breach to Cabinet.

The limit for 'other long term liabilities' includes the Council's best estimate of finance lease liabilities that may be recognised following adoption of IFRS16 on 1 April 2022.

*Table 5: Operational boundary for external debt*

Operational Boundary	2022/23 £m	2023/24 £m	2024/25 £m	2025/26 £m	2026/27 £m
Borrowing	10	10	10	10	10
Other long-term liabilities	2	2	3	3	3
Total Debt	12	12	13	13	13

### **Authorised Limit for External Debt**

The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Authority can legally owe.

The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

*Table 6: Authorised limit for external debt*

Authorised Limit	2022/23 £m	2023/24 £m	2024/25 £m	2025/26 £m	2026/27 £m
Borrowing	20	20	20	20	20
Other long-term liabilities	5	5	5	5	5
Total Debt	25	25	25	25	25



## Treasury Management Indicators

### Prudential indicator for the Liability Benchmark

This strategy incorporates the Liability benchmark – shown at table 2 as a Performance indicator relevant to the Council.

Whilst the Council is debt-free, this indicator is of relatively lesser value. However, if the Council does take out borrowing, any substantial mismatches between actual loan debt outstanding and the liability benchmark will be explained.

Any years where actual loans are less than the benchmark indicate a future borrowing requirement; any years where actual loans outstanding exceed the benchmark represent an overborrowed position, which will result in excess cash requiring investment (unless any currently unknown future borrowing plans increase the benchmark loan debt requirement).

### Security and credit risk

*Table 7: Security risk indicators*

Measure	Target
Portfolio Average Credit Rating (time weighted)	Minimum "A" rating
Proportion Exposed to Bail-in (%)	Less than the average of other District Councils
Fair Value of external funds	<ul style="list-style-type: none"> <li>• Overall Fair value of external funds</li> </ul> Less <ul style="list-style-type: none"> <li>• Nominal value of funds invested</li> </ul> Plus <ul style="list-style-type: none"> <li>• reserves set aside to reduce risk</li> </ul> Is greater than zero.

### Liquidity

Officers will continue to manage the Council's treasury management investments ensuring that sufficient cash is available to accommodate known payments. In the unlikely circumstance that a large unexpected cash payment is required and the Council does not have sufficient liquidity immediately available, the Council will use its facility to borrow temporarily for cash management purposes.

*Table 8: Liquidity risk indicators*

Measure	Target
Proportion of investments available within 7 days (%)	Compare and explain against District Council average
Proportion available within 100 days (%)	Compare and explain against District Council average

### **Maturity Structure of Borrowing**

As the Council is debt free it currently holds no fixed long term borrowing for which a maturity profile exists.

### **Prudential limits for long term treasury management investments**

The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments in response to adverse economic or market conditions or credit rating downgrades.

Table 9 sets out the upper limit for each forward financial year period for the maturing of investments for periods longer than 364 days up to their final maturities beyond the end of the financial period.

*Table 9: Limits on investment periods (£m)*

	Maturing during			No fixed maturity
	2023/24	2024/25	2025/26	
Limit on principal invested beyond year end	20	20	20	80

### **Market and economic risk**

The Council is exposed to risk in terms of its exposure to interest rate movements on its investments, although the effects on the Council of such movements are not considered to be material as most sums invested are at fixed interest rates for short periods.

Of much more significance is the risk of property price movements and interest rate risk relating to the Council's investment in external pooled funds.

To measure the significance of these risks, the Council calculates the effect of a 1% change in interest rates and a 5% change in property prices on the Fair Value of the external funds when preparing its Statement of Accounts.

It will compare these figures against the individual counterparty limits set out above in table 4, which are seen as representative of a measure of the maximum amount that the council is willing to risk.

A Treasury exception will be reported to Cabinet where the economic risk exceeds 50% the Council's individual Counterparty limit (equivalent to £3.5m).

This indicator is calculated and reported annually as part of the Council's statement of accounts. Outside of this, an exception will be reported where it is clear there are significant changes to the risk, mainly because of changes to the composition of the investment portfolio or to variation in the fair value of the portfolio. The position as at 31 March 2022 is set out in table 10.

*Table 10: Exposure to economic risk (£m)*

	1% change in Interest rates	5% change in equity prices	5% change in property prices	TOTAL
CCLA Property Fund	-	-	(0.52)	
External Pooled Funds and Money markets	(0.53)	(0.38)	(0.05)	
<b>TOTAL</b>	<b>(0.53)</b>	<b>(0.38)</b>	<b>(0.57)</b>	<b>1.48</b>

## Other Items

There are several additional items that the Council is obliged by CIPFA or DLUHC to include in its Treasury Management Strategy.

### Policy on Use of Financial Derivatives

The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to.

Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the *Localism Act 2011* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be

subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria assessed using the appropriate credit rating for derivative exposures. An allowance for credit risk calculated using the methodology in the Treasury Management Practices document will count against the counterparty credit limit and the relevant foreign country limit.

In line with the CIPFA Code, the Authority will seek external advice and will consider that advice before entering any financial derivatives to ensure that it fully understands the implications.

## **Markets in Financial Instruments Directive II**

The Authority has opted up to professional client status with providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Authority's treasury management activities, the Director of Corporate Services believes this to be appropriate. A list of counterparties who have accepted elective professional status of the Council is included in the Council's treasury management practices.

## **Investment of Money Borrowed in Advance of Need**

Although not envisaged at this stage, the Council may, exceptionally, borrow to pre-fund future borrowing requirements, where this is expected to provide the best long term value for money. Any borrowing in advance of need must comply with DLUHC Guidance.

Since amounts borrowed will be invested until spent, the Council is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Council's overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit as set out in table 6. The maximum period between borrowing and expenditure is expected to be two years, although the Council is not required to link particular loans with particular items of expenditure.

## **Investment Training**

The Council will critically assess the existing skills available to ensure robust decision making and effective ongoing management and monitoring, commensurate with the Authority's risk appetite and investing activities

Member and officer training is essential to understanding roles, responsibilities, keep up to date with changes and to effectively plan, discharge and scrutinize Treasury activity.

The training needs of the officers involved on treasury management are identified through the annual performance and development appraisal process, and additionally when the responsibilities of individual members of staff change. Staff attend relevant training courses, seminars and conferences as needed.

Training will be provided to members when requested and at a minimum annually and as part of Member induction.

### **Investment Advisers**

The Council's treasury advisor is Arlingclose Limited and receives specific advice on investment, debt and capital finance issues. Responsibility for final decision making remains with the Council and its officers.

The quality of this service is controlled and monitored against the contract by the Financial Services Divisional Manager.

## **Reporting**

### **Treasury investments**

The Council/Cabinet will receive as a minimum:

- An annual report on the strategy and plan to be pursued in the coming year and on the need to review the requirements for changes to be made to the Treasury Management Strategy Statement.
- A mid-year review
- An annual report on the performance of the treasury management function, on the effects of decisions taken and the transactions executed in the past year, by 30th September in the next financial year, including any circumstances of non-compliance with the organisation's treasury management policy statement and Treasury Management Practices.

The body responsible for scrutiny of treasury management policies and practices is the Corporate Governance and Audit Committee. Monitoring reports on Treasury performance and compliance with this strategy will be prepared and presented to this Committee as a minimum for the half year to September and the full year to March.

The Leader of the Council, the Cabinet Member for Corporate Services and the members of the Corporate Governance & Audit Committee receive monthly monitoring reports of the investments held.

## Other Options Considered

The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Director of Corporate Services believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

*Table 11: Alternatives considered*

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller

## Investment Strategy 2022/23

### Part 2 - Commercial Investments

The Council may invest in commercial opportunities with the intention of making a profit that will be spent on local public services.

To provide specific guidance on the enhanced scrutiny and assessment of risk required, the Council has approved an investment opportunities protocol. All decisions to make commercial investments will comply with this protocol.

The Council will apply the policy and processes established by its investment opportunities protocol in deciding whether to make a commercial investment or not. This protocol, which includes the Land and Property Sub Category, provides specific guidance on the enhanced scrutiny required, including:

- Acquisitions or original build should be within the District Council's area, or sufficiently close by to be easily managed;
- Preference will be given to acquisitions where they achieve a community or economic benefit and strengthen the local economy;
- The acquisition provides an acceptable rate of return for the additional risk taken on, and will not increase the Council's ongoing revenue costs in the longer term; and,
- Where necessary, Specialist advisers are to be employed to provide advice and act for the Council.

To mitigate the impact of uncertainty the Council's investment objective is to provide a spread of investments with varying degrees of risk, given that it is recognised that the inherent risk is generally reflected either in the price or the rate of return (i.e. the higher the risk, the higher the return and vice versa).

The consideration of any investment shall include a risk assessment that measures as objectively as possible the likelihood and severity of the impact should the risks identified be realised. This can provide comparison against the potential benefits (financial and otherwise) for which the investment is being considered in the first place, and form part of the decision making process.

Among the risk factors to be considered are:

- Acquisition Risk – the Council may incur abortive transaction costs (such as professional fees) without guarantee of securing the investment as the Council may be one of several bidders in a competitive market;

- Price & Cost Risk – Once acquired the value of the investment may fluctuate over time, which due to the nature of property investments, will likely reflect variations in supply and demand;
- Economic / Political Risk – the ability to retain or dispose of an investment may be inhibited by the economic and political environment at any point in time; and,
- Market Risk – the Council’s ability to influence the price, financial return or other benefits pertaining to the investment may be limited by the market in which it operates

The value of the Council’s current commercial investment portfolio is disclosed in the Council’s statement of accounts and set out below using the latest valuation information available (31 March 2022). It is not possible to prepare a formal expectation of value in advance of the actual valuation exercise undertaken for to provide information for the Council’s annual accounts. Where any valuations are felt to be unrealistic or may have changed materially, this is noted in the table below.

*Table 12: Property held for investment purposes in £ millions*

Property reference	Actual	31.3.2022 actual	
	Purchase cost	Gains or (losses)	Value in accounts
IP001	0.87	0.38	1.25
IP002	0.87	0.14	1.01
IP003	2.51	2.97	5.48
IP004	1.61	(0.36)	1.25
IP005	1.63	0.01	1.64
IP006	3.64	(0.39)	3.25
LD264	0.06	0.0	0.06
<b>TOTAL</b>	<b>11.19</b>	<b>2.75</b>	<b>13.94</b>

## Security

The Council defines security for investment properties as maintaining the fair value of the investment property portfolio above the purchase price paid.

The Council recognises that any form of property investment is not without risk since the value of any investment may rise or fall over time, especially where it is to be retained over many years.



A fair value assessment for all commercial investments held by the Council has been undertaken within the last 12 months. Of the seven properties owned by the Council for investment purposes, their total market value was assessed at £13.94m on 31 March 2022, significantly above the total initial purchase cost.

Within this, two of the properties had a fair value that was below the initial purchase cost. Whilst it is possible that the fair value of these investment properties would not provide security against loss, this would only occur if the Council were compelled to sell these properties. Investment property is considered a long-term asset and the Council only invests once it is satisfied that the asset can be held over a period longer than 5 years and does not borrow to fund the purchase.

The Council is satisfied that the true market value of these properties provides adequate security for the investment of public funds. Should the 2022/23 year-end accounts preparation and audit process value these any properties materially below their purchase cost, then the Director of Corporate Services will assess if the risk is such that a report together with an updated investment strategy is necessary detailing the impact of the loss on the security of investments and any possible revenue consequences arising therefrom.

### **Liquidity**

Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice, and dependent on which property sector it falls in, can take a considerable period to sell in certain market conditions such as those that currently exist. Because of this, the Council only invests in non-treasury assets where strategic forecasts indicate the asset can be held over an appropriate timeframe.

The Council does not borrow to finance non-treasury investments and therefore has no need to generate cash to repay borrowing. It recognises that unforeseen events can occur and maintains both a short term and medium term (five year) cashflow forecast which it expects will give the Council sufficient notice of any need to liquidate any non-treasury investments.

The Council also holds significant cash and short-term investment balances at any one time.

### **Proportionality – Commercial Investments**

Income from commercial investments is expected to remain below 10% of the Council's net revenue stream.

The Council currently builds the following sources of income from investments into its base budget as these sources of income have demonstrated an ability to provide a constant, predictable return over the medium term. The figures are presented here are a proportion of net cost of net revenue stream as presented in the Council's financial strategy

Table 13: Proportionality of Commercial Investments (£m)

	2021/22 Actual	2022/23 Forecast	2023/24 Forecast	2024/25 Forecast	2025/26 Forecast	2026/27 Forecast
Investment income * (£m)	0.90	0.90	0.90	0.90	0.90	0.90
Net revenue stream (£m) **	22.3*	23.7*	13.3	14.7	15.0	15.4
Proportion	4.0%	3.8%	6.8%	6.1%	6.0%	5.9%

Investment income is net of direct costs but before changes in fair value (ie; net operating surplus).

The net revenue stream indicator prior to 2023-24 was based on net cost of services as the Council did not previously calculate this figure as part of its financial strategy. For 2023-24 this indicator is based on net revenue stream projections which are now prepared as part of the Council's financial strategy.

Forecast commercial income levels for 2023-24 and future years are not available at the date of writing this strategy. The figures are based on best estimates assuming 'no change'.

### Part 3 - Service Investments

The Council may choose to make loans or provide guarantees to local enterprises, local charities and other entities as part of a wider strategy for local economic growth and to support its Corporate Priorities.

'Investments for service purposes' (or service investments) are taken or held primarily and directly for the delivery of public services (including housing, regeneration and local infrastructure) or in support of joint working with others to deliver such services. The Council has also determined that loans made to employees under the Council's employment terms and conditions also falls within this category of investment.

They are distinct from treasury investments in that:

- They are not principally made to manage the Council's short term and surplus cash balances;
- They may or may not involve financial returns; however, primary purposes of these investments are their contribution to the Council's corporate objectives and statutory responsibilities.

Service investments are non-specified investments, and this requires the council to determine:

- procedures for determining which categories of investments may be prudently used
- which categories of investments have been defined as suitable for use;
- the upper limits for the maximum amounts, both individually and cumulatively, that may be held in each identified category, and the overall amount held in non-specified investments, including confirmation that investments made have remained within those limits

### **Governance and suitability**

All service investments must demonstrate a clear contribution towards the Council's strategic objectives or delivery of statutory responsibilities.

Governance arrangements for any new investments will be subject to the processes set out in the Council's constitution, including any delegation arrangements provided in that document.

Any fundamentally new or additional significant service investment outside those specified as approved investment vehicles below will be required to have direct Council approval. Any such approval will require the Council's s.151 to:

- confirm (after seeking advice from the Council's Monitor Officer) the legality of the proposed investment and the nature of the transaction, and that all authorities to proceed have been obtained;
- satisfy themselves that the documentation is adequate both to deliver the organisation's objectives and protect the organisation's interests;
- ensure that relevant due diligence has taken place;
- ensure that counterparties are judged satisfactory in the context of the organisation's creditworthiness policies and that limits have not been exceeded; and,
- be content that the terms of any transactions have been fully checked against the market and have been found to be competitive, or that there are sufficient and valid reasons for the Council to depart from market competitive rates.

Outside of this, the section 151 officer has delegated authority to implement this investment strategy, subject to the following overarching responsibilities:

- the total exposure is limited to the funding approved for this purpose in advance by the Council's Cabinet;
- appropriate due diligence is carried out on service investment proposals in accordance with the risk appetite of the authority and the requirements of Statutory Codes and Regulations;
- the total investment is proportionate to the Council's available financial resources (see 'proportionality - service investments', below); and,
- proportionate and adequate governance process is in place for the approval, monitoring, and ongoing risk management of the investment.

### **Approved Service Investments**

1. **Company and Entity Loans.** Loans to external companies, other entities (charities, voluntary associations etc) and non-incorporated entities will only be made for Capital purposes and not to support any revenue expenditure of the borrower. No loan will be made to any entity or organisation who does not make a significant contribution to the local economy.
2. **Loans to local individuals.** These will only be made to current residents of the District and must relate to the furtherance of Council priorities and objectives, or the proper discharge of the Council's functions. For soft loans secured by a charge against the property asset, the Council's loan and the mainstream lender's loan will not, as a combined sum, exceed 95% of the property value.
3. **Loans to employees.** There will only be made to individuals who have a current employment contract with the District Council and for purposes agreed by management.
4. **Loan Commitments and Guarantees:** The Authority may provide guarantees in very limited circumstances. In the exceptional circumstance that the Council provides a financial guarantee, this will be in accordance with the Council's constitution.

The most likely guarantee provided by the Council is for pension liabilities associated with TUPE and other transfers of staff from public to private sector where staff have remained within the Local Government Pension Scheme (LGPS). These guarantees are not financial guarantees linked to an underlying debt instrument and, as such, they are not deemed to be a service investment.

## Risk Management

Any particular investment will carry its own risks, and therefore this strategy determines individual limits on service investment categories based on potential risk.

For any investment, there is always the risk that the original investment may not be repaid. In this respect service investments, by their nature, are not the same as Treasury investments, and therefore the objective isn't to prioritise security above all other considerations or even to the same extent as for Treasury investments. A balanced view will be taken that considered the overall public good against the risk of loss of public funds.

### Proportionality – Service investments

This investment strategy determines limits for each category of approved service investment and sets an overall ceiling for service investment as required by the Regulations.

The Council's Financial strategy sets out the extent to which the overall Council budget is supported by income from non-Treasury investments. Apart from this, the Council's revenue budget is also exposed to the risk of impairment losses from service investments.

The Council only includes debt taken on formal loan terms in the figures below. It excludes monies owed as part of its normal operational activities, for example trade debtors, monies owed for other operational purposes, such as Council Tax and Business rates arrears, and monies owned under leasing agreements.

The percentage limits set below are based on a proportion of the Council's average net revenue stream, estimated at £14.5m over the next five years in the Council's financial strategy.

*Table 14: Loans for service purposes in £000 – annual limits to 2026/27*

Category	2021/22 Actual Income %	2022/23 to 2026/27 Income %	Income Limit p.a	Upper lending Limit TOTAL
Company and Entity Loans	NIL	<1	145	1,000
Loans to local individuals	<1	<1	145	1,000
Loans to employees	<1	<1	75	500
Financial Guarantees	N/A	N/A	N/A	See below
Overall			365	2,500

It is not possible to determine a limit for any financial guarantees in advance however no guarantee will be entered into without explicit consideration of the requirements of the Prudential Code and approval by both the s.151 officer and that required by the Council's constitution.

## Part 4 - Non-Specified Investments

The Guidance defines non-specified investments as any non-treasury investment that does not meet the following criteria:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
  - the UK Government,
  - a UK local authority, parish council or community council, or
  - a body or investment scheme of "high credit quality".

The Council's only qualifying non-specified investments are those listed above under service and commercial investments. The Council has already proportionality limits for these investments at Tables 13 and 14.

If the need arises to make a further non-specified investment, the investment will comply with limits both individually and cumulatively in table 15, below.

*Table 15: Non-Specified Investment Limits*

Limits (excluding Treasury Investments)	Cash limit (£m)
Total medium and long-term investments	20
Total investments without credit ratings or rated below A-	20
Total non-specified investments	30

*For clarity, in accordance with paragraph 21 of the DLUHC Guidance these limits do NOT apply to Treasury Investments (which include external investments in pooled funds)*

## Appendix A

### Arlingclose's Economic Outlook for the remainder of 2022/23 (based on 26<sup>th</sup> September 2022 interest rate forecast)

**Officer's commentary: Although the most recent forecast available, the economic landscape is changing so rapidly that this is likely to be out of date by the time this strategy comes into force. Officers will continue to evaluate economic updates as they are published.**

	Current	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25
Official Bank Rate													
Upside risk	0.00	0.50	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	2.25	4.25	5.00	5.00	5.00	5.00	5.00	5.00	5.00	4.75	4.25	3.75	3.25
Downside risk	0.00	-1.00	-1.00	-0.75	-0.50	-0.50	-0.50	-0.75	-1.25	-1.50	-1.75	-1.75	-1.75

Arlingclose expects Bank Rate to rise further during 2022/23 to reach 5% by the end of the year.

The MPC is particularly concerned about the demand implications of fiscal loosening, the tight labour market, sterling weakness and the willingness of firms to raise prices and wages.

The MPC may therefore raise Bank Rate more quickly and to a higher level to dampen aggregate demand and reduce the risk of sustained higher inflation. Arlingclose now expects Bank Rate to peak at 5.0%, with 200bps of increases this calendar year.

This action by the MPC will slow the economy, necessitating cuts in Bank Rate later in 2024.

Gilt yields will face further upward pressure in the short term due to lower confidence in UK fiscal policy, higher inflation expectations and asset sales by the BoE. Given the recent sharp rises in gilt yields, the risks are now broadly balanced to either side. Over the longer term, gilt yields are forecast to fall slightly over the forecast period.

#### Background:

Monetary policymakers are behind the curve having only raising rates by 50bps in September. This was before the "Mini-Budget", poorly received by the markets, triggered a rout in gilts with a huge spike in yields and a further fall in sterling. In a shift from recent trends, the focus now is perceived to be on supporting sterling whilst also focusing on subduing high inflation.

There is now an increased possibility of a special Bank of England MPC meeting to raise rates to support the currency. Followed by a more forceful stance over concerns on the looser fiscal outlook. The MPC is therefore likely to raise Bank Rate higher than would otherwise have been necessary given already declining demand. A prolonged economic downturn could ensue.

Uncertainty on the path of interest rates has increased dramatically due to the possible risk from unknowns which could include for instance another Conservative leadership contest, a general election, or further tax changes including implementing windfall taxes.

The government's blank cheque approach to energy price caps, combined with international energy markets priced in dollars, presents a fiscal mismatch that has contributed to significant decline in sterling and sharp rises in gilt yields which will feed through to consumers' loans and mortgages and business funding costs.

UK government policy has mitigated some of the expected rise in energy inflation for households and businesses flattening the peak for CPI, whilst extending the duration of elevated CPI. Continued currency weakness could add inflationary pressure.

The UK economy already appears to be in recession, with business activity and household spending falling. The short- to medium-term outlook for the UK economy is relatively bleak.

Global bond yields have jumped as investors focus on higher and stickier US policy rates. The rise in UK government bond yields has been sharper, due to both an apparent decline in investor confidence and a rise in interest rate expectations, following the UK government's shift to borrow to loosen fiscal policy. Gilt yields will remain higher unless the government's plans are perceived to be fiscally responsible.

The housing market impact of increases in the Base Rate could act as a "circuit breaker" which stops rates rising much beyond 5.0%, but this remains an uncertainty.