Treasury Management Strategy Statement

Minimum Revenue Provision Policy Statement and Annual Investment Strategy

Cambridgeshire Police And Crime Commissioner
2023/24

INDEX

1 INTRODUCTION

1.1 Background

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

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

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

CIPFA defines treasury management as:

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

Local authority, in the definition above, encompasses the Police and Crime Commisioner.

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

1.2 Reporting requirements

1.2.1 Capital Strategy

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

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

The aim of this strategy is to ensure that the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite are understood.

1.2.2 Treasury Management reporting

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

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

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

A mid-year treasury management report – This will update the Commissioner on the progress of the capital and treasury position, amending prudential indicators as necessary, and whether any policies require revision.

An annual treasury report – This provides details of actual prudential and treasury indicators and actual treasury operations at the year end compared to the estimates within the strategy.

1.2.3 Scrutiny

The above reports are required to be adequately scrutinised before being recommended to the Commissioner. This role is undertaken by the Chief Finance Officer and the Business Co-ordination Board.

1.2.4 Quarterly reports

In addition to the three major reports detailed above, from the 2023/24 financial year two quarterly reports at the end of June and the end of December are also required. However, these additional reports do not have to be reported to the Commissioner, but do require to be adequately scrutinised. This role is undertaken by the CFO. These reports should specifically comprise of updated Treasury/Prudential Indicators.

1.3 Treasury Management Strategy for 2023/24

The strategy for 2023/24 covers two main areas:

Capital issues

- the capital plans and the prudential indicators;

- the Minimum Revenue Provision (MRP) policy.

Treasury management issues

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

These elements cover the requirements of the Local Government Act 2003, the Department for Levelling Up, Housing and Communities (DLUHC) Investment Guidance, DLUHC MRP Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code.

Affordability and Financial Planning: The Capital Programme and the Medium Term Financial Strategy (MTFS) will include forecasts on capital expenditure, revenue consequences of capital programmes and the requirement to financially support capital investment, mainly through borrowing. This work will have identified the potential financial position for the Force in respect of the coming medium term, considering known information and stated assumptions

Capital Sustainability: For the period of the MTFS there is a necessary move away from funding of the capital programme through use of capital reserves and grants into a position of funding through borrowing for specific projects. The replacement of the Parkside police station and custody provision in South Cambridgeshire is the largest capital project in recent years and will require a significant amount of capital investment.

Approval Process: Once the Commissioner has approved the capital programme, then capital expenditure can be committed against these approved schemes. Whether capital projects are funded from grant, capital allocations or borrowing, the revenue costs must be able to be met from existing revenue budgets. Following approval by the Commissioner capital expenditure is then monitored on a regular basis at the Force Executive Board (FEB) and the Business Coordination Board (BCB) meetings.

Capital receipts: Capital receipts cannot be spent on revenue items but will reduce the requirement for borrowing. The Commissioner is currently reviewing the pool of surplus land and underutilised assets in the portfolio which may release surplus land and building to realise capital receipts.

Prudential Borrowing: The Commissioner can set their own borrowing levels based on capital need and the ability to pay for the borrowing. The levels will be set by using the indicators and factors set out in the Prudential Code. The borrowing costs are not supported by the Government so the Commissioner needs to ensure the repayment costs can be funded. Due to the ongoing debt charges (i.e. MRP and external interest charges) the Chief Finance Officer (CFO) will keep under review external borrowing and any potential alternative funding source for financing the capital programme.

1.4 Training

The CIPFA Code requires the responsible officer to ensure that those with responsibility for treasury management, particularly those responsible for its scrutiny, receive adequate training in treasury management. The Commissioner and members of the substantive Joint Audit Committee (JAC) will be provided with appropriate training. The training needs of treasury management officers are periodically reviewed.

2 THE CAPITAL PROGRAMME 2023/24 – 2026/27

The Commissioner's capital expenditure plans are the key driver of treasury management activity. The capital expenditure plans are reflected in the prudential indicators, which are designed to assist with this overview and confirmation of capital expenditure plans. These indicators are separated out in Appendix 5.1, with the following table providing an overview.

Table 1

£000's		2021/22 Actual	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate
Opening Capital Financing Requirement (CFR)		**21,982**	**22,761**	**26,354**	**46,300**	**89,727**	**97,423**
Capital investment:							
Tangible assets additions		7,306	12,098	23,298	52,472	12,953	7,436
Intangible assets additions		496	-	-	-	-	-
TOTAL CAPITAL EXPENDITURE	(A)	**7,802**	**12,098**	**23,298**	**52,472**	**12,953**	**7,436**
Source of Finance:							
Capital receipts		(1,551)	(972)	-	(5,000)	-	(5,496)
Government Grants		(185)	(32)	(187)	-	-	-
Other sources		-	-	-	-	-	-
		(1,736)	**(1,004)**	**(187)**	**(5,000)**	**-**	**(5,496)**
Sums set aside from Revenue:							
Direct revenue contributions		(4,307)	(5,190)	(1,940)	(1,940)	(1,940)	(1,940)
		(4,307)	**(5,190)**	**(1,940)**	**(1,940)**	**(1,940)**	**(1,940)**
Reserves:							
Tfr from Capital Reserves		-	(1,008)	-	-	-	-
Tfr from Other Reserves		-	(125)	-	-	-	-
		-	**(1,133)**	**-**	**-**	**-**	**-**
TOTAL FINANCING	(B)	**(6,043)**	**(7,327)**	**(2,127)**	**(6,940)**	**(1,940)**	**(7,436)**
Net financing need	(A)+(B)	**1,759**	**4,771**	**21,171**	**45,532**	**11,013**	**-**
Minimum Revenue Provision (MRP)	(C)	**(980)**	**(1,178)**	**(1,225)**	**(2,105)**	**(3,317)**	**(4,522)**
Movement in CFR	(A)+(B)+(C)	**779**	**3,593**	**19,946**	**43,427**	**7,696**	**(4,522)**
Closing Capital Financing Requirement	(D)	**22,761**	**26,354**	**46,300**	**89,727**	**97,423**	**92,901**
Borrowing represented by:							
Loan Finance		16,740	16,153	35,939	80,617	86,706	82,796
Finance Lease		16	8	1	-	-	-
TOTAL BORROWING	(E)	**16,756**	**16,161**	**35,940**	**80,617**	**86,706**	**82,796**
Under/(Over) borrowing	(D)-(E)	**6,005**	**10,193**	**10,360**	**9,110**	**10,717**	**10,105**

Table 1 shows the movement in Capital Financing Requirement from the unaudited position in the 2021/22 accounts to the end of the Medium-Term Financial Strategy period. This takes account of the capital programme for the same period.

- Total capital expenditure is shown, which for 2023/24 to 2026/27 amounts to £96.2m and includes a major project to replace the Parkside police station and custody provision in South Cambridgeshire, alongside several other large projects.
- Total financing includes the different sources of financing, direct revenue contributions and use of capital reserves.
- The Minimum Revenue Provision is a charge to the revenue budget to reflect a repayment of the capital outlay (see 2.5 for more detail).
- The Net Financing Need is the difference of capital expenditure to the total of financing available; this shows the requirement to borrow to support the current plans.
- Loan Finance represents the overall debt position from borrowing; the oustanding loan balance, deducting principal repayments within year and adding any planned borrowing.
- The table also shows the currently under-borrowed position which is the difference of the Capital Financing Requirement and the current level of Loans and Finance Leases outstanding. A key Prudential Indicator is set on these figures and detailed in section 3 Borrowing.

2.1 Capital expenditure and Financing

A key prudential indicator, the Commissioner's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle are summarised within **Table 1**, and detail how the plans are being financed by capital or revenue resources. Any shortfall of resources results in a borrowing need. See also the table at Appendix 5.1.1.

2.2 The Commissioner's borrowing need (the Capital Financing Requirement)

The second prudential indicator is the Commisioner's Capital Financing Requirement (CFR), also outlined in the table at Appendix 5.1.2. The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Commissioner's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

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

The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Commissioner's borrowing requirement, these types of scheme include a borrowing facility and so the Commissioner is not required to separately borrow for these schemes. The Commissioner currently has £8k (shown in **Table 1**, Finance Lease) of such schemes within the CFR.

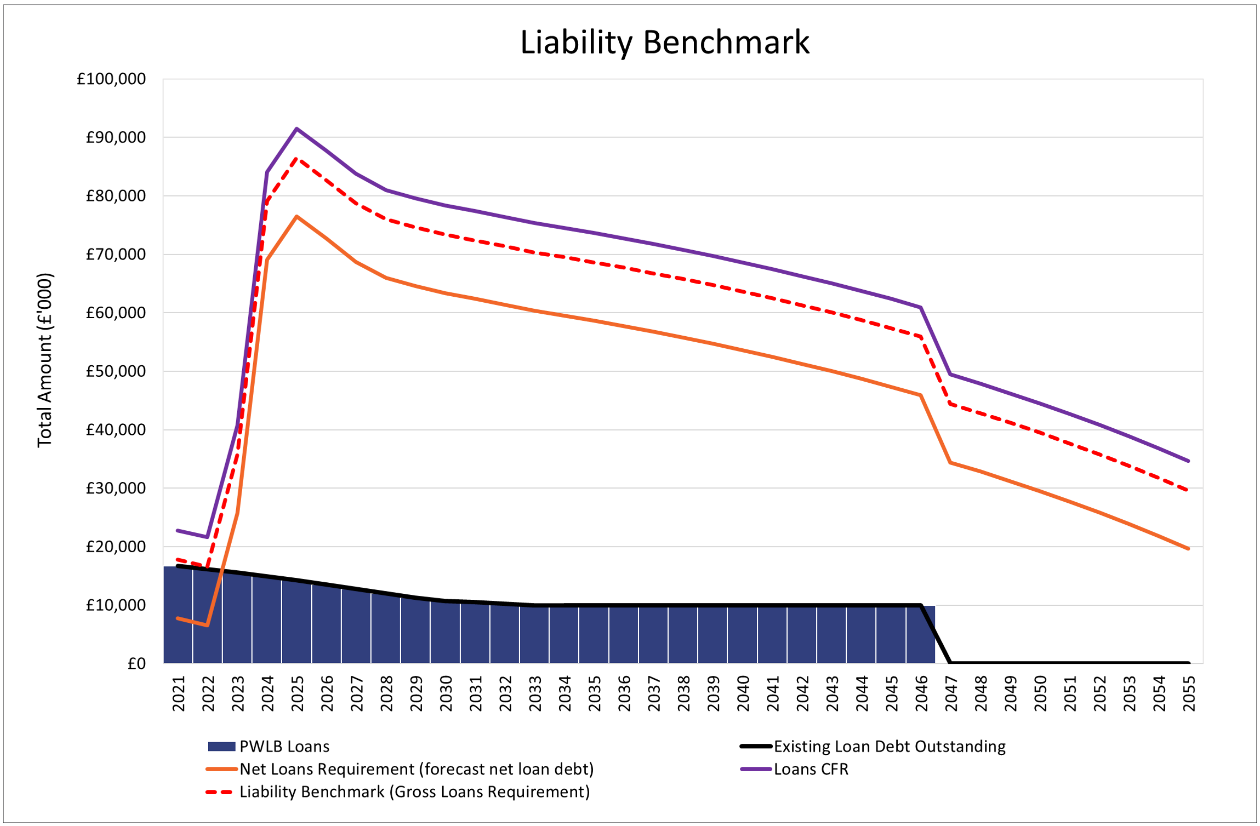
2.3 Liability Benchmark

A third and new prudential indicator for 2023/24 is the Liability Benchmark. The Commissioner is required to estimate and measure the Liability Benchmark for the forthcoming financial year and the following two financial years, as a minimum.

There are four components to the Liability Benchmark:

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

The following graph illustrates the above components with the current debt shown in the blue bars. The sharp increase in the other components are reflective of the increased borrowing need for the planned capital expenditure for the major capital schemes.



The Liability Benchmark will be analysed as part of the annual Treasury Management strategy, and 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). The Treasury Strategy will explain how the treasury risks inherent in these mismatched positions will be managed.

2.4 Core funds and expected investment balances

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). **Table 2** shows estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Table 2 – Cash available to invest

YEAR END RESOURCES £000's		2021/22 Actual	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate
General and Earmarked Reserve		20,052	17,324	16,558	16,362	16,212	16,062
Capital Receipts Reserve		1,143	-	-	-	-	-
TOTAL RESERVES		**21,195**	**17,324**	**16,558**	**16,362**	**16,212**	**16,062**
Provisions		2,132	2,132	2,132	2,132	2,132	2,132
TOTAL CORE FUNDS AVAILABLE	(A)	**23,327**	**19,456**	**18,690**	**18,494**	**18,344**	**18,194**
Working Capital:							
Stock		1,170	1,170	1,170	1,170	1,170	1,170
Debtors		23,144	23,144	23,144	23,144	23,144	23,144
Creditors		(26,540)	(26,540)	(26,540)	(26,540)	(26,540)	(26,540)
		(2,226)	**(2,226)**	**(2,226)**	**(2,226)**	**(2,226)**	**(2,226)**
Under-borrowing		6,005	10,193	10,360	9,110	10,717	10,105
TOTAL EXISTING REQUIREMENT	(B)	**3,779**	**7,967**	**8,134**	**6,884**	**8,491**	**7,879**
Cash available to invest	(A)-(B)	**19,548**	**11,489**	**10,556**	**11,610**	**9,853**	**10,315**

Table 2 above shows the value of the remainder of core funds available to invest after consideration of cash backed reserves, provisions and the under-borrowed amount are offset against the working capital requirements of the organisation. The levels of provision and working capital are projected forward at the same level as for 2021/22.

2.6 Minimum revenue provision (MRP) policy statement

Under Regulation 27 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, where the Authority has financed capital expenditure by borrowing it is required to make a provision each year through a minimum revenue charge (MRP).

The Commissioner is required to calculate a prudent provision of MRP which ensures that the outstanding debt liability is repaid over a period that is reasonably commensurate with that over which the capital expenditure provides benefits. The MRP Guidance (2018) gives four ready-made options for calculating MRP, but the Commissioner can use any other reasonable basis that it can justify as prudent.

The MRP policy statement requires full approval in advance of each financial year. The Commissioner is recommended to approve the following MRP Statement.

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

- **Existing practice** – MRP will follow the existing practice outlined in former DLUHC regulations. This option provides for an approximate 4% reduction in the borrowing need (CFR) each year.

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

- **Asset life method** – MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction). This option provides for a reduction in the borrowing need over approximately the asset's life.

Repayments included in annual PFI or finance leases are applied as MRP.

MRP Overpayments – a change introduced by the revised DLUHC MRP Guidance was the allowance that any charges made over the statutory minimum revenue provision (MRP), voluntary revenue provision or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year. Up until the 31 March 2022 the total VRP overpayments were zero.

3 BORROWING

The capital expenditure plans set out in Section 2 provide details of the service activity of the Commissioner. The Treasury Management function ensures that the Commissioner's cash is organised in accordance with the the relevant professional codes, so that sufficient cash is available to meet this service activity and the Commissioner's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 Current portfolio position

The overall Treasury Management portfolio as at 31 March 2021 and for the position as at 31 December 2022 are shown below for both borrowing and investments.

Table 3

TREASURY PORTFOLIO				
	31 March 2022		31 December 2022	
Treasury Investments	**£000**	**%**	**£000**	**%**
Banks (UK)	9,059	100%	4,260	21%
Banks (Rest of World)	0	0%	11,000	53%
Local Authorities	0	0%	0	0%
DMADF (H.M. Treasury)	0	0%	0	0%
Money Market Funds	0	0%	5,275	26%
Certificates of Deposit	0	0%	0	0%
Total Managed In-house	**9,059**	**100%**	**20,535**	**100%**
Bond Funds	0	0%	0	0%
Property Funds	0	0%	0	0%
Total Managed Externally	**0**	**0%**	**0**	**0%**
Total Treasury Investments	**9,059**	**100%**	**20,535**	**100%**
Treasury External Borrowing				
Local Authorities	0	0%	0	0%
PWLB	16,740	100%	16,407	100%
Total External Borrowing	**16,740**	**100%**	**16,407**	**100%**
Net Treasury Investments / (Borrowing)	**(7,681)**		**4,128**	

The Commissioner's forward projections for borrowing are summarised in **Table 1**, which shows the actual external debt, against the underlying capital borrowing need, (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

Within the prudential indicators there are a number of key indicators to ensure that the Commissioner's activities are operated within well-defined limits. One of these is that the Commissioner needs to ensure that the gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2023/24 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Chief Finance Officer reports that the Commissioner complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

3.2 Treasury Indicators: limits to borrowing activity

The operational boundary. This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

In order to calculate an operational boundary, an operational buffer of 10% is added to the value of the Capital Financing Requirement. In addition, where there is the potential for borrowing to be needed earlier than planned, the estimated loan requirement is also added.

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

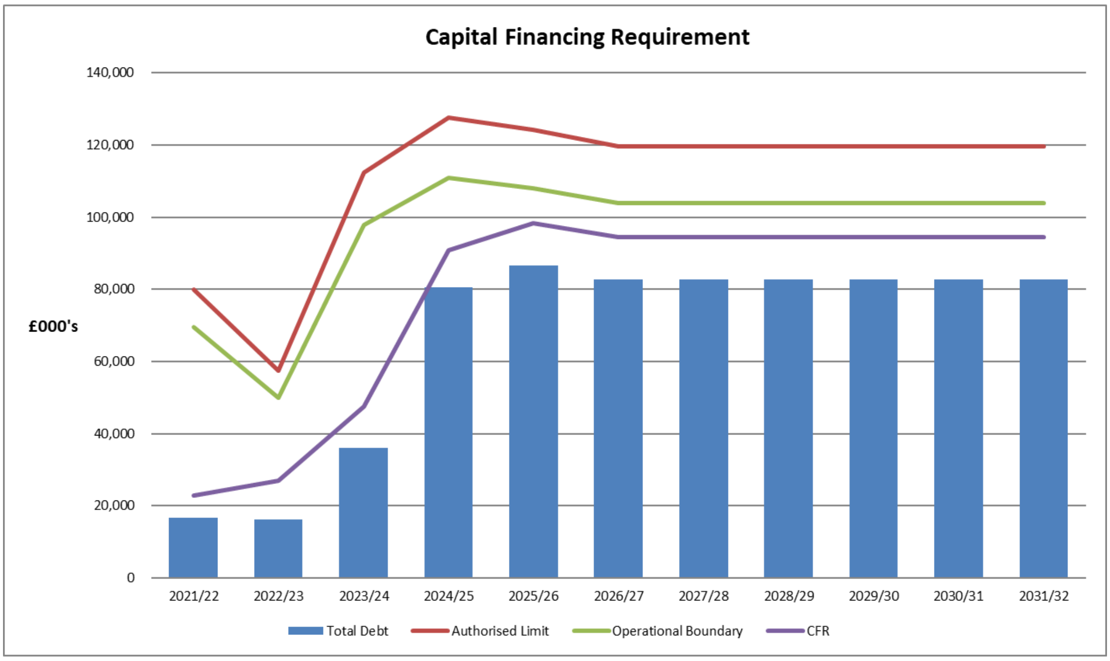
1. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all authorities and councils' plans, or those of a specific authority or council, including the Commissioner, although this power has not yet been exercised.
2. The Authorised Limit has been determined to be 15% in excess of the operational boundary.
3. The below highlights the Authorised Limit the Commissioner has approved for 2023/24 and forecasts the changes expected over the period to 2026/27:

Table 4

LIMITS TO BORROWING ACTIVITY £000's	2021/22 Actual	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate
Capital Financing Requirement (CFR)	22,761	26,354	46,300	89,727	97,423	92,901
Operational Margin (10% of CFR)			4,630	8,973	9,742	9,290
			50,930	**98,700**	**107,165**	**102,191**
Borrowing Capability Factor *			45,532	11,013	-	-
OPERATIONAL BOUNDARY	**69,567**	**50,023**	**96,462**	**109,713**	**107,165**	**102,191**
AUTHORISED LIMIT (15% above Operational Boundary)	**80,002**	**57,526**	**110,931**	**126,170**	**123,240**	**117,520**

** Net Financing Need (see Table 1) for following year brought forward - this allows for borrowing in readiness for expected capital outlay*

The Capital Financing Requirement graph below illustrates the relationship between the Commissioner's current and planned borrowing, with the CFR, Operational Boundary and the Authorised Limit.



3.3 Borrowing strategy

The Commissioner is currently maintaining an under-borrowed position (see **Table 1**). This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Commissioner's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as medium and longer dated borrowing rates are expected to fall from their current levels once prevailing inflation concerns are addressed by tighter near-term monetary policy. That is, Bank Rate increases over the remainder of 2022 and the first half of 2023.

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

- *if it was felt that there was a significant risk of a sharp FALL in borrowing rates*, then borrowing will be postponed.
- *if it was felt that there was a significant risk of a much sharper RISE in borrowing rates than that currently forecast,* fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

Any decisions will be reported to the appropriate decision making body at the next available opportunity.

3.4 Policy on borrowing in advance of need

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

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

3.5 Debt rescheduling

There are no plans for rescheduling our current borrowing in the debt portfolio. All rescheduling will be discussed with the Commissioner prior to any decision being taken.

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

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

- Local authorities (primarily shorter dated maturities out to 3 years or so – generally still cheaper than the Certainty Rate).
- Financial institutions (primarily insurance companies and pension funds but also some banks, out of forward dates where the objective is to avoid a “cost of carry” or to achieve refinancing certainty over the next few years).

Our advisors will keep us informed as to the relative merits of each of these alternative funding sources.

4 ANNUAL INVESTMENT STRATEGY

4.1 Investment policy

The Commissioner's investment policy has regard to the following:

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

The Commissioner's investment priorities will be security first, liquidity second, then return.

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

1. Minimum acceptable credit criteria are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.
2. Other information: ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Commissioner will engage with advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.
3. Other information sources used will include the financial press, share price and other such information pertaining to the financial sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.
4. The Commissioner has defined the list of types of investment instruments that the treasury management team are authorised to use. There are two lists in appendix 5.4 under the categories of 'specified' and 'non-specified' investments.
   - Specified investments are those with a high level of credit quality and subject to a maturity limit of one year.
   - Non-specified investments are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use. Once an investment is classed as non-specified, it remains non-specified all the way through to maturity i.e. an 18 month deposit would still be non-specified even if it has only 11 months left until maturity.
5. Non-specified investments limit. The Commissioner has determined that zero Non-specified investments will be undertaken. This will limit the maximum total

exposure to non-specified investments to 0% of the total investment portfolio, (see paragraph 4.3).

6. Lending limits, (amounts and maturity), for each counterparty will be set through applying the matrix table in paragraph 4.2.
7. The Commissioner will set a limit for the amount of the investments which are invested for longer than 365 days, (see paragraph 4.4).
8. Investments will only be placed with counterparties from the UK and countries with a specified minimum sovereign rating, (see paragraph 4.3).
9. The Commissioner has engaged external consultants to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of the Commissioner in the context of the expected level of cash balances and need for liquidity throughout the year.
10. All investments will be denominated in sterling.
11. As a result of the change in accounting standards for 2019/20 under IFRS 9, the Commissioner will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund.

However, the Commissioner will also pursue value for money in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see paragraph 4.5). Regular monitoring of investment performance will be carried out during the year.

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

4.2 Creditworthiness policy

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

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

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

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

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

- Banks 1 - good credit quality – the Commissioner will only use banks which:
  i. are UK banks; and/or
  ii. are non-UK and domiciled in a country which has a minimum sovereign Long Term rating of AA- and have, as a minimum, the following Fitch, Moody's and Standard and Poors credit ratings (where rated):
  iii. Short Term – F1
  iv. Long Term – A-
- Banks 2 – Part nationalised UK bank – Royal Bank of Scotland. This bank can be included provided it continues to be part nationalised or it meets the ratings in Banks 1 above.
- Banks 3 – The Commissioner's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time invested.
- Money market funds (MMFs) CNAV – AAA
- Money market funds (MMFs) LVNAV – AAA
- Money market funds (MMFs) VNAV – AAA
- Ultra-Short Dated Bond Funds with a credit rating of at least 1.25 – AAA
- Ultra-Short Dated Bond Funds with a credit rating of at least 1.50 - AAA
- UK Government (including gilts, Treasury Bills and the DMADF)
- Local authorities, parish councils, Commissioners etc

A limit of 0% will be applied to the use of non-specified investments.

Use of additional information other than credit ratings. Additional requirements under the Code require the Commissioner to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating Watches/Outlooks) will be applied to compare the relative security of differing investment counterparties.

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

	Fitch Rating	**Money and/or % Limit**	**Time Limit**
Banks 1 - higher quality	A- / F1	25% of available funds (max £10m)	365 days
Banks 2 – part nationalised	A- / F1	25% of available funds (max £10m)	365 days
Commissioner' bank (when not within Banks 1)		£10m	Overnight
DMADF	AAA	unlimited	6 months
Local authorities	N/A	£10m	365 days
	Fund rating	**Money and/or % Limit**	**Time Limit**
Money market funds CNAV	AAA	100% of available funds	Liquid
Money market funds LVNAV	AAA	100% of available funds	Liquid

Money market funds VNAV	AAA	100% of available funds	Liquid
Ultra-Short Dated Bonds Funds	AAA	100% of available funds	Liquid

The proposed criteria for specified and non-specified investments are shown in Appendix 5.5 for approval.

4.3 Country and sector limits

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

The Commissioner has determined that approved counterparties from the UK and countries with a minimum sovereign credit rating of AA- from Fitch or equivalent will be used. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

In addition:

- no more than 50% of available funds will be placed in a country outside of the UK (this applies to Banks 1 (see 4.2 above) only, not Money Market funds);
- limits in place above will apply to a group of companies;
- sector limits will be monitored regularly for appropriateness.

4.4 Investment strategy

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

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

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.
- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

Investment returns expectations - The current forecast shown in appendix 5.4, includes a forecast for Bank Rate to reach 4.5% in Q2 2023.

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

2022/23 (remainder)	3.95%
2023/24	4.40%
2024/25	3.30%

2025/26	2.60%
2026/27	2.50%
Later years	2.80%

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

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

The Commissioner has approved the treasury indicator and limit for investments greater than 365 days as:

Maximum principal sums invested > 365 days	2023/24	2024/25	2025/26
Principal sums invested > 365 days	£0	£0	£0

For its cash flow generated balances, the Commissioner will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated deposits (overnight to 365 days) in order to benefit from the compounding of interest.

4.5 Investment risk benchmarking

These benchmarks are simple guides to maximum risk, so they may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the mid-year or Annual Report.

- Security - the Commissioner's maximum security risk benchmark for the current portfolio, when compared to these historic default tables, is:
  - 0.008% historic risk of default when compared to the whole portfolio.
- Liquidity - in respect of this area the Commissioner seeks to maintain:
  - Bank overdraft - £100k
  - Liquid short-term deposits having the lower of at least £5m or 25% of funds available with a week's notice.
- Yield - local measures of yield benchmarks are:
  - Investments - internal returns above the 7-day SONIA compounded rate.

SONIA

The publication of official LIBOR figures (and related LIBID calculations) ceased at the close of 2021. As such the Treasury Strategy and activity now refers to SONIA (Sterling Overnight Index Average), which is the risk-free rate for sterling markets administered by the Bank of England.

For reference, SONIA is based on actual transactions and reflects the average of the interest rates that banks pay to borrow sterling overnight from other financial institutions and other institutional investors.

To support the Risk-Free Rate transition in sterling markets the Bank of England began publishing the SONIA Compounded Index from 3rd August 2020. This simplifies the calculation of compounded interest rates and in doing so provides a standardised basis through its publication as an official source.

4.6 Environmental, Social & Governance (ESG)

ESG consideration with the Commissioner's investment activity will routinely take place and as the ESG area expands there will be further development in the Commissioner's overall strategy in this regard. Treasury Management Practice (TMP1) now includes ESG within the framework of investing activity (see Appendix 5.5 for greater detail).

4.7 End of year investment report

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

5 APPENDICES

5.1 APPENDIX: Prudential and Treasury Indicators 2023/24 – 2026/27

5.1.1 Capital Expenditure

This provides a summary of the Commissioner's capital expenditure. It reflects matters previously agreed and those proposed for the forthcoming financial periods.

Capital Expenditure		**2021/22 Actual**	**2022/23 Estimate**	**2023/24 Estimate**	**2024/25 Estimate**	**2025/26 Estimate**	**2026/27 Estimate**
Total Capital Expenditure	(A)	**7,802**	**12,098**	**23,298**	**52,472**	**12,953**	**7,436**
Financed by:							
Capital receipts		(1,551)	(972)	-	(5,000)	-	(5,496)
Revenue contribution		(4,307)	(5,190)	(1,940)	(1,940)	(1,940)	(1,940)
Grants and other contributions		(185)	(1,165)	(187)	-	-	-
Finance lease and PFI liabilities		-	-	-	-	-	-
Total Financing	(B)	**(6,043)**	**(7,327)**	**(2,127)**	**(6,940)**	**(1,940)**	**(7,436)**
Net financing need for year	(A)-(B)	**1,759**	**4,771**	**21,171**	**45,532**	**11,013**	**-**

5.1.2 Capital Financing Requirement

This shows the difference between the Commissioner's capital expenditure and the revenue or capital resources set aside to finance that spend. The CFR will increase where capital expenditure takes place and will reduce as the Commissioner makes Minimum Revenue Provision ("MRP") or Voluntary Revenue Provision ("VRP") or otherwise sets aside revenue or capital resources to finance expenditure.

Capital Financing Requirement	**2021/22 Actual**	**2022/23 Estimate**	**2023/24 Estimate**	**2024/25 Estimate**	**2025/26 Estimate**	**2026/27 Estimate**
Opening CFR	21,982	22,761	26,354	46,300	89,727	97,423
Capital spend	7,802	12,098	23,298	52,472	12,953	7,436
Resources used	(6,043)	(7,327)	(2,127)	(6,940)	(1,940)	(7,436)
MRP & VRP	(980)	(1,178)	(1,225)	(2,105)	(3,317)	(4,522)
Closing CFR	**22,761**	**26,354**	**46,300**	**89,727**	**97,423**	**92,901**

5.1.3 Authorised Limit

This represents a control on the maximum level of external debt the Commissioner can incur. The Commissioner has to show this aggregate amount split into the element in respect of actual external borrowing and that which relates to 'other long-term liabilities' - the latter being credit arrangements, as defined in statute and which will include the principal element of any finance lease or Private Finance Initiative obligations payable.

Authorised Limit	**2021/22 Actual**	**2022/23 Estimate**	**2023/24 Estimate**	**2024/25 Estimate**	**2025/26 Estimate**	**2026/27 Estimate**
Borrowing	79,802	57,326	110,731	125,970	123,040	117,320
Other Long Term Liabilities	200	200	200	200	200	200
Total Authorised Limit	**80,002**	**57,526**	**110,931**	**126,170**	**123,240**	**117,520**

5.1.4 Operational Boundary

This is the limit beyond which external debt is not normally expected to exceed. Again, the Commissioner is required to disclose an aggregate limit and separately disclose the element that relates to actual external borrowing and that which relates to other long-term liabilities. Unlike the Authorised Limit, the Operational Boundary is not an absolute limit but it reflects the Commissioner's expectations of the level at which external debt would not ordinarily be expected to exceed.

Operational Boundary	**2021/22 Actual**	**2022/23 Estimate**	**2023/24 Estimate**	**2024/25 Estimate**	**2025/26 Estimate**	**2026/27 Estimate**
Borrowing	69,467	49,923	96,362	109,613	107,065	102,091
Other Long Term Liabilities	100	100	100	100	100	100
Total Operational Boundary	**69,567**	**50,023**	**96,462**	**109,713**	**107,165**	**102,191**

5.1.5 External Debt

The Commissioner has to disclose the closing balance for actual gross borrowing in respect of the financial period just ended, together with the level of other long-term liabilities and so the actual aggregate level of external debt at the Balance Sheet date. This clarifies the overall level of external debt, and allow comparison to the Commissioner's actual borrowing need as provided by the Gross debt and the CFR Indicator.

Actual External Debt as at 31st March	**2022/23 Estimate**
Borrowing	16,153
Other Long Term Liabilities	8
Total External Debt	**16,161**

5.1.6 Gross Debt and the Capital Financing Requirement

The Commissioner should only borrow to support a capital purpose, and borrowing should not be undertaken for revenue or speculative purposes. If the level of gross borrowing is below the Commissioner's capital borrowing need – the CFR – it demonstrates compliance with the requirement of this Indicator.

Gross Debt and the CFR	**2021/22 Actual**	**2022/23 Estimate**	**2023/24 Estimate**	**2024/25 Estimate**	**2025/26 Estimate**	**2026/27 Estimate**
CFR	22,761	26,354	46,300	89,727	97,423	92,901
Gross Borrowing	16,756	16,161	35,940	80,617	86,706	82,796
Under/(Over) Borrowing	**6,005**	**10,193**	**10,360**	**9,110**	**10,717**	**10,105**

5.1.7 Liability Benchmark

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).

Liability Benchmark	**2021/22 Actual**	**2022/23 Estimate**	**2023/24 Estimate**	**2024/25 Estimate**	**2025/26 Estimate**	**2026/27 Estimate**
Existing Loan Debt Outstanding	16,740	16,153	15,539	14,896	14,224	13,522
Liability Benchmark (Gross Loans Requirement)	17,740	16,562	35,737	79,079	86,459	82,679

(Over)/Under Liability Benchmark	**1,000**	**409**	**20,199**	**64,183**	**72,235**	**69,158**

5.1.8 Ratio of Financing Costs

This Indicator shows the trend in the cost of capital (borrowing and other long-term obligation costs net of investment income) against the net revenue stream – i.e. taxation and non-specific grant income. The higher the ratio, the higher the proportion of resources tied up just to service net capital costs, and which represent a potential affordability risk.

Ratio of Financing Costs		**2021/22 Actual**	**2022/23 Estimate**	**2023/24 Estimate**	**2024/25 Estimate**	**2025/26 Estimate**	**2026/27 Estimate**
Interest cost on existing borrowing		579	553	526	498	469	438
Interest cost on new borrowing		-	-	-	1,968	3,119	3,222
Gains/losses on debt rescheduling		-	-	-	-	-	-
Interest and investment income		(114)	(50)	(250)	(250)	(225)	(225)
MRP & VRP		980	1,178	1,225	2,105	3,317	4,522
Total Financing Costs	(A)	**1,445**	**1,681**	**1,501**	**4,321**	**6,680**	**7,957**
Net Budget Requirement	(B)	**161,654**	**171,513**	**178,177**	**183,415**	**190,163**	**193,842**
Ratio of financing costs	(A)/(B)	**0.89%**	**0.98%**	**0.84%**	**2.36%**	**3.51%**	**4.11%**

5.1.9 Maturity Structure of Borrowing

The Commissioner is required to set gross limits on maturities for the periods shown and covers both fixed and variable rate borrowings. The reason being to try and control the Commissioner's exposure to large sums falling due for refinancing.

Maturity structure of borrowing:	**Actual**	**Lower Limit**	**Upper Limit**
Under 12 months	4%	0%	100%
12 to 24 months	4%	0%	100%
2 to 5 years	13%	0%	100%
5 to 10 years	16%	0%	100%
Over 10 years	63%	0%	100%

5.1.10 Limit for Principal Sums Invested for Longer Than a Year

This Indicator is seeking to support control of liquidity risk. The limits should be set with regard to the Commissioner's liquidity needs and reduce the potential need to have to make early exit from an investment in order to recover funds.

	Actual	**Limit**
Upper limit on total principal sums invested longer than a year	£ -	£ -

A limit of zero is set to ensure that investments are not tied up for any period greater than 12 months.

5.2 APPENDIX: Interest Rate Forecasts

The PWLB rates below are based on the new margins over gilts announced on 8th November 2022. PWLB forecasts shown below have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012.

Link Group Interest Rate View	08.11.22												
	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
BANK RATE	3.50	4.25	4.50	4.50	4.50	4.00	3.75	3.50	3.25	3.00	2.75	2.50	2.50
3 month ave earnings	3.60	4.30	4.50	4.50	4.50	4.00	3.80	3.30	3.00	3.00	2.80	2.50	2.50
6 month ave earnings	4.20	4.50	4.60	4.50	4.20	4.10	3.90	3.40	3.10	3.00	2.90	2.60	2.60
12 month ave earnings	4.70	4.70	4.70	4.50	4.30	4.20	4.00	3.50	3.20	3.10	3.00	2.70	2.70
5 yr PWLB	4.30	4.30	4.20	4.10	4.00	3.90	3.80	3.60	3.50	3.40	3.30	3.20	3.10
10 yr PWLB	4.50	4.50	4.40	4.30	4.20	4.00	3.90	3.70	3.60	3.50	3.40	3.30	3.20
25 yr PWLB	4.70	4.70	4.60	4.50	4.40	4.30	4.10	4.00	3.90	3.70	3.60	3.50	3.50
50 yr PWLB	4.30	4.40	4.30	4.20	4.10	4.00	3.80	3.70	3.60	3.40	3.30	3.20	3.20

5.3 APPENDIX: Economic Background

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

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

	UK	Eurozone	US
Bank Rate	3.0%	1.5%	3.75%-4.00%
GDP	-0.2%q/q Q3 (2.4%y/y)	+0.2%q/q Q3 (2.1%y/y)	2.6% Q3 Annualised
Inflation	11.1%y/y (Oct)	10.0%y/y (Nov)	7.7%y/y (Oct)
Unemployment Rate	3.6% (Sep)	6.6% (Sep)	3.7% (Aug)

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

The UK unemployment rate fell to a 48-year low of 3.6%, and this despite a net migration increase of c500k. The fact is that with many economic participants registered as long-term sick, the UK labour force actually shrunk by c£500k in the year to June. Without an increase in the labour force participation rate, it is hard to see how the UK economy will be able to grow its way to prosperity, and with average wage increases running at 5.5% - 6% the MPC will be concerned that wage inflation will prove just as sticky as major supply-side shocks to food and energy that have endured since Russia's invasion of Ukraine on 22nd February 2022.

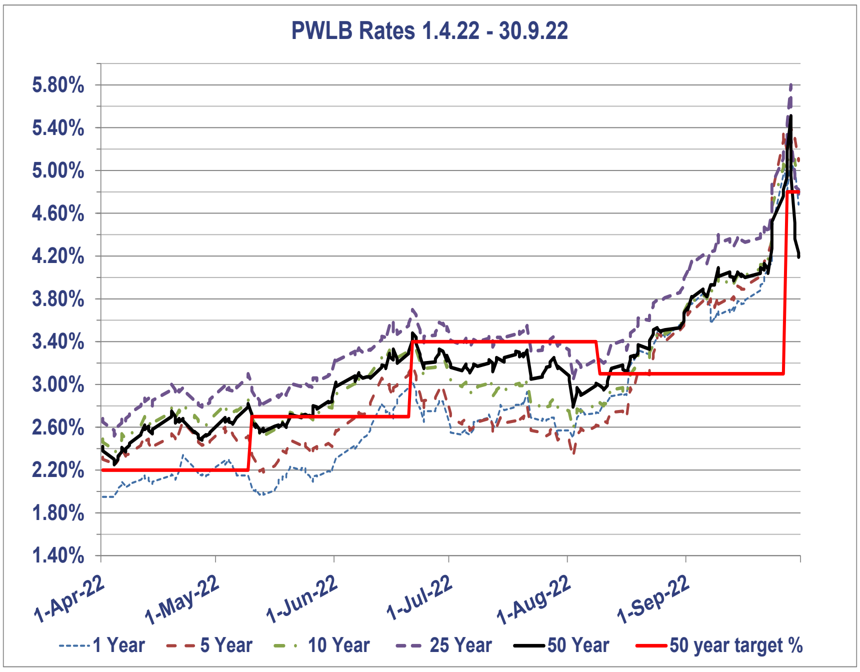
Throughout Q3 Bank Rate increased, finishing the quarter at 2.25% (an increase of 1%). Q4 has seen rates rise to 3% in November and the market expects Bank Rate to hit 4.5% by May 2023.

Following a Conservative Party leadership contest, Liz Truss became Prime Minister for a tumultuous seven weeks that ran through September and December. Put simply, the markets did not like the unfunded tax-cutting and heavy spending policies put forward by her Chancellor, Kwasi Kwarteng, and their reign lasted barely seven weeks before being replaced by Prime Minister Rishi Sunak and Chancellor Jeremy Hunt. Their Autumn Statement of 17th November gave rise to a net £55bn fiscal tightening, although much of the "heavy lifting" has been left for the next Parliament to deliver. However, the markets liked what they heard, and UK gilt yields have completely reversed the increases seen under the previous tenants of No10/11 Downing Street.

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

The £ has strengthened of late, recovering from a record low of $1.035, on the Monday following the Truss government's "fiscal event", to $1.20. Notwithstanding the £'s better run of late, 2023 is likely to see a housing correction of some magnitude as fixed-rate mortgages have moved above 5% and affordability has been squeezed despite proposed Stamp Duty cuts remaining in place.

In the table below, the rise in gilt yields, and therein PWLB rates, through the first half of 2022/23 is clear to see.



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

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

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

CENTRAL BANK CONCERNS

At the start of November, the Fed decided to push up US rates by 0.75% to a range of 3.75% - 4%, whilst the MPC followed a day later by raising Bank Rate from 2.25% to 3%, in line with market expectations. EZ rates have also increased to 1.5% with further tightening in the pipeline.

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

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

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

5.4 APPENDIX: Prospects for interest rates

The Commissioner has appointed Link Group as its treasury advisor and part of their service is to assist the Commissioner to formulate a view on interest rates. Link provided the following forecasts on 8th November 2022. These are forecasts for certainty rates, gilt yields plus 80 bps.

Link Group Interest Rate View	08.11.22												
	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
BANK RATE	3.50	4.25	4.50	4.50	4.50	4.00	3.75	3.50	3.25	3.00	2.75	2.50	2.50
3 month ave earnings	3.60	4.30	4.50	4.50	4.50	4.00	3.80	3.30	3.00	3.00	2.80	2.50	2.50
6 month ave earnings	4.20	4.50	4.60	4.50	4.20	4.10	3.90	3.40	3.10	3.00	2.90	2.60	2.60
12 month ave earnings	4.70	4.70	4.70	4.50	4.30	4.20	4.00	3.50	3.20	3.10	3.00	2.70	2.70
5 yr PWLB	4.30	4.30	4.20	4.10	4.00	3.90	3.80	3.60	3.50	3.40	3.30	3.20	3.10
10 yr PWLB	4.50	4.50	4.40	4.30	4.20	4.00	3.90	3.70	3.60	3.50	3.40	3.30	3.20
25 yr PWLB	4.70	4.70	4.60	4.50	4.40	4.30	4.10	4.00	3.90	3.70	3.60	3.50	3.50
50 yr PWLB	4.30	4.40	4.30	4.20	4.10	4.00	3.80	3.70	3.60	3.40	3.30	3.20	3.20

Our central forecast reflects a view that the MPC will be keen to demonstrate its anti-inflation credentials by delivering a succession of rate increases. This has happened throughout 2022, but the new Government's policy of emphasising fiscal rectitude will probably mean Bank Rate does not now need to increase to further than 4.5%.

Further down the road, we anticipate the Bank of England will be keen to loosen monetary policy when the worst of the inflationary pressures have lessened – but that timing will be one of fine judgment: cut too soon, and inflationary pressures may well build up further; cut too late and any downturn or recession may be prolonged.

The CPI measure of inflation will peak at close to 11% in Q4 2022. Despite the cost-of-living squeeze that is still taking shape, the Bank will want to see evidence that wages are not spiralling upwards in what is evidently a very tight labour market. Wage increases, excluding bonuses, are currently running at 5.7%.

Regarding the plan to sell £10bn of gilts back into the market each quarter (Quantitative Tightening), this has started but will focus on the short to medium end of the curve for the present. This approach will prevent any further disruption to the longer end of the curve following on from the short-lived effects of the Truss/Kwarteng unfunded dash for growth policy.

In the upcoming months, our forecasts will be guided not only by economic data releases and clarifications from the MPC over its monetary policies and the Government over its fiscal policies, but the on-going conflict between Russia and Ukraine. (More recently, the heightened tensions between China/Taiwan/US also have the potential to have a wider and negative economic impact.)

On the positive side, consumers are still estimated to be sitting on over £160bn of excess savings left over from the pandemic so that will cushion some of the impact of the above challenges. However, most of those are held by more affluent people whereas lower income families already spend nearly all their income on essentials such as food, energy and rent/mortgage payments.

PWLB RATES

Yield curve movements have become less volatile under the Sunak/Hunt government. PWLB 5 to 50 years Certainty Rates are, generally, in the range of 3.75% to 4.50%. The medium to longer part of the yield curve is currently inverted (yields are lower at the longer end of the yield curve compared to the short to medium end). Over the last two years, the coronavirus outbreak has done huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings until raising it to 0.25% at its meeting on 16th December 2021.

We view the markets as having built in, already, nearly all the effects on gilt yields of the likely increases in Bank Rate and the poor inflation outlook but markets are volatile and further whipsawing of gilt yields across the whole spectrum of the curve is possible.

The balance of risks to the UK economy

The overall balance of risks to economic growth in the UK is to the downside. Indeed, the Bank of England projected two years of negative growth in their November Quarterly Monetary Policy Report.

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

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

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

- The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly and for a longer period within the UK economy, which then necessitates an even more rapid series of increases in Bank Rate faster than we currently expect.
- The Government acts too slowly to increase taxes and/or cut expenditure to balance the public finances, in the light of the cost-of-living squeeze.
- The pound weakens because of a lack of confidence in the UK Government's fiscal policies, resulting in investors pricing in a risk premium for holding UK sovereign debt.
- Longer term US treasury yields rise strongly, if inflation numbers disappoint on the upside, and pull gilt yields up higher than currently forecast.

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

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

5.5 APPENDIX: Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

The DLUHC issued Investment Guidance in 2018, and this forms the structure of the Commissioner's policy below. These guidelines do not apply to either trust funds or pension funds which operate under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for councils and authorities to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires the Commissioner to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. The former Police Authority adopted the Code in February 2006 and the Commissioner will apply its principles to all investment activity. In accordance with the Code, the Director of Finance has produced the treasury management practices (TMPs). This part, TMP 1(1), covering investment counterparty policy requires approval each year.

Annual investment strategy - The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of following:

- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments that the Commissioner will use. These are high security (i.e. high credit rating, although this is defined by the Commissioner, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

The investment policy proposed for the Commissioner is:

Strategy guidelines – The main strategy guidelines are contained in the body of the treasury strategy statement.

Specified investments – These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Commissioner has the right to be repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

1. The UK Government (such as the Debt Management Account deposit facility, UK treasury bills or a gilt with less than one year to maturity).
2. Supranational bonds of less than one year's duration.
3. A local authority, housing association, parish council or community council.

4. Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency. For category 4 this covers pooled investment vehicles, such as money market funds, rated AAA by Standard and Poor's, Moody's and / or Fitch rating agencies.
5. A body that is considered of a high credit quality (such as a bank or building society). For category 5 this covers bodies with a minimum Short Term rating of F1 (or the equivalent) as rated by Standard and Poor's, Moody's and / or Fitch rating agencies.

Within these bodies, and in accordance with the Code, the Commissioner has set additional criteria to set the time and amount of monies which will be invested in these bodies. These criteria are set out below:

	Fitch Rating	**Money and/or % Limit**	**Time Limit**
Banks 1 - higher quality	A- / F1	25% of available funds (max £10m)	365 days
Banks 2 – part nationalised	A- / F1	25% of available funds (max £10m)	365 days
Commissioner' bank (when not within Banks 1)		£10m	Overnight
DMADF	AAA	unlimited	6 months
Local authorities	N/A	£10m	365 days
	Fund rating	**Money and/or % Limit**	**Time Limit**
Money market funds CNAV	AAA	100% of available funds	Liquid
Money market funds LVNAV	AAA	100% of available funds	Liquid
Money market funds VNAV	AAA	100% of available funds	Liquid
Ultra-Short Dated Bonds Funds	AAA	100% of available funds	Liquid

Non-specified investments – not used

The monitoring of investment counterparties - The credit rating of counterparties will be monitored regularly. The Commissioner receives credit rating information (changes, rating watches and rating outlooks) from Link Asset Services as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Commissioner's CFO, and if required new counterparties which meet the criteria will be added to the list.

Environmental, Social & Governance (ESG) Considerations – The Treasury Management Code has been updated to reflect the more commonplace discussion around Environmental, Social & Governance (ESG) considerations. The following wording (page 18 of the Code) suggests the scope of what is included:

> "The organisation's credit and counterparty policies should set out its policy and practices relating to environmental, social and governance (ESG)

> investment considerations. This is a developing area, and it is not implied that the organisation's ESG policy will currently include ESG scoring or other real-time ESG criteria at individual investment level."

A clear understanding of what ESG investment considerations means requires elucidation to ensure that unexpected risks to investment activity does not arise. ESG, for investment purposes, is about understanding the ESG "risks" that an entity is exposed to and evaluating how well it manages these risks. All entities will be subject to these to one extent or other. It should be noted that it is not the same as Socially Responsible Investing, which is typically where you apply negative screens to investment consideration. Equally it is not the same as Sustainable Investing, where investing in products and companies is based on expected sustainable and beneficial societal impact, alongside a financial return.

There is such a huge potential for misunderstanding this core aspect and this could have material unintended consequence, for example limiting of potential counterparty options, thus decreasing diversification. The above could then lead to authorities widening credit criteria to take on more names, or those with a stronger "ESG" performance, which could then increase credit risk. This would place the cornerstone of prudent investing at risk.

All of the main agencies are now extolling how they incorporate ESG risks alongside more traditional financial risk metrics when assessing counterparty ratings. As such, the incorporation of ESG by the mainstream rating agencies is, to an extent, is already being done.

The Governance aspect is by far the most important one when considering treasury investments, the majority of which are shorter-term in nature. This is because poor governance can have a more immediate impact on the financial circumstances of an entity and the potential for a default event that would impact the amount the local authorities receive back from their investments. Those financial institutions that are viewed as having poor/weak corporate governance are generally less well rated in the first instance or have a higher propensity for being subject to negative rating action. So, this element of ESG is of high importance to an investor that is following investment guidance with the security, liquidity and yield (SLY) principle at its core.

ESG consideration with the Commissioner's investment activity will routinely take place. Indeed, where appropriate and available options are provided, consideration to Socially Responsible and Sustainable investing will play a factor, however, paramount is the security and liquidity of the SLY principle; it is expected that a trade-off with yield will be made for ethical investment opportunities and these considerations will be made on a case-by-case basis. As the ESG area expands there will be further development in the Commissioner's overall strategy in this regard.

5.6 APPENDIX: Treasury Management scheme of delegation

(i) Commissioner / Business Co-Ordination Board (BCB)

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

(ii) Commissioner / BCB

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

(iii) Resources Group / Commissioner

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

5.7 APPENDIX: The Treasury Management role of the section 151 officer

The S151 officer (CFO to Commissioner)

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.

5.9 APPENDIX: Key Considerations

2021 revised CIPFA Treasury Management Code and Prudential Code – changes which will impact on future TMSS/AIS reports and the risk management framework

CIPFA published the revised Codes on 20th December 2021 and has stated that revisions need to be included in the reporting framework from the 2023/24 financial year. The Commissioner, therefore, has to have regard to these Codes of Practice when preparing the Treasury Management Strategy Statement and Annual Investment Strategy, and also related reports during the financial year, which are taken to the Commissioner for approval.

The revised Treasury Management Code requires all investments and investment income to be attributed to one of the following three purposes:

Treasury management

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

Service delivery

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

Commercial return

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

All investments held by the Commissioner are currently attributed to the first category, Treasury Management.

The revised Treasury Management Code will require an authority to implement the following:

1. **Adopt a new liability benchmark treasury indicator** to support the financing risk management of the capital financing requirement; this is to be shown in chart form for a minimum of ten years, with material differences between the liability benchmark and actual loans to be explained;
2. **Long-term treasury investments**, (including pooled funds), are to be classed as commercial investments unless justified by a cash flow business case;

3. **Pooled funds** are to be included in the indicator for principal sums maturing in years beyond the initial budget year;
4. Amendment to the **knowledge and skills register** for officers and members involved in the treasury management function - to be proportionate to the size and complexity of the treasury management conducted by each authority;
5. **Reporting to members is to be done quarterly**. Specifically, the Chief Finance Officer (CFO) is required to establish procedures to monitor and report performance against all forward-looking prudential indicators at least quarterly. The CFO is expected to establish a measurement and reporting process that highlights significant actual or forecast deviations from the approved indicators. However, monitoring of prudential indicators, including forecast debt and investments, is not required to be taken to Full Council and should be reported as part of the authority's integrated revenue, capital and balance sheet monitoring;
6. **Environmental, social and governance (ESG)** issues to be addressed within an authority's treasury management policies and practices (TMP1).

The Commissioner has implemented each of the above, however, does not hold any long-term treasury investments (2), nor pooled funds (3).

The main requirements of the Prudential Code relating to service and commercial investments are:

1. The risks associated with service and commercial investments should be proportionate to their financial capacity – i.e. that plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services;
2. An authority must not borrow to invest for the primary purpose of commercial return;
3. It is not prudent for local authorities to make any investment or spending decision that will increase the CFR, and so may lead to new borrowing, unless directly and primarily related to the functions of the authority, and where any commercial returns are either related to the financial viability of the project in question or otherwise incidental to the primary purpose;
4. An annual review should be conducted to evaluate whether commercial investments should be sold to release funds to finance new capital expenditure or refinance maturing debt;
5. A prudential indicator is required for the net income from commercial and service investments as a proportion of the net revenue stream;
6. Create new Investment Management Practices to manage risks associated with non-treasury investments, (similar to the current Treasury Management Practices).

The Commissioner does not hold any non-treasury investments.

An authority's Capital Strategy or Annual Investment Strategy should include:

1. The authority's approach to investments for service or commercial purposes (together referred to as non-treasury investments), including defining the authority's objectives, risk appetite and risk management in respect of these investments, and processes ensuring effective due diligence;
2. An assessment of affordability, prudence and proportionality in respect of the authority's overall financial capacity (i.e. whether plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services);
3. Details of financial and other risks of undertaking investments for service or commercial purposes and how these are managed;
4. Limits on total investments for service purposes and for commercial purposes respectively (consistent with any limits required by other statutory guidance on investments);
5. Requirements for independent and expert advice and scrutiny arrangements (while business cases may provide some of this material, the information contained in them will need to be periodically re-evaluated to inform the authority's overall strategy);
6. State compliance with paragraph 51 of the Prudential Code in relation to investments for commercial purposes, in particular the requirement that an authority must not borrow to invest primarily for financial return;

As this TMSS and AIS deals solely with treasury management investments, the categories of service delivery and commercial investments should be addressed as part of the Capital Strategy report.

However, as investments in commercial property have implications for cash balances managed by the treasury team, it will be for each authority to determine whether to add a high-level summary of the impact that commercial investments have, or may have, if it is planned to liquidate such investments within the three-year time horizon of this report, (or a longer time horizon if that is felt appropriate).