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OXFORD CITY COUNCIL

To:	**Cabinet**
Date:	**9 February 2022**
Report of:	**Head of Financial Services**
Title of Report:	**Treasury Management Strategy 2022/23**

Summary and recommendations	
Purpose of report:	To present the Council's Treasury Management Strategy for 2022/23 together with the Prudential Indicators for 2022/23 to 2025/26
Key decision:	Yes
Executive Board Member:	Councillor Ed Turner, Deputy Leader, Statutory - Finance and Asset Management
Corporate Priority:	All
Policy Framework:	The Treasury Management Strategy / Capital Strategy is a policy framework document

Recommendation(s): That the Cabinet resolves to:

Recommend that Council approves:

1. The Treasury Management Strategy 2022/23 as set out in paragraphs 22 to 63 of this report and the Prudential Indicators for 2022/23 – 2025/26 as set out in Appendix 2;
2. The Borrowing Strategy 2022/23 at paragraphs 38 to 40 of this report;
3. The Minimum Revenue Provision (MRP) Statement at paragraphs 41 to 43 which sets out the Council's policy on charging borrowing to the revenue account; and
4. The Investment Strategy for 2022/23 and the investment criteria as set out in paragraphs 44 to 62 of this report and in Appendix 1.

Appendices	
Appendix 1	Credit and Counterparty Risk Management
Appendix 2	Prudential Indicators 2022/23 – 2025/26
Appendix 3	Environmental, Social and Governance (ESG) Policy

Summary

1. The Council's Treasury Management Strategy has been written in accordance with the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice.

2. The report presents the Council's prudential indicators for 2022/23 – 2025/2026. Notable indicators include capital expenditure and borrowing limits as these are areas of significant activity.

3. The average value of investments during the calendar year to 31st December 2021 was £105.9m. The actual daily value fluctuated between £86.9m and £123.4m. This is an decrease on the previous calendar year, when average balances were £114.3m and daily values ranged from £95.6m to £131.6m.

4. All external debt as at 31 March 2021 (£198.5m) relates to the Housing Revenue Account self-financing debt taken out in 2012 which is held at fixed rates with varying fixed periods to maturity.

5. The Council's General Fund Capital Programme over the next four years is funded from a combination of government grants, capital receipts, revenue, Community Infrastructure Levy and prudential borrowing. However, due to the scale of investment over the period to 2022/23 to 2025/26, including the loans to the Council's Housing Company (£72.5 million), the level of prudential borrowing will increase to over £671.7 million in 2025/26 from the projected £359.7 million at the end of 2021/22. Borrowing from internal resources will be maximised, however much of the borrowing will need to be from external resources with anticipated external borrowing increasing from £198.5 million to £571.5 million in 2025/26. The Housing Revenue Account Capital Programme is largely funded from council house rents over time but includes £224.3 million borrowing from 2022/23 to 2025/26.

6. The CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice were revised in late 2017 and these versions have been fully adopted from 2019/20 onwards. The codes include a requirement to produce a Capital Strategy (which the Council already did previously) and included additional requirements for this and also for non-Treasury Investments. In order to maintain the clarity between Treasury and non-Treasury Management Activity, all non Treasury Investment capital activity is covered by the Capital Strategy.

7. CIPFA published updated Treasury Management and Prudential Codes on 20th December 2021, however there is a soft introduction of the codes with local authorities not being expected to have to change their Treasury Management Strategies and Annual Investment Statements for 2022/23. Full implementation is be required for 2023/24. The key changes are around the focus on commercial investments and amendments to prudential indicator requirements.

8. All Prudential Indicators continue to be covered together in the Treasury Strategy. This will allow the indicators to be seen as a whole and in the context of Treasury

Management activity to which they are closely related. There are, however, some cross-overs to areas covered by the Capital Strategy.

9. The Prudential Indicators have been revised in line with the Codes of Practice. Additional disclosures are included to cover the Government's focus on "commercial activities". This focus has occurred due to some Councils (which have been featured in the press) incurring substantial expenditure buying investment properties to support their revenue budgets.

10. The Department for Levelling Up, Housing and Communities (DLUHC) is consulting on changes to regulations around Minimum Revenue Provision and, although the outcome of this is not yet known, the treasury budgets and consequently, the prudential indicators include the latest assessment of potential financial impacts. The driver for this change was to restrict local authorities financing capital expenditure on investments in commercial projects made primarily for yield, although it has wider impications. The Government has already closed access to all Public Works Loans Board (PWLB) borrowing if such schemes are included in an authority's capital programme. The new CIPFA codes have also adopted a similar set of restrictions to discourage further capital expenditure on commercial investments for yield.

11. The limit for non-specified investments is proposed to remain at 30% of the previous year's total investment portfolio or £30 million, whichever is the greater, which allows capacity for occasional non-specified investments other than pooled investment funds such as investments with local authorities for longer than 364 days.

Loans to the Council's Companies

12. Over the four year life of the Council's Medium Term Financial Strategy to 2025/26 it is assumed that the Council will give additional loans to the Council's Housing Company to the value of around £72.5million. During this period some extisting loans will be repaid with the maximum year end outstanding housing company loans being expected to be £72.8 million. Whereas these are not treasury investments, there is however a positive impact on the Council's net investment income due to a markup being charged on the loans of 3.2% on all loans awarded after 1st April 2021. As at the end of December 2021 the Council had loans outstanding to OxWED (now a Limited Liability Partnership of £12.12 million with accrued interest to 31st March 2022 estimated at £4.39 million and ongoing interest of £1.15 million upwards per annum.

Interest and Economic Outlook

13. The Council has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Link Group provided the following forecasts on 22nd December 2021. The PWLB forecasts are for the certainty rates, for which the Council is eligible, which are gilt yields plus 80 bps.

Link Group Interest Rate View	20.12.21													
	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
BANK RATE	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25
3 month ave earnings	0.20	0.30	0.50	0.50	0.60	0.70	0.80	0.90	0.90	1.00	1.00	1.00	1.00	1.00
6 month ave earnings	0.40	0.50	0.60	0.60	0.70	0.80	0.90	1.00	1.00	1.10	1.10	1.10	1.10	1.10
12 month ave earnings	0.70	0.70	0.70	0.70	0.80	0.90	1.00	1.10	1.10	1.20	1.20	1.20	1.20	1.20
5 yr PWLB	1.40	1.50	1.50	1.60	1.60	1.70	1.80	1.80	1.80	1.90	1.90	1.90	2.00	2.00
10 yr PWLB	1.60	1.70	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10	2.20	2.30
25 yr PWLB	1.80	1.90	2.00	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.40	2.40	2.50	2.50
50 yr PWLB	1.50	1.70	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.20	2.20	2.30	2.30

14. 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 its December meeting on 16th December 2021 where the Bank of England base rate was raised to 0.25%. As shown in the forecast table above, the forecast for Bank Rate now includes five increases, one in December 2021 to 0.25%, then quarter 2 of 2022 to 0.50%, quarter 1 of 2023 to 0.75%, quarter 1 of 2024 to 1.00% and, finally, one in quarter 1 of 2025 to 1.25%.

Forecasts for Bank Rate

15. It is not expected that Bank Rate will go up fast after the initial rate rise as the supply potential of the economy is not believed to have been damaged during the pandemic. It should, therefore, be able to cope well with meeting demand after supply shortages subside over the next year, without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the Monitary Policy Committee (MPC) 2% target after the spike up to around 5%. The forecast includes five increases in Bank Rate over the three-year forecast period to March 2025, ending at 1.25%. However, it is likely that these forecasts will change within a relatively short timeframe for the following reasons: -

- There are increasing grounds for expecting the economic recovery to have faltered during the summer and into the autumn. This which would create a dilemma for the MPC as to whether to focus on combating inflation or supporting economic growth through keeping interest rates low.

- Concern whether some current key supply shortages will cause economic activity in some sectors to take a significant hit.

- Rising gas and electricity prices in October and next April and increases in other prices caused by supply shortages and increases in taxation next April, are already going to deflate consumer spending power without the MPC having to take any action on Bank Rate to cool inflation.

- Conversely, consumers are sitting on over £160bn of “excess” savings left over from the pandemic so there may be an impact on the economyif this is spent in part or in total?

- It is estimated that there were around 1 million people who came off furlough at the end of September 2021 and it is still uncertain how many of those did not have jobs on 1st October 2021 and would therefore be available to fill labour shortages in some sectors of the economy.

- Supply shortages which have been driving up both wages and costs, could reduce significantly within the next six months or so and alleviate one of the MPC's key current concerns.

- There could be further changes resulting from Covid and even the possibility of another lockdown, which could all depress economic activity.

- If the UK invokes article 16 of the Brexit deal over the dislocation in trading arrangements with Northern Ireland, this has the potential to end up in a no deal Brexit.

16. In summary, with the high level of uncertainty, it is likely that these forecasts will be revised again over the next few months.

Gilt yields / PWLB rates

17. As the interest forecast table for PWLB certainty rates above shows, there is likely to be a steady rise over the forecast period, with some degree of increase due to rising treasury yields in the United States (US). There is likely to be exceptional volatility and unpredictability in respect of gilt yields and PWLB rates due to the following factors: -

- How strongly changes in gilt yields are correlated to changes in US treasury yields (see below). Over 10 years since 2011 there has been an average 75% correlation between movements in US treasury yields and gilt yields. However, from time to time these two yields can diverge. Lack of spare economic capacity and rising inflationary pressures are viewed as being much greater dangers in the US than in the UK. This could mean that future central bank rates will end up rising earlier and higher in the US than in the UK if inflationary pressures were to escalate; the consequent increases in treasury yields could well spill over to cause lesser increases in gilt yields. There is, therefore, an upside risk to forecasts for gilt yields due to this correlation. The Council's treasury advisors, The Link Group, forecasts have included a risk of a 75% correlation between the two yields.

- The US Federal Reserve (the equivalent of the Bank of England) may take action to counter increasing treasury yields if they rise beyond a yet unspecified level which could impact on UK markets.

- The MPC may act to counter increasing gilt yields if they rise beyond a yet unspecified level.

- Inflationary pressures may not be temporary in both the US and the UK and so put upward pressure on treasury and gilt yields.

- Central banks may implement their new average or sustainable level inflation monetary policies.

- How well the central banks manage the withdrawal of Quantitive Easing purchases of their national bonds will have an effect.

18. The forecasts are also predicated on an assumption that there is no break-up of the Eurozone or EU within the forecasting period, despite the major challenges ahead, and that there are no major disruptions in international relations, especially between the US and China / North Korea and Iran, which have a major impact on international trade and world GDP growth.

Investment and borrowing rates

19. **Investment returns** are expected to improve in 2022/23. However, while markets are pricing in a series of Bank Rate rises, actual economic circumstances may see the MPC fall short of these forecasts. Investment rates included in the MTFP range from 0.10% for Money Market Funds to 4.80% for property funds.

20. **Borrowing interest rates** fell to historically very low rates as a result of the COVID crisis and the quantitative easing operations of the Bank of England and still remain at historically low levels. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years. In the MTFP, a range of borrowing rates are assumed (based on PWLB rate forecasts) ranging from 1.88% to 2.53%.

21. The current margins over gilt yields are as follows: -.

    - **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
    - **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)
    - **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
    - **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
    - **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

Treasury Management Strategy Statement

Background

22. The Council 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 counterparties or instruments commensurate with the Council's risk appetite, providing adequate liquidity initially before considering investment return.

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

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

25. Whilst any 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 and need different consideration and due diligence.

26. 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."

27. Revised reporting has been required for the 2019/20 reporting cycle onwards due to revisions of the MHCLG Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code. The reporting changes included the introduction of the requirement to approve a capital strategy (which the Council produced in a slightly different form previously), to provide a longer-term focus to the capital plans, and greater reporting requirements surrounding any commercial activity undertaken under the Localism Act 2011. The capital strategy is being reported separately and includes the additional requirements introduced with these changes.

Treasury Management Advisors

28. Treasury advice and market information is provided by Link Group. A procurement exercise was undertaken during 2018 and the contract was awarded to Link Group in September 2018 for 3 years and an option to extend for a further 2 years has been taken up with the contract now expiring in 2023. The information provided by Link Group that is used for making investment decisions has been considered in the writing of this report and its associated appendices.

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

Borrowing and Debt

30. Under the Prudential Code, individual authorities are responsible for deciding their level of borrowing. The system is designed to allow authorities with an affordable borrowing requirement, to borrow in order to pay for capital investment.

31. The arrangements also facilitate 'invest to save' schemes where they are affordable, prudent and sustainable.

32. The parameters for determining the level of prudential borrowing are:

- A balanced revenue budget that includes the revenue consequences of any capital financing i.e. interest, debt repayment and running costs of any new project; and
- That the impact of the Authorised Borrowing Limit on Council Tax or council rents is reasonable.

33. The draft Capital Programme for 2022/23 to 2025/26, which appears elsewhere on the Agenda; includes the following expenditure which is currently planned to be financed by borrowing:

- £72.5 million loans to the Housing Company, primarily to finance the purchase of new affordable housing at Barton and housing developments;
- £20.1 million for community centres and area regeneration
- £33 million on regeneration properties
- £17.8 million on corporate and other property refurbishment
- £224.3 million to finance Housing Revenue Account (HRA) capital expenditure.

34. The S151 officer has delegated authority to determine the need for external borrowing taking into account prevailing interest rates and associated risks. Borrowing may be undertaken to fund the approved Capital Programme or to fund future debt maturities and a combination of long-term and short-term fixed and variable rate borrowing may be considered which may include borrowing in advance of future years' requirements. In using the delegated authority, the S151 Officer will take into account the following factors:

- The on-going revenue liabilities created, and the implications for the future plans and budgets;
- The economic and market factors that might influence the manner and timing of any decision to borrow;
- The pros and cons of alternative forms of funding including internal borrowing;
- The impact of borrowing in advance on cash balances and the consequent increase in counterparty risk.

35. Council officers, in conjunction with the Council's treasury advisors, Link Group, monitor prevailing interest rates and market forecasts, thereby allowing the Council to respond to any changes that may impact on the timing and manner of borrowing decisions, to ensure these are optimised.

36. The Council currently has £198.5m of external debt held at fixed rates with varying maturity terms up to 2057. This debt relates to the Council's housing stock within

its HRA. The first repayment, of £20 million, was made at the end of 2020/21. Debt to the same value was taken out in order to replace the debt repaid. The first repayment of the remaining existing debt, in the sum of £20 million, will now take place in 2025-26 and it is currectly expected that this will be refinanced.

37. The Council's Capital Financing Requirement (CFR) is an indication of the Council's underlying need to borrow to fund its capital investments; this borrowing can be undertaken internally using available resources or externally by borrowing from a reputable institution or the Public Works Loans Board (PWLB). The estimated level of CFR for each year can be found in the Prudential Indicators in Appendix 2.

Borrowing Strategy 2022/23

38. The Council currently has £90.7 million internal borrowing as at 1st April 2021. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt since cash supporting the Council's reserves, balances and cash flow has been used as a temporary funding source. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.

39. The Head of Financial Services will continue to monitor interest rates and take a pragmatic approach to changing circumstances. Due to the risks within the economic forecast, and the increased fluctuations in cashflow being experienced, caution will be adopted with the 2022/23 treasury operations, although the decrease in PWLB rates has made the PWLB more competitive again than other sources of borrowing. Additionally the Council will consider carefully when to take out borrowing, balancing the need for cash to fund capital expenditure and the cost of borrowing:

- If it is considered that there is a likelihood of a significant fall in long and short term rates (e.g. due to a marked increase of risks in respect of recession or deflation), then long term borrowing will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

- Alternatively, if it is felt that there is a significant risk of a sharp increase in long and short term rates than currently forecast, then external borrowing is likely to be taken earlier.

Borrowing in Advance of Need

40. The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds. Prior to borrowing in advance the risks and benefits of undertaking the borrowing will be considered. Actual borrowing will be subsequently reported through either the mid-year performance report or annual report as appropriate. Due to the amount of

prudential borrowing in the Capital Programme, the potential benefits of earlier borrowing will be closely monitored.

Minimum Revenue Provision (MRP) Statement 2022/23

41. Prudential borrowing increases the Council's Capital Financing Requirement (CFR) or underlying need to borrow. Whether the Council actually borrows externally to finance capital expenditure is a treasury management decision which is not directly linked to the capital financing decision. In practice, the Council is likely to use a combination of internal and external borrowing in the medium term to fund the Capital Programme. The amount of external borrowing undertaken will depend on the borrowing requirement compared to the projected level of cash balances. The Council is required to make a prudent charge to its revenue account for borrowing, whether that borrowing is financed internally or externally. This charge is known as the Minimum Revenue Provision (MRP) and reflects the repayment cost of principal borrowed.

42. Regulations require the Council to approve an MRP policy on an annual basis and to calculate in each financial year an amount of MRP that it considers to be prudent. In doing this, the Council has to pay regard to governmental statutory guidance on MRP. MRP is not charged until the financial year after the expenditure has been incurred and the asset being financed has become operational.

43. It is recommended that this MRP methodologies continue to be adopted for 2022/23, noting that these are likely to change for 2023/24 when there will be a change in regulations:

    a) For borrowing incurred before 1 April 2008 the practice of making a 4% annual charge on the reducing balance, outlined in the former Department for Communities and Local Government (DCLG) regulations, will apply.

    b) For borrowing that relates to the assets transferred from the Housing Revenue Account (HRA) to the General Fund (GF), MRP will be based on the estimated useful life of the assets, taking into account the number of years the assets have been in existence, and previous funding allocated to them.

    c) There will be no annual MRP charge made for the following items where they are deemed to be capital under s25(b)/s25(d) of The Local Authorities Capital Finance and Accounting (England) Regulations 2003 and where it is anticipated the investment will be repaid in full:

        i. The Council's investments in a Directly Managed Property Fund;
        ii. Loans to other organisations, such as a company in which the Council has an interest;
        iii. Treasury management investments undertaken in accordance with section 12 of the Local Government Act 2003;
        iv. Borrowing related to capital expenditure incurred on assets which are to be leased to one of the Council's companies; and
        v. Other borrowing related to expenditure where it is anticipated the investment will be repaid in full.

The repayment to the Council for these will be a capital receipt of which the Council will set aside the amount for which borrowing was used in order to repay that borrowing. Each item where there is no annual MRP charge will be reviewed on at least an annual basis and if there is a likelihood of capital loss, a prudent MRP provision will then be made. Although this aspect of the policy is still considered to be prudent it is this element that the Government are looking to make changes which could require an annual MRP charge regardless of whether loan agreements are in place to repay the loans.

d) For all borrowing incurred after 1 April 2008 relating to expenditure other than that which is covered in c) above, the MRP will be charged using the Asset Life Method. The default methodology under this option is that MRP will be based on the estimated life of the asset and will be charged to the revenue account in equal instalments over the life of the asset. Where the Head of Financial Services, in their capacity of section 151 officer, is comfortable that the asset or the income arising from that asset is appreciating over time, MRP will be based on an annuity charge over the estimated life of the asset. Applying the annuity method results in an annual charge to revenue which takes account of the time value of money. The charges made through the annuity method thus results in a consistent charge over an asset's life, taking into account the real value of the annual charges when they fall due.

e) For finance leases the council will charge MRP to its General Fund each year dependant on the life of the underlying asset.

Annual Investment Strategy 2022/23

Management of Risk

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

45. The Council's investment policy has regard to the following: -
    - MHCLG's Guidance on Local Government Investments ("the Guidance")
    - CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the Code")
    - CIPFA Treasury Management Guidance Notes 2018

    The Council's investment priorities will be security first, portfolio liquidity second and then yield (return).

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

    a) 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.

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

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

d) This authority has defined the list of **types of investment instruments** that the treasury management team are authorised to use. There are two lists in Appendix 1 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.

47. As a result of the change in accounting standards for 2018/19 under IFRS 9, the Council will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. In November 2018, the Ministry of Housing, Communities and Local Government concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years commencing from 1st April 2018. Even were this over-ride removed now, this would not give cause for concern since the value of investments is significnalty higher than the original cost, although it is worth noting this may not always be the case.

Interest rates

48. Average cash balances for the year to 31st December 2021 were £101.09m, having fluctuated between £83.3m and £113.01m.

49. In March 2020, the bank base rate decreased to 0.10% and has remained at that level for much of 2021, The rate was then increased in December 2021 to 0.25%. Despite this, the Council's property funds are forecast to return around 3.5% on the initial investment value and the new multi-asset funds, which have been invested in to prudently increase interest rate returns, are forecast to return around 3% on the investment value. Overall investment returns are likely to remain uncertain during 2021/22 due to the ongoing pressures of the Covid Pandemic and uncertainties about interest rates.

Investment Durations

50. Most existing investment deal terms are for 6 months or 364 days. Investments are made in accordance with the Council's Treasury Management Strategy such that returns are balanced against security of investment and liquidity of cash to ensure funding of day to day cash flows and yield. Consequently, procedures are in place to determine the maximum periods that funds may be invested for, as well as the nature of those investments. The Council works to achieve the optimum rate of return on its investments commensurate with proper levels of security and liquidity.

Creditworthiness

51. Investment instruments identified for use are listed in Appendix 1 under the Specified and Non-specified investment categories. Counterparty limits are set in accordance with the Council's Treasury Management Practices (TMPs).

52. The Council utilises the creditworthiness services provided by Link Group. The model combines the credit ratings, credit watches and credit outlooks provided by the credit rating agencies - Fitch, Moody's and Standard and Poor's in a weighted scoring system which is then combined with an overlay of Credit Default Swap (CDS) spreads and sovereign ratings. The end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the duration of investments.

53. The Council is alerted to changes to ratings by Link Group's creditworthiness service and takes the following action in respect of updates:

    - If a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, it is withdrawn immediately from further use.
    - If a counterparty's credit rating is placed on negative watch or negative outlook, officers carry out a review to determine whether the institution is still worthy of inclusion on the counterparty list. If there is any doubt, the counterparty is temporarily suspended pending the credit rating agency's full review.

54. As part of the creditworthiness methodology a minimum sovereign rating equal to the UK sovereign rating from Fitch (or equivalent from other agencies if Fitch does not provide one) has been determined.

55. In addition to the recommendations from Link Group, the S151 Officer and Treasury Management Team have agreed to limit the amounts invested with any one country (excluding the UK) or sector as follows:

    - No more than 20% of the previous year's average investment balance (to 31st December) with any one counterparty or group or £15 million, whichever is the greater;

- Maximum of 10% of total investments to be with institutions in other countries that meet the required criteria.

56. To ensure that the Investment Strategy is not breached and to also be aware of any new opportunities, the Council's counterparty list is reviewed on a daily basis taking into account market information and changes to the methodology used. The list is maintained by the Treasury Management Team, and reported to the S151 Officer on a regular basis.

57. The Investment Strategy provides delegated authority for the S151 Officer to determine the most appropriate form of investment dependant on prevailing interest rates and counterparty risk at the time.

Specified and Non-Specified investments

58. In approving the Investment Strategy, Members are approving the types of investments the Council can undertake. Investments are classified as either Specified or Non-specified and are shown in more detail in Appendix 1.

59. The Investment Strategy defines a Specified Investment as one that is in sterling, no more than one year in duration or, if in excess of one year can be repaid earlier on request and with counterparties that meet the Council's credit rating criteria. Additionally, once the duration of a Non-specified Investment falls below 365 days, it also falls into the Specified Investment category.

60. Non-specified investments are any other type of investment including pooled investment funds. Whilst generally these investments will earn a higher rate of return they are inherently more risky in nature and therefore limited to either a maximum of 30% (currently £31.8 million) of the previous full year's average monthly investment balance to 31st December, or £30 million, whichever is the greater. The Council currently has £10 million of property investments; £7 million with Lothbury property fund and £3 million with CCLA Investment Management Ltd property fund. A further investment of £10 million has been placed split equally between Fidelity and Artemis multi asset funds. In the MTFP to be approved by Council there is a proposal to make a further £5 million investment into a pooled investment fund.

61. Investments may be arranged in advance and there has been a significant rise in "forward deals" in recent times. Trades arranged up to four weeks in advance of the start date are still classified as Specified Investments provided the duration of the investment from the start date to the maturity is no longer than 364 days. Trade dates are factored into the duration of the investment if arranged more than four weeks in advance because there is an increased risk due to funds being contractually committed.

Ethical Investment Policy

62. The Council adopted an ethical investment policy in 2015/16. No changes are proposed to the policy which is set out below:

    The Council will not knowingly invest directly in businesses whose activities and practices pose a risk of serious harm to individuals or groups, or whose activities

are inconsistent with the Council's mission and values. This would include, inter alia, avoiding direct investment in institutions with material links to:

a. Human rights abuse (e.g. child labour, political oppression)
b. Environmentally harmful activities (e.g. pollutants, destruction of habitat, fossil fuels)
c. Socially harmful activities (e.g. tobacco, gambling)

There is a new Environmental, Social and Governance Policy attached at Appendix 3. This will be refined over time as more consistent metrics are developed.

Prudential Indicators

63. The Council is required to set out a number of indicators, relating to the affordability and prudence of its Treasury Strategy. These indicators are detailed in Appendix 2 for the period 2021/22 – 2025/26, and will be monitored and reported on an annual basis.

Other implications

64. Environmental Impact – following the inclusion of the Ethical Investment Policy, this ensures that through our investments we will not knowingly, directly invest in businesses that undertake harmful environmental activities.

Financial implications

65. All financial issues are addressed in the body and appendices of the report. The Council's assumptions for net investment interest for the General Fund for 2022/23 to 2025/26 are as follows:

	2022/23 £000's	2023/24 £000's	2024/25 £000's	2025/26 £000's
Interest Payable	8,581	11,170	13,393	14,428
Interest from companies on borrowing	-3,372	-3,063	-4,086	-4,841
Transfer from HRA	-8,990	-10,895	-12,422	-12,789
Treasury management investment interest	-1,140	-1,371	-1,516	-1,656
Net investment interest	-4,921	-4,159	-4,631	-4,858

66. This includes the cost of borrowing, interest from companies and interest from external investments.

Legal issues

67. This report fulfils four key requirements:
    - The reporting of the Prudential Indicators setting out the Council's expected capital activities (as required by the CIPFA Prudential Code for Capital Finance in Local Authorities).
    - Agreeing the Council's Minimum Revenue Provision (MRP) Policy, which sets out how the Council will pay for capital assets through revenue each year (as required by guidance under the Local Government and Public Involvement in Health Act 2007).

- Agreeing the Treasury Management Strategy, which links day to day Treasury Management to the Capital Programme and the Treasury Management Prudential Indicators. The key indicator is the Authorised Limit, the maximum amount of debt the Council could afford in the short term, but which would not be sustainable in the longer term. This is the Affordable Borrowing limit required by S3 of the Local Government Act 2003.
- Agreeing the Investment Strategy, this sets out the Council's criteria for choosing investment counterparties and limiting exposure to the risk of loss.

68. The Local Government Act 2003 and supporting regulations require the Council to have regard to the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set prudential and treasury indicators to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

69. The Council's Constitution requires the Treasury Management Strategy to be reported to the Cabinet and Full Council outlining the expected treasury activity for the forthcoming four years on an annual basis.

Level of risk

70. Risks are managed as set out in this report and appendices.

71. The value of property funds is reliant on the value of the property held by the funds and of multi-asset funds on the value of the assets held by those funds. Property and investment asset values can go down as well as up. The Funds that the Council uses are monitored to ensure that they hold an asset portfolio which will mitigate the risk of specific sectors suffering a loss. The regular returns from Property Funds are from property rentals so as long as the properties remain tenanted there will be a return. The risk of holding property is also affected by the uncertainty over the exit from the EU and changes in the market such as retail. The regular returns from Multi-asset Funds are from income returns which are reliant on the earnings of the underlying assets.

72. As at 31st December 2021, the Lothbury property fund is still returning around 3% revenue on the original investment and the CCLA property fund is returning around 4%. Despite the challenges of the current economic environment, the capital values of the funds, as at 31st December 2021, are still higher than the original investment value by approvimately 21% for Lothbury and 35% for CCLA.

73. Increases and decreases in the value of funds now have to be charged to the revenue account, although there is a statutory mitigation from Government that allows these impacts to be reversed out for the next few years.

Equalities impact

74. The Council has adopted an ethical investment policy to help reduce the environmental, health and wellbeing impacts that could potentially arise from investments. There are no other equalities impacts relating to this report.

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Background Papers: None

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