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Background

The Authority 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 Authority's low risk appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of the Authority's capital plans. These capital plans provide a guide to the borrowing need of the Authority, essentially the longer-term cash flow planning, to ensure that it 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 risk or cost objectives.

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 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, including its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."*

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.

1.1 Reporting Requirements

1.2.1 Capital Strategy

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

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

The aim of the strategy is to ensure that all the Authority's elected members fully understand the overall long-term policy objectives and resulting Capital Strategy requirements, governance procedures and risk appetite.

1.2.2 Treasury Management Reporting

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

a. **Prudential and treasury indicators and treasury strategy** (this report) - The first, and most important report is forward looking and covers: -
   - the capital plans, (including prudential indicators)
   - a minimum revenue provision (MRP) policy, (how residual capital expenditure is charged to revenue over time)
   - the Treasury Management Strategy, (how the investments and borrowings are to be organised), including treasury indicators; and
   - an Annual Investment Strategy, (the parameters on how investments are to be managed)

b. **A mid-year treasury management report** – This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision.

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

Scrutiny
The above reports are required to be adequately scrutinised before being recommended to the Full Authority. This role is undertaken by the Finance, Audit & Performance Management (FAPM) Committee.

Quarterly reports – In addition to the three major reports detailed above, from 2023/24 quarterly reporting (end of June/end of December) is also required. However, these additional reports do not have to be reported to Full Authority but do require adequate scrutinised. This role is undertaken by the FAPM Committee.

1.2 Treasury Management Strategy for 2023/24

The strategy for 2023/24 covers two main areas:

Capital issues
- the capital expenditure plans and the associated 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 Authority
- 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, Welsh Government Investment Guidance and MRP Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code.

1.3 Training

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

Furthermore, pages 47 and 48 of the Code state that they expect "all organisations to have a formal and comprehensive knowledge and skills or training policy for the effective acquisition and retention of treasury management knowledge and skills for those responsible for management, delivery, governance, and decision making.

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

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

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

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

To date it is assumed members undertake training with their home authority although further training will be arranged as required.

A formal record of the training received by officers central to the Treasury function will be maintained by 31 December 2023. Similarly, a formal record of the treasury management/capital finance training received by members will also be maintained by the same date.

1.4 Treasury Management Consultants

The Authority uses Link Group, Link Treasury Services Limited as its external treasury management advisors.

The Authority recognises that responsibility for treasury management decisions always remains with the organisation 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.

It also recognises that there is value in employing external providers of treasury management services to acquire access to specialist skills and resources. The Authority will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented and subjected to regular review.

2. THE CAPITAL PRUDENTIAL INDICATORS 2023/24 – 2025/26

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

2.1 Capital Expenditure and Financing

This prudential indicator is a summary of the Authority's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts: -

Capital, Prudential and Treasury Indicators	2021/22 Outturn	2022/23 Mid Year Review	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Opening CFR	41,630	41,630	46,478	56,538	63,876
Capital Spending	**2,444**	**10,347**	**14,861**	**12,250**	**14,827**
CERA	-200	-200	-200	-200	-200
Capital Receipts	-189	-39			
Capital Grant	-392	-1,444			
Revenue Reserves	0				
Borrowing requirement for the year	**1,662**	**8,665**	**14,661**	**12,050**	**14,627**
Repayment of Debt					
MRP	-2,701	-3,398	-4,163	-4,622	-5,452
MRP on PFI	-365	-419	-437	-91	-320
Closing CFR	**40,227**	**46,478**	**56,538**	**63,876**	**72,731**
Movement in closing CFR	-1,403	6,251	10,060	7,338	8,855
Gross Borrowing at 1 April	29,062	28,146	26,737	35,355	43,960
New Borrowing	0	0	10,000	10,000	10,000
Loan Repayments	-916	-1,409	-1,383	-1,395	-1,406
Gross Borrowing at 31 March	28,146	26,737	35,355	43,960	52,554
Investments/Deposits at 31 March	-3,198	-7,158	-2,058	-1,000	-1,000
Investments/Deposits at 1 April	-7,158	-2,058	-1,000	-1,000	-1,000
Net borrowing at 1 April	25,864	20,989	24,680	34,355	42,960
Net borrowing at 31 March	20,989	24,680	34,355	42,960	51,554
Other long term liabilities i.e. PFI	4,097	3,679	3,242	3,151	2,831
Gross Debt	32,244	30,416	38,596	47,111	55,385
Under/Over borrowed (Gross Debt vs CFR)	**7,984**	**16,062**	**17,942**	**16,765**	**17,346**

The table summarises how capital plans are being financed with any shortfall of resources resulting in a borrowing need, i.e. increase in capital finance requirement (CFR).

2.2 The Authority's Borrowing Need (Capital Financing Requirement (CFR))

The second prudential indicator is the Authority's CFR. The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Authority's indebtedness and so its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

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

The CFR includes any other long-term liabilities e.g., PFI schemes. Whilst these increase the CFR, and therefore the Authority's borrowing requirement, these types of schemes include a borrowing facility by the PFI provider and so the Authority is not required to separately borrow for these schemes.

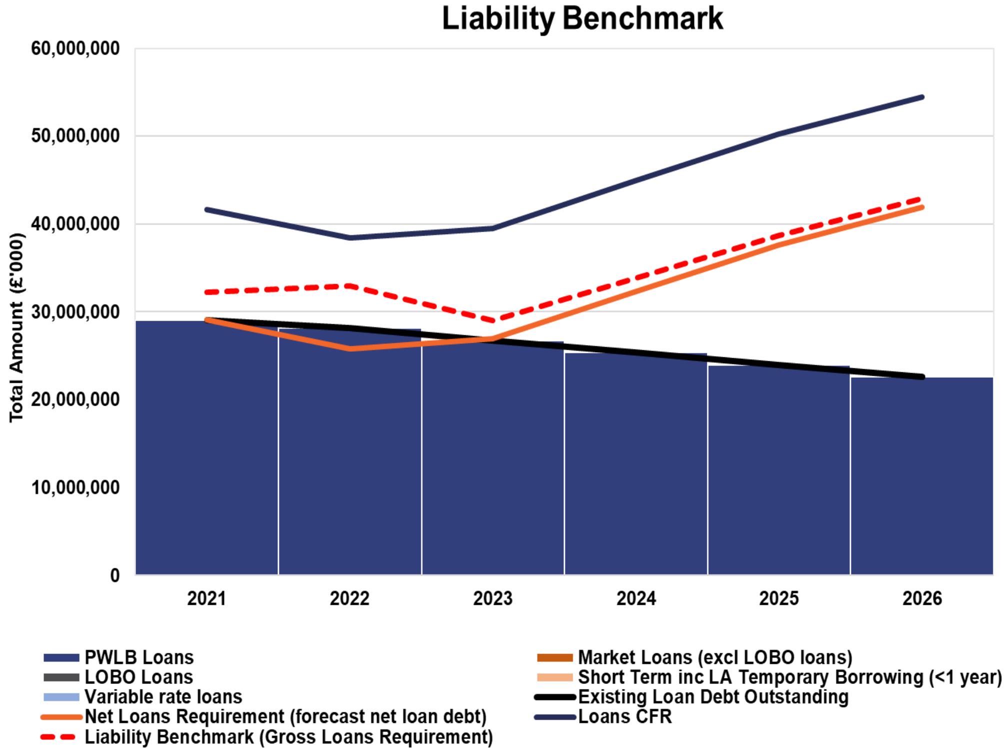
The Authority is asked to approve the CFR projections below:

2.3 Liability Benchmark

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

There are four components to the LB: -

1. **Existing loan debt outstanding**: the Authority'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 Authority'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 Liability Benchmark (Gross Loans Requirement) is a forecast of the level of gross loan debt the Authority will require in accordance with its budget plans.

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).

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.). Detailed below are estimates of the year-end balances for each resource and anticipated day-to-day cash flow balances.

Year End Resources	2021/22	2022/23	2023/24	2024/25	2025/26
	Actual	**Estimate**	**Estimate**	**Estimate**	**Estimate**
Useable Reserves	17,174	16,653	15,524	15,129	14,773
Capital receipts	0	0	0	0	0
Provisions	38	38	38	0	0
Total core funds	**17,212**	**16,691**	**15,562**	**15,129**	**14,773**
Working capital*	7,312	3,058	1,900	1,900	1,900
Under/over borrowing**	7,984	16,062	17,942	16,765	17,346
Expected investments	0	0	0	0	0

*Working capital balances shown are estimated year-end; these may be higher mid-year

2.5 Minimum Revenue Provision (MRP) Policy Statement

Under Regulation 22 an Authority that has financed capital expenditure by borrowing is required to make a provision each year through a revenue charge (MRP). The Authority 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 Authority can use any other reasonable basis that it can justify as prudent.

The MRP policy statement requires full Authority approval in advance of each financial year.

The Authority is recommended to approve the following MRP Statement*:*

For expenditure incurred before 1 April 2008 which forms part of supported capital expenditure, the MRP policy will be:

- **4% reducing balance (regulatory method) -** MRP will follow the historical practice outlined in former regulations as 4% of the opening GF CFR balance less adjustment A (option 1);

From 1 April 2008 for all unsupported borrowing the MRP policy will be;

- **Asset life method (straight line)** – MRP will be based on the estimated life of the assets (option 3);

Capital expenditure will be subject to MRP charge in the year the asset becomes operational.

The Authority will apply the asset life method for any expenditure capitalised under a Capitalisation Direction.

MRP in respect of assets acquired under Finance Leases or PFI will be charged at an amount equal to the principal element of the annual repayment.

MRP Overpayments - Under the MRP guidance, any charges made more than the statutory MRP can be made, are known as voluntary revenue provision (VRP). VRP can be reclaimed in later years if deemed necessary or prudent. For these amounts to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year. There have been no VRP to date or planned for 2023/24.

3. BORROWING

The capital expenditure plans set out in Section 2 provide details of the service activity of the Authority. The treasury management function ensures that the Authority's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity and the Authority'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 26 February 2023 is shown below for both borrowing and investments.

Borrowing/External Debt	**21/22**	**22/23**	**23/24**	**24/25**	**25/26**
PWLB					
Opening Principal	29,040,744.88	28,138,845.46	26,736,946.05	35,354,126.64	43,959,387.23
New Borrowing	0.00	0.00	10,000,000.00	10,000,000.00	10,000,000.00
EIP Principal Repaid	-401,899.42	-401,899.41	-382,819.41	-363,739.41	-363,739.41
Maturity Principal Repaid	-500,000.00	-1,000,000.00	-1,000,000.00	-1,031,000.00	-1,042,000.00
Closing Principal	28,138,845.46	26,736,946.05	35,354,126.64	43,959,387.23	52,553,647.82
Non PWLB/Salix					
Opening Principal	20,750.01	6,916.67	0.00	0.00	0.00
New Borrowing	0.00	0.00	0.00	0.00	0.00
EIP Principal Repaid	0.00	0.00	0.00	0.00	0.00
Maturity Principal Repaid	-13,833.34	-6,916.67	0.00	0.00	0.00
Closing Principal	6,916.67	0.00	0.00	0.00	0.00
Total					
Opening Principal	29,061,494.89	28,145,762.13	26,736,946.05	35,354,126.64	43,959,387.23
New Borrowing	0.00	0.00	10,000,000.00	10,000,000.00	10,000,000.00
EIP Principal Repaid	-401,899.42	-401,899.41	-382,819.41	-363,739.41	-363,739.41
Maturity Principal Repaid	-513,833.34	-1,006,916.67	-1,000,000.00	-1,031,000.00	-1,042,000.00
Closing Principal	28,145,762.13	26,736,946.05	35,354,126.64	43,959,387.23	52,553,647.82
Total principal paid	-915,732.76	-1,408,816.08	-1,382,819.41	-1,394,739.41	-1,405,739.41

The Authority's loan portfolio primarily comprises loans payable at their maturity date. 16 out of 22 are of this type. The remaining loans are repayable on an equal instalment of principle basis (EIP) and total £2.1million at 31 March 2023.

Current Deposit Balances

LLOYDS CURRENT ACCOUNT	3,267,238.32
BARCLAYS CURRENT ACCOUNT	2,338,313.03
	5,605,551.35

Current Bank of England (BoE) rate is 4%

Lloyds is BoE rate -0:10

Barclays BoE rate -0:30

The above also includes the Authority's forward projections for borrowing in summary.

The table 2.1 provides an overview of the above and the position of actual external debt, against the CFR, highlighting any over or under borrowing and Members can see current and future projections result in a consistent, under borrowed position.

Within the range of prudential indicators there are several key indicators to ensure that the Authority operates its activities within well-defined limits. One of these is that the Authority needs to ensure that its gross debt does not, except in the short-term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 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 or speculative purposes.

The Treasurer reports that the Authority complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes account of 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.

Operational Boundary £000	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Debt	46,000	57,000	64,000	73,000
Other long-term liabilities	5,000	3,500	3,500	3,000
Total	51,000	60,500	67,500	76,000

The Authorised Limit for external debt

This is a key prudential indicator and represents a control on the maximum level of borrowing. This represents a legal limit beyond which external debt is prohibited, and this limit needs to be set or revised by the Full Authority. 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.

- 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 local authority plans, or those of a specific authority, although this power has not yet been exercised.
- The Authority is asked to approve the following Authorised Limit:

Authorised Limit £000	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Debt	48,000	58,000	65,000	74,000
Other long-term liabilities	5,000	3,500	3,500	3,00
Total	53,000	61,500	68,500	77,000

Members can track both operational boundary and authorised limits for debt against the CFR in table 2.1.

3.3 Affordability Prudential Indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, and within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Authority's overall finances. The Authority is asked to approve the following indicators: -

Ratio of Financing Costs to Net Revenue Stream

This indicator identifies the trend in the cost of capital, (borrowing and other long-term obligation costs net of investment income), against the net revenue stream.

	2021/22 Actual	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate
Total	5.91%	6.68%	5.78%	6.93%	8.53%

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

3.4 Prospects for Interest Rates

The Authority has appointed Link Group as its treasury advisor and part of their service is to assist the Authority to formulate a view on interest rates. Link provided the following forecasts on 07 February 2023. These are forecasts for Bank Rate, average earnings and PWLB certainty rates, gilt yields plus 80 bps.

Link Group Interest Rate View	07.02.23												
	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26
BANK RATE	4.25	4.50	4.50	4.25	4.00	3.75	3.25	3.00	2.75	2.75	2.50	2.50	2.50
3 month ave earnings	4.30	4.50	4.50	4.30	4.00	3.80	3.30	3.00	2.80	2.80	2.50	2.50	2.50
6 month ave earnings	4.40	4.50	4.40	4.20	3.90	3.70	3.20	2.90	2.80	2.80	2.60	2.60	2.60
12 month ave earnings	4.50	4.50	4.40	4.20	3.80	3.60	3.10	2.70	2.70	2.70	2.70	2.70	2.70
5 yr PWLB	4.00	4.00	3.90	3.80	3.70	3.60	3.50	3.40	3.30	3.20	3.10	3.10	3.10
10 yr PWLB	4.20	4.20	4.10	4.00	3.90	3.80	3.60	3.50	3.50	3.40	3.30	3.30	3.20
25 yr PWLB	4.60	4.60	4.40	4.30	4.20	4.10	3.90	3.80	3.70	3.60	3.50	3.40	3.40
50 yr PWLB	4.30	4.30	4.20	4.10	3.90	3.80	3.60	3.60	3.40	3.30	3.20	3.20	3.10

Additional notes by Link on this forecast table: -

- The central forecast for interest rates reflects a view that the Monetary Policy Committee (MPC) would be keen to further demonstrate its anti-inflation credentials by delivering a succession of rate increases. This has happened but the Government's continued policy of emphasising fiscal rectitude will probably mean bank rate will not need to increase to further than 4.5%.

- It is anticipated the Bank of England (the Bank) will be keen to loosen monetary policy when the worst of the inflationary pressures are behind us 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. One judgment is that there will be scope for an early Christmas present for households with a December rate cut priced in, ahead of further reductions in 2024 and 2025.

- The CPI measure of inflation looks to have peaked at 11.1% in Q4 2022, currently 10.5%. 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.

- Regarding the plan to sell £10bn of gilts back into the market each quarter i.e., quantitative tightening, this has started and will focus on the short, medium, and longer end of the curve in equal measure.

- In the coming months, 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 significant 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

- The yield curve movements have become less volatile of late, and PWLB 5 to 50 years certainty rates are, generally, in the range of 3.75 - 4.75%.

- We view the markets as having built in, nearly all the effects on gilt yields of the likely increases in bank rate and the elevated inflation outlook.

The balance of risks to the UK economy: -

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

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 coming year 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 remain elevated for a longer period within the UK economy, which then necessitates bank rate staying higher for longer than we currently project or even necessitates a further series of increases in later in the year or in 2024.

- **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 remains more stubborn than the market currently anticipates, pulling gilt yields up higher consequently.

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

Borrowing advice: Our long-term (beyond 10 years) forecast for bank rate stands at 2.5%. As all PWLB certainty rates are currently 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 suggested budgeted earnings rates for investments up to about three months' duration in each financial year are rounded to the nearest 10bps as follows: -

Average earnings in each year	
2022/23 (remainder)	4.30%
2023/24	4.30%
2024/25	3.20%
2025/26	2.60%
2026/27	2.50%
Years 6 to 10	2.80%
Years 10+	2.80%

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

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.

3.5 Borrowing Strategy

The Authority is currently maintaining an under-borrowed position. This means that the CFR has not been fully funded with loan debt as cash supporting the Authority'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 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 Treasurer 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 FAPM committee at the next available opportunity.

3.6 Policy on Borrowing in Advance of Need

The Authority will not borrow more than or in advance of its needs purely to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved CFR estimates and will be considered carefully to ensure that value for money can be demonstrated and that the Authority can ensure the security of such funds.

3.7 Rescheduling

Rescheduling of current borrowing in our debt portfolio is unlikely to occur as there is still a large difference between premature redemption rates and new borrowing rates.

If rescheduling is to be undertaken, it will be reported to the FAPM committee at the earliest meeting following its action.

3.8 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 sourcing funding from the following for the following reasons:

- Local authorities (primarily shorter dated maturities out to 3 years or so – generally still cheaper than the Certainty Rate).

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

3.9 Approved Sources of Long and Short-term Borrowing

On Balance Sheet	Fixed
PWLB	●
Local Authorities	●
Banks	●
Local Authority Bills	●
Overdraft	●
Internal (capital receipts & revenue balances)	●
Finance Leases	●

Variable borrowing will not be undertaken as the Authority seeks budget certainty.

4 ANNUAL INVESTMENT STRATEGY

4.1 Investment Policy – Management of Risk

The Welsh Government and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with treasury (financial) investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets and service investments is not undertaken or intended to be undertaken by this Authority.

The Authority's investment policy has regard to the following: -

- The Welsh Government's Guidance on Local Government Investments ("the Guidance")
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2021 ("the Code")
- CIPFA Treasury Management Guidance Notes 2021

The Authority's investment priorities will be security first, portfolio liquidity second and then yield (return). The Authority will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with regard to the Authority's risk appetite.

The above guidance from Welsh Government and CIPFA places 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: -

1. Minimum acceptable **credit criteria** are applied 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 Authority 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.

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

4. This Authority has defined the list of **types of investment instruments** that the treasury management team are authorised to use. This Authority will use 'specified' investments only.

   Specified investments are those with a high level of credit quality and subject to a maturity limit of one year or have less than a year left to run to maturity, if originally, they were classified as being non-specified investments solely due to the maturity period exceeding one year.

Non-specified investments are those with less high credit quality, may be for periods more than one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.

5. **Lending limits** i.e., amounts and maturity for each counterparty will be set at £10 million and for <365 days.

6. **Transaction limits** are set for each type of investment in 4.2.

7. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating**, (see paragraph 4.3).

8. This Authority has engaged **external consultants**, (see paragraph 1.4), to provide expert advice on how to optimise an appropriate balance of security, liquidity, and yield, given the risk appetite of this Authority in the context of the expected level of cash balances and need for liquidity throughout the year.

9. All investments will be denominated in **sterling**.

10. As a result of the change in accounting standards for 2022/23 under IFRS 9, this Authority 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. (The Welsh Government has passed a statutory override to allow Welsh local authorities time to adjust their portfolio of all pooled investments by delaying implementation of IFRS 9 for five years until 31.3.23. At the current juncture it has not been determined whether a further extension to the over-ride will be agreed by Government.

However, this Authority 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 with the exception of counter parties from the UK only, whilst our investments will be in sterling, our potential counterparties can be chosen from the country approved list in the appendices.

4.2 Creditworthiness Policy

This Authority applies the creditworthiness service provided by the Link Group. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody’s and Standard & Poor’s. The credit ratings of counterparties are supplemented with the following overlays: -

1. “watches” and “outlooks” from credit rating agencies;
2. CDS spreads that may give early warning of changes in credit ratings;
3. sovereign ratings to select counterparties from only the most creditworthy countries.

This modelling approach combines credit ratings, and any assigned Watches and Outlooks, in a weighted scoring system which is then combined with an overlay of CDS spreads. The end-product of this is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Authority to determine the suggested duration for investments. The Authority will, therefore, use counterparties within the following durational bands.

- Yellow 5 years *
- Dark pink 5 years for Ultra-Short Dated Bond Funds with a credit score of 1.25
- Light pink 5 years for Ultra-Short Dated Bond Funds with a credit score of 1.5
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 100 days

The Link creditworthiness service uses a wider array of information other than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings.

Typically, the minimum credit ratings criteria the Authority uses will be a short-term rating (Fitch or equivalents) of F1 and a long-term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances, consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

All credit ratings will be monitored before an investment is made and during. The Authority is alerted to changes to ratings of all three agencies through its use of the Link creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Authority's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Authority will be advised of information in movements in Credit Default Swap spreads against the iTraxx European Senior Financials benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link. Extreme market movements may result in downgrade of an institution or removal from the Authority's lending list.

Sole reliance will not be placed on the use of this external service. In addition, this Authority will also use market data and market information, as well as information on any external support for banks to help support its decision-making process.

Y	Pi1	Pi2	P	B	O	R	G	N/C
1	1.25	1.5	2	3	4	5	6	7
Up to 5yrs	Up to 5yrs	Up to 5yrs	Up to 2yrs	Up to 1yr	Up to 1yr	Up to 6mths	Up to 100days	No Colour

Creditworthiness.

Significant levels of downgrades to Short and Long-Term credit ratings have not materialised since the crisis in March 2020. In the main, where they did change, any alterations were limited to Outlooks. However, more recently the UK sovereign debt rating has been placed on Negative Outlook by the three major rating agencies in the wake of the Truss/Kwarteng unfunded tax-cuts policy. Although the Sunak/Hunt government has calmed markets, the outcome of the rating agency reviews is unknown at present, but it is possible the UK sovereign debt rating will be downgraded.

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

CDS prices

Although bank CDS prices, (these are market indicators of credit risk), spiked upwards during the days of the Truss/Kwarteng government, they have returned to more average levels since then. However, sentiment can easily shift, so it will remain important to undertake continual monitoring of all aspects of risk and return in the current circumstances. Link monitor CDS prices as part of their creditworthiness service to local authorities and the Authority has access to this information via its Link-provided Passport portal.

Limits

Due care will be taken to consider the exposure of the Authority's total investment portfolio to non-specified investments, countries, groups and sectors.

a. **Non-specified treasury management investment limit.** The Authority has determined that it will not undertake these investments

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

4.3 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 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.

Investment returns expectations.

The current forecast shown in paragraph 3.3, 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 follows: -

Average earnings in each year	
2022/23 (remainder)	4.30%
2023/24	4.30%
2024/25	3.20%
2025/26	2.60%
2026/27	2.50%
Years 6 to 10	2.80%
Years 10+	2.80%

The above will be used as a benchmark for actual returns to be assessed against.

For its cash flow generated balances, the Authority will seek to utilise mainly its business accounts.

4.4 Investment Performance / Risk Benchmarking

This Authority will use an investment benchmark to assess the investment performance of its investment portfolio, as above.

4.5 End of Year Investment Report

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

4.6 External Fund Managers

The Authority does not use or plan to use external fund managers.

5 APPENDICES

1. Economic background
2. Approved countries for investments
3. Treasury management scheme of delegation
4. The treasury management role of the section 112 officer

5.1 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 in 2022. 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	4.0%	2.5%	4.5%-4.75%
GDP	-0.3%q/q Q3 (1.9%y/y)	+0.1%q/q Q4 (1.9%y/y)	2.9% Q4 Annualised
Inflation	10.5%y/y (Dec)	8.5%y/y (Jan)	6.5%y/y (Dec)
Unemployment Rate	3.7% (Nov)	6.6% (Dec)	3.4% (Jan)

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 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 face some further upward pressures before dropping back slowly through 2023 to finish the year in the range of 4% - 5%.

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 c500k 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 over 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 22 February 2022.

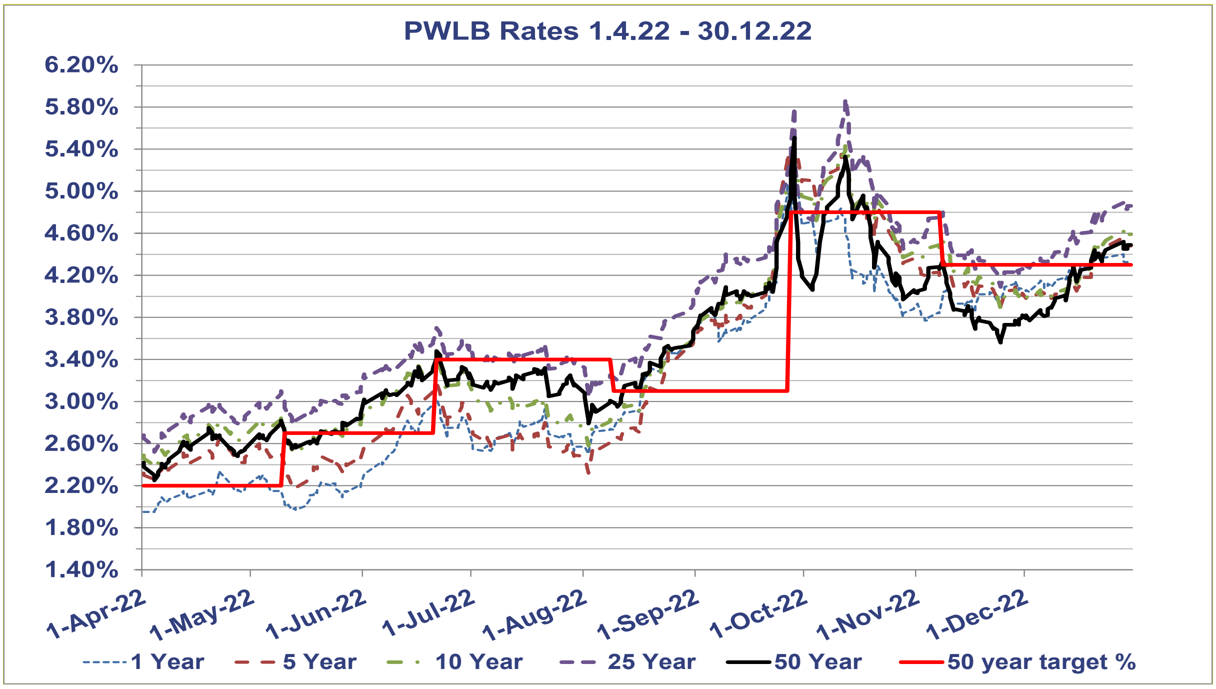
Throughout Q3 Bank Rate increased, finishing the quarter at 2.25% (an increase of 1%). Since then, rates rose to 3.5% in December and 4% in February and the market currently expects Bank Rate to hit 4.5% by June 2023.

Following a Conservative Party leadership contest, Liz Truss became Prime Minister for a tumultuous seven weeks that ran through September and October. 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 the 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 2023. 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. Indeed, their February Monetary Policy Report suggests five quarters of negative growth, albeit a shallow recession with GDP expected to shrink 0.5% in 2023 and 0.25% in 2024.

The £ has remained resilient of late, recovering from a record low of $1.035, on the Monday following the Truss government's "fiscal event", to $1.22. 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 nine months of 2022/23 is clear to see.



However, the peak in rates on 28th September as illustrated in the table covering April to December 2022 below, has been followed by the whole curve shifting lower. PWLB rates at the front end of the curve are generally over 1.25% lower now whilst the 50 years is also over 1% lower.

HIGH/LOW/AVERAGE PWLB RATES FOR 01.04.22 – 30.12.22

	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%	5.45%	5.88%	5.51%
Date	28/09/2022	28/09/2022	12/10/2022	12/10/2022	28/09/2022
Average	3.26%	3.41%	3.57%	3.85%	3.51%
Spread	3.16%	3.26%	3.09%	3.36%	3.26%

The S&P 500 and FTSE 100 have climbed in the early weeks of 2023, albeit the former finished 19% down in 2022 whilst the latter finished up 1%.

CENTRAL BANK CONCERNS – DECEMBER 2022 & FEBRUARY 2023

In December, the Fed decided to push up US rates by 0.5% to a range of 4.25% to 4.5%, whilst the MPC followed by raising Bank Rate from 3% to 3.5%, in line with market expectations. EZ rates have also increased to 2% with further tightening in the pipeline.

Having said that, the sentiment expressed in 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.

At the start of February, US rates have further increased by 0.25% to a range of 4.5% - 4.75%, whilst UK Bank Rate increased 0.5% to 4%.

Regarding UK market expectations, although they now expect Bank Rate to peak within a lower range of 4.25% - 4.5%, 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 and labour market have proven stronger than expected.

In addition, the Bank's central message that GDP will fall for five quarters starting with Q1 2023 may prove to be a little pessimistic. Will the 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).

5.2 APPROVED COUNTRIES FOR INVESTMENTS

This list is based on those countries which have sovereign ratings of AA- or higher, (we show the lowest rating from Fitch, Moody's and S&P) and also, (except - at the time of writing - for Hong Kong and Luxembourg), have banks operating in sterling markets which have credit ratings of green or above in the Link creditworthiness service.

Based on lowest available rating

AAA

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

AA+

- Canada
- Finland
- U.S.A.

AA

- Abu Dhabi (UAE)
- France

AA-

- Belgium
- Qatar
- **U.K.**

5.3 TREASURY MANAGEMENT SCHEME OF DELEGATION

(i) Fire Authority

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

(ii) FAPM committees

- 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) Treasurer with responsibility for scrutiny

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

5.4 THE TREASURY MANAGEMENT ROLE OF THE SECTION 112 OFFICER

The S112 (responsible) officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.
- preparation of a Capital Strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long-term timeframe *(to be determined in accordance with local priorities.)*
- ensuring that the Capital Strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money
- ensuring that due diligence has been carried out on all treasury investments and is in accordance with the risk appetite of the authority
- ensure that the Authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing
- ensuring the proportionality of all investments so that the Authority does not undertake a level of investing which exposes the Authority to an excessive level of risk compared to its financial resources
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long-term liabilities
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees
- ensuring that members are adequately informed and understand the risk exposures taken on by the Authority
- ensuring that the Authority has adequate expertise, either in house or externally provided, to carry out the above
- creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed, to include the following: -
    - *Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;*
    - *Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;*
    - *Decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;*

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

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