COUNCIL MEETING – 23RD FEBRUARY 2023

AGENDA ITEM NO. 5 (2)

ANNUAL TREASURY MANAGEMENT STRATEGY AND ANNUAL NON-TREASURY INVESTMENT STRATEGY 2023/24

A report from the meeting of Corporate Governance, Audit and Standards Committee held on 30th January 2023.

1 INTRODUCTION

1.1 This report sets out the proposed Treasury Management Strategy and Non-Treasury Investment Strategy for the year 2023-24, including the borrowing and investment strategies and treasury management indicators for capital finance for 2023-24 and the Minimum Revenue Provision Statement.

1.2 Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2021 Edition (the CIPFA Code) which requires approval of a treasury management strategy before the start of each financial year. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

1.3 The CIPFA Treasury Management Code of Practice 2021 Edition, requires the Authority to have a separate Non-Treasury Investment Strategy (Appendix 2) which must be approved before April 2022.

1.4 Local authorities are also required by regulation to 'have regard to' the provisions of the Prudential Code for Capital Finance in Local Authorities (Prudential Code) 2021.

2 PURPOSE

2.1 The primary purpose of the treasury management operation is to ensure that 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 low risk approach, pursuing optimum performance while ensuring that security of the investment is considered ahead of investment return. The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure.

2.2 The secondary function of the treasury management operation 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 the Council can meet its capital spending obligations. The management of longer-term cash may involve the arrangement of long and/or short-term loans (external borrowing) or may use longer term cash flow surpluses in lieu of external borrowing (internal borrowing).

2.3 Accordingly, the Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as: *"The management of the Council'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".*

2.4 The primary purpose of non-treasury investment management operations is to ensure that all investment decisions that are made primarily to generate a profit have a suitable level of security and liquidity. Ensuring risks and rewards are monitored regularly.

2.5 The secondary function of investment management is to generate potential returns and monitor performance of returns on a regular basis.

2.6 The purpose of the indicators is to set a framework for affordable, prudent and sustainable capital investment.

2.7 The appendices (1 to 3) set out the Treasury Management Strategy, Investment Strategy and Minimal Revenue Provision Statement for 2023-24 and fulfil key legislative requirements as follows:

<u>Appendix 1</u>

- The **Treasury Management Strategy** which sets out how the Council's treasury operation will support capital decisions taken during the period, the day-to-day treasury management and the limitations on activity through treasury prudential indicators, in accordance with CIPFA's Code of Practice on Treasury Management and Prudential Code;
- The **Annual Borrowing Strategy** which sets out the Council's objectives for borrowing together with the approved sources of long and short-term borrowing and;
- **Annual Treasury Management Investment Strategy** which sets out the Council's criteria for choosing investment counterparties and limiting exposure to the risk of loss, in accordance with CIPFA's Code of Practice on Treasury Management.

<u>Appendix 2</u>

- The **Non-Treasury Investment Strategy** sets out the Council's investment decisions taken during the period and monitors performance and security, in accordance with MHCLG Investment Guidance.

Appendix 3

- The Council's **Minimum Revenue Provision (MRP) Statement,** which sets out how the Council will pay for capital assets through revenue each year, as required by the Local Government Act 2003 (Regulations 27 and 28 in the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003).

2.8 These policies and parameters provide an approved framework within which officers undertake the day-to-day capital, treasury and non-treasury investment activities.

3 SCOPE

3.1 This report covers the Council's treasury management and investment activities as set out in paragraphs 2.1 to 2.5 above. The funds invested consist of short-term cash available due to timing of income and expenditure, prudential borrowing and the Council's capital receipts.

3.2 Arlingclose advice continues to indicate that the Council should diversify investment risk (spreading smaller amounts over an increasing number of counterparties) wherever possible.

3.3 The Council incurred no prudential code borrowing in 2021-22 in relation to its capital expenditure. Borrowing to support the financing of its approved capital programme in 2023-24 however will be required. The Council therefore commences 2023-24 in a position where its investment holdings continue to remain significant but also carries significant and accumulating debt. There will be an inevitable requirement to incur some further borrowing to service capital expenditure in future years.

3.4 Careful observation of the "gross debt v capital financing requirement" indicator will need to be undertaken progressively throughout the financial year.

3.5 Where a material change to the attached strategies occurs during the year a revised strategy will be presented to Full Council before the change is implemented.

4 RECOMMENDATIONS

4.1 The Council is recommended to approve:

(i) Approval of the Treasury Management Strategy 2023-24, Annual Borrowing Strategy 2023-24 attached at Appendix 1, and
(ii) Approve Annual Non-Treasury Investment Strategy attached 2023-24 at Appendix 2; and
(iii) Approval of the Minimum Revenue Provision (MRP) Statement set out in Appendix 3.

P.J. CULLUM
CHAIRMAN OF THE CORPORATE GOVERNANCE, AUDIT AND STANDARDS COMMITTEE

APPENDIX 1

TREASURY MANAGEMENT STRATEGY 2023-24

1 INTRODUCTION

1.1 Treasury management is the management of the Council's cash flows, borrowing and investments, and the associated risks. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Council's prudent financial management.

1.2 Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2021 Edition* (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year. This report fulfils the Council's legal obligation under the *Local Government Act 2003* to have regard to the CIPFA Code. The Coporate Governance Audit and Strategy Committee is the nominated Committee responsible for the effective scrutiny of the Treasury Management Strategy and policies.

1.3 Investments held for service purposes or for commercial profit are considered in a separate part of this report, the Investment Strategy at **Appendix 2**.

1.4 This strategy covers:

- External context
- Current borrowing and investment portfolio position
- Annual Borrowing Strategy
- Annual Investment Strategy
- Performance Indicators

2 EXTERNAL CONTEXT

Economic background (6 January 2023)

2.1 The ongoing impact on the UK from the war in Ukraine, together with higher inflation, higher interest rates, uncertain government policy, and a deteriorating economic outlook, will be major influences on the Authority's treasury management strategy for 2023/24.

2.2 The Bank of England (BoE) increased Bank Rate by 0.5% to 3.5% in December 2022, this followed the 0.75% rise in November which was the largest single rate hike since 1989 and the eighth successive rise since December 2021. The December decision was voted for by a 63 majority of the Monetary Policy Committee (MPC), with one of the two dissenters voting for no change at 3.0% rise and the one for just a larger rise of 0.75% rise.

2.3 The November quarterly Monetary Policy Report (MPR) forecast a prolonged but shallow recession in the UK with CPI inflation remaining elevated at over 10% in the near-term. While the projected peak of inflation is lower than in the August report, due in part to the government's support package for household energy costs, inflation is expected remain higher for longer over the forecast horizon and the economic outlook remains weak, with unemployment projected to start rising.

2.4 The UK economy contracted by 0.3% between July and September 2022, but the BoE forecasts Gross Domestic Product(GDP) will decline 0.75% in the second half of the calendar year due to the squeeze on household income from higher energy costs and goods prices. Growth is then expected to continue to fall throughout 2023 and the first half of 2024.

2.5 CPI inflation is expected to peak at around 11% in the last calendar quarter of 2022 and then fall sharply to 1.4%, below the 2% target, in two years' time and to 0% in three years' time if Bank Rate follows the path implied by financial markets with a peak of 5.25%. However, the BoE has stated it considers this path to be too high, suggesting that the peak in interest rates will be lower, reducing the risk of inflation falling too far below target. Market rates have fallen since the time of the November MPR.

2.6 The labour market remains tight for now, with the most recent statistics showing the unemployment rate fell to 3.7%, driven mostly by a shrinking labour force. Earnings were up strongly in nominal terms by 6.1% for both total and regular pay but factoring in inflation means real pay for both measures was (2.7)%. Looking forward, the MPR shows the labour market weakening in response to the deteriorating outlook for growth, leading to the unemployment rate rising to around 6.5% in 2025.

2.7 Interest rates have also been rising sharply in the US, with the Federal Reserve increasing the range on its key interest rate by 0.5% in December 2022 to 4.25 - 4.5%. This rise follows the fourth successive 0.75% rise in a pace of tightening that has seen rates increase from 0.25 - 0.50% in March 2022. Annual inflation has been slowing in the US but remains above 7%. GDP grew at an annualised rate of 3.2% (revised up from 2.9%) between July and September 2022, but with official interest rates expected to rise even further in the coming months, a recession in the region is widely expected at some point during 2023.

2.8 Inflation has been rising consistently in the Euro Zone since the start of the year, hitting an annual rate of 10.6% in October 2022 before declining to 10.1% in November. Economic growth has been weakening with an upwardly revised expansion of just 0.3% (from 0.2%) in the three months to September 2022. As with the UK and US, the European Central Bank has been on an interest rate tightening cycle, pushing up its three key interest rates by 0.5% in December, following two consecutive 0.75% rises taking its main refinancing rate to 2.5% and deposit facility rate to 2.0%.

Credit outlook:

2.9 Credit default swap (CDS) prices have followed an upward trend throughout the year, indicating higher credit risk. They have been boosted by the war in Ukraine, increasing economic and political uncertainty and a weaker global and UK outlook, but remain well below the levels seen at the beginning of the Covid-19 pandemic.

2.10 CDS price volatility has been higher in 2022 compared to 2021 and this year has seen a divergence in prices between ringfenced (retail) and non-ringfenced (investment) banking entities once again.

2.11 The weakening economic picture during 2022 led the credit rating agencies to reflect this in their assessment of the outlook for the UK sovereign as well as several local authorities and financial institutions, revising them from to negative from stable.

2.12 There are competing tensions in the banking sector which could impact bank balance sheet strength going forward. The weakening economic outlook and likely recessions in many regions increase the possibility of a deterioration in the quality of banks' assets, while higher interest rates provide a boost to net income and profitability.

2.13 However, the institutions on our adviser Arlingclose's counterparty list remain well-capitalised and their counterparty advice on both recommended institutions and maximum duration remain under constant review and will continue to reflect economic conditions and the credit outlook.

Interest rate forecast (December 2022)

2.14 The Authority's treasury management adviser Arlingclose forecasts that Bank Rate will continue to rise in 2022 and 2023 as the Bank of England attempts to subdue inflation which is significantly above its 2% target.

2.15 While interest rate expectations reduced during October and November 2022, multiple interest rate rises are still expected over the forecast horizon despite looming recession. Arlingclose expects Bank Rate to rise to 4.25% by June 2023 under its central case, with the risks in the near- and medium-term to the upside should inflation not evolve as the Bank forecasts and remains persistently higher.

2.16 Yields are expected to remain broadly at current levels over the medium-term, with 5,10 and 20 year gilt yields expected to average around 3.6%, 3.7%, and 3.9% respectively over the 3-year period to September 2025. The risks for short, medium and longer-term yields are judged to be broadly balanced over the forecast horizon. As ever, there will undoubtedly be short-term volatility due to economic and political uncertainty and events.

2.17 A more detailed economic and interest rate forecast provided by Arlingclose is in Appendix A.

2.18 For the purpose of setting the budget, it has been assumed that new treasury investments will be made at an average rate/yield of 2.73%, and that new long-term loans will be borrowed at an average rate of 4.75%.

3 LOCAL CONTEXT

3.1 On 31 December 2022, the Council held £100.0m of short-term borrowing, long-term liabilities of £1.7m and £27.9m of investments. This is set out in further detail below in table 3. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Balance sheet (Capital Expenditure, Gross Debt and Capital Financing Requirement summary)	2021-22 Actual £m	2022-23 Forecast £m	2023-24 Budget £m	2024-25 Estimate £m	2025-26 Estimate £m
Debt (incl. leases)	101.7	115.4	128.7	128.2	128.0
Capital Financing Requirement	121.6	144.3	171.0	171.0	171.0
Difference	19.9	28.1	42.3	42.8	43.0
Investments	36.1	31.9	31.9	31.9	31.9

3.2 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

3.3 The Council has an increasing CFR due to the capital programme, stable level of investments and will therefore be required to borrow up to £27m over the forecast period.

3.4 CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. The table above shows that the Council expects to comply with this recommendation during 2023-24 and following two financial years.

3.5 **Liability benchmark:** To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as in the table above, but that cash and investment balances are kept to a minimum level of £10m at each year-end to maintain sufficient liquidity but minimise credit risk.

3.6 The liability benchmark is an important tool to help establish whether the Council is likely to be a long-term borrower or long-term investor in the future, and so shape its strategic focus and decision making. The liability benchmark itself represents an estimate of the cumulative amount of external borrowing the Council must hold to fund its current capital and revenue plans while keeping treasury investments at the minimum level required to manage day-to-day cash flow.

Liability Benchmark	2021-22 Actual	2022-23 Forecast	2023-24 Budget	2024-25 Estimate	2023/24 Estimate
Outstanding borrowing	100.0	115.0	128.0	128.0	128.0
Investment minimum	(10.0)	(10.0)	(10.0)	(10.0)	(10.0)
Investments held that can be redeemed	(36.1)	(36.1)	(31.9)	(31.9)	(31.9)
Liability benchmark	73.9	73.1	86.1	86.1	86.1

3.7 Following on from the medium-term forecasts in the table above, the long-term liability benchmark assumes capital expenditure funded by borrowing of £27m the first year, minimum revenue provision on new capital expenditure based on a 50-year asset life and income, expenditure and reserves all increasing by inflation of 4.25% a year.

Existing Investment & Debt Portfolio	Actual Portfolio at 31-Dec-22	Average Rate %
External Borrowing		
Local Authorities	100.0	0.63
Other Long-term Liabilities		
Leases	1.7	
Total Gross External Debt	**101.7**	
Treasury Investments		
Managed In-house		
Money Market Funds	6.0	0.97
Managed Externally		
CCLA LAMIT Property Fund	3.9	5.03
M&G Investments Strategic Corporate Bond Fund	5.0	2.53
UBS Multi-asset Fund	2.0	4.31
Kames Diversified Monthly Income Fund	4.0	2.21
Columbia Threadneedle Investments	5.0	4.55
Schroder Income Maximiser Fund	2.0	4.61
Total Investments	**27.9**	**2.73**
Net Debt	**73.8**	

4 CURRENT BORROWING & INVESTMENT PORTFOLIO POSITION

4.1 The Guidance on Local Government Investments in England gives priority to security and liquidity, and the Council’s aim has been to achieve a yield commensurate with these principles. The Council continues to follow Arlingclose advice in the knowledge that whilst long-term interest rate forecasts remain low it should generate enhanced returns with counterparties other than banks and to invest across a diverse investment portfolio.

4.2 During 2021-22 the Council has generated returns from existing long-term pooled fund investments together with diversification within the Council's investment portfolio. The Council held the following investments on 31 December 2022:

- £22.2m in pooled funds (providing a balance across a range of 6 different types of funds).
- Various temporary investments of minor amounts held in Money Market funds all for durations of 6 months or less

The table above illustrates the Council's investment and debt portfolio position as at 31 December 2022.

5 ANNUAL BORROWING STRATEGY 2023-24

5.1 The Council currently holds £100.0m of loans, representing no change the previous year, as part of its previous strategy for funding prior years' capital programmes. The balance sheet forecast in table 1 shows that the Council expects to borrow up to £27m in 2023-24.

5.2 Capital expenditure in 2022-23 financial year includes expenditure on the Union Yard regeneration project. Prudential borrowing will therefore be required in order to achieve overall financing. The Council will incur some further borrowing during 2023-24 in order assist in the financing of its capital programme.

5.3 In order to manage the risk associated with borrowing to fund capital expenditure on 15 November 2022 Cabinet agreed new capital principles:

- All new capital investment priorities should be funded from either capital receipts or external sources (grants)
- The financing of new capital investment should focus on ensuring borrowing is limited to the lowest possible value

5.4 **Objectives**: The Council's chief objective when borrowing money will be to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

5.5 **Strategy:** Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is more cost effective to borrow in the short-term to either use internal resources, or to borrow short-term loans instead. The Council is anticipating undertaking refinancing of some of its existing debt portfolio as it becomes due and move a proportion of the debt to longer-term more stable interest rates.

5.6 By adopting this approach, the Council is able to reduce net borrowing costs (despite forgone investment income) and reduce overall treasury risk. The benefits of internal/short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years, however long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Council with this 'cost of carry' and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2023-24 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

5.7 Alternatively, the Council may arrange forward starting loans, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

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

5.9 In addition, the Council may borrow further short-term loans to cover unplanned cash flow shortages.

5.10 **Sources of borrowing**: The approved sources of long-term and short-term borrowing are summarised below:

- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
- Money market loans (long term & temporary)
- Any bank or building society authorised to operate in the UK
- UK Local Authorities
- UK public and private sector pension funds (except the Local Government Pension Scheme administered by Hampshire County Council)
- Capital market bond investors
- UK Municipal Bond Agency plc and other special purpose companies created to enable local authority bond issues.
- Lottery monies

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

- Leasing
- Hire purchase
- Private Finance Initiative
- Sale and leaseback

5.12 The Council has previously raised the majority of its borrowing from Local Authorities, but it continues to investigate other sources of finance, that may be available at more favourable rates.

5.13 **Municipal Bonds Agency:** UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It issues bonds on the capital markets and lends the proceeds to local authorities. This is a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a guarantee to refund their investment if the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to Council.

5.14 **Short-term and variable rate loans**: These loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators in Section 7.

6 ANNUAL TREASURY MANAGEMENT INVESTMENT STRATEGY 2023-24

6.1 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. As at 31 December 2022 the Council's investment balance stood at £27.4m. The Council estimates that the level of investment held in Money Market Funds (MMFs) will increase to £10m at the financial year end. In future years the Council estimates to hold on average £25m.

6.2 **Objectives**: The CIPFA Code requires the Authority to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Authority will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested. The Authority aims to be a responsible investor and will consider environmental, social and governance (ESG) issues when investing.

6.4 **Strategy**: Given the increasing risk and very low returns from short-term unsecured bank investments, the Council aims to maintain a diverse range of secure and/or higher yielding asset classes during 2023-24. the Authority expects to be a long-term borrower and new treasury investments will therefore be made primarily to manage day-to-day cash flows using short-term low risk instruments. The existing portfolio of strategic pooled funds will be maintained to diversify risk into different sectors and boost investment income.

6.5 The CIPFA Code does not permit local authorities to both borrow and invest long-term for cash flow management. But the Authority may make long-term investments for treasury risk management purposes, including to manage interest rate risk by investing sums borrowed in advance for the capital programme for up to three years; to manage inflation risk by investing usable reserves in instruments whose value rises with inflation; and to manage price risk by adding diversification to the strategic pooled fund portfolio.

6.5 **Business models:** Under the IFRS 9 standard, the accounting for certain investments depends on the Council's "business model" for managing them. The Council aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

6.6 **Approved counterparties:** The Council may invest its surplus funds with any of the counterparty types in the table below, subject to the cash limits (per counterparty) and the time limits shown. The schedule of approved counterparties is underpinned by a detailed list of named counterparties. This list is maintained within Financial Services for treasury management operational purposes.

Sector	Time limit Years	Counterparty Limit £m	Sector Limit £m
Local authorities & other government entities	25	10	Unlimited
Money market funds*	N/a	7	30
Strategic pooled funds	N/a	5	30

*** Minimum credit rating:** Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating is no lower than A-. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise, the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

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

6.8 **Money market funds:** Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the Authority will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

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

6.10 Investments may be made with banks or any public or private sector organisations that meet the above credit rating criteria. The Council may also invest with organisations and pooled funds without credit ratings, following an external credit assessment and advice from the Council's treasury management adviser.

6.11 **Credit rating:** Investment limits are set by reference to the lowest published long-term credit rating from a selection of external rating agencies. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

6.12 **Investment limits**: The Council's revenue reserves available to cover investment losses are forecast to be £2 million on 31 March 2023. In order that no more than 20% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £7 million. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries. Detail of investment limits are given in table 4 above.

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

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

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

6.15 **Liquidity management**: The Council reviews cash flow daily to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments.

6.16 **Other Information on the Security of Investments**: The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Council's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

6.17 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, this is not reflected in general credit-ratings. In these circumstances, where the Council feels the whole market has been affected, it will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government, or with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

7 TREASURY MANAGEMENT PRUDENTIAL INDICATORS

7.1 The Treasury Management Code requires that local authorities set a number of indicators for treasury management performance, which have been set as below. A voluntary measure for credit risk as set out in paragraph 7.2

7.2 **Credit Risk (Credit Score Analysis)**: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating / credit score of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

The advice from Arlingclose is to aim for an average A-, or higher, average credit rating, with an average score of 7 or lower. The scores are weighted according to the size of our deposits (value-weighted average) and the maturity of the deposits (time-weighted average).

Credit risk indicator	Target
Portfolio average credit rating	A-
Portfolio average credit score	7.0

7.3 **Liquidity:** The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount cash available within a rolling three-month period, without additional borrowing

Liquidity risk indicator	Target
Total cash available within 3 months	£1m

7.4 **Interest Rate Exposures**: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates will be:

Interest rate risk indicator	Limit
Upper limit on one-year revenue impact of a 1% <u>rise</u> in interest rates	£500,000
Upper limit on one-year revenue impact of a 1% <u>fall</u> in interest rates	£500,000

The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.

7.5 **Maturity Structure of Borrowing**: This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing will be:

Maturity Structure	Upper	Lower
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

7.6 **Principal Sums Invested for Periods Longer than a Year**: The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

Principal Sums Invested	2023-24	2024-25	2025-26
Limit on principal invested beyond year end at any one time	£90m	£90m	£90m

8 RELATED MATTERS

8.1 The CIPFA Code requires the Council to include the following in its treasury management strategy.

8.2 **Policy on Use of Financial Derivatives**: Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk, and to reduce costs or increase income at the expense of greater risk. The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e., those that are not embedded into a loan or investment).

The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

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

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

8.3 **Markets in Financial Instruments Directive**: The Council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but with the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the Executive Head of Finance believes this to be the most appropriate status.

8.4 **Investment Training**: The investment training needs of the Council's treasury management staff are assessed on a continuous basis, discussed as part of the staff development reviews and reviewed as the responsibilities of individual members of staff change.

Staff regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA.

8.5 **Financial Implications - Investments:** The budget for investment income in 2023-24 is £1.25m (gross of borrowing interest), based on an average investment portfolio of £30m at interest rates ranging from 0.01% liquid MMF and other short-term investments to 6.9% on the highest yielding long-term pooled investment fund. Performance of investments against budget will be reviewed on an ongoing basis and as part of our quarterly budget monitoring process.

8.6 **Financial Implications - Borrowing:** The budget for interest costs in relation to borrowing in 2023-24 is £4.6m (not including IFRIC 4 lease accounting interest). It is determined using the current average rate of interest on borrowing incurred for 2022-23 and taking into account recent interest rate movements and the borrowing strategy. The Council's actual borrowing at the end of 2023-24 is estimated to be in the region of £127m

8.7 **Other Options Considered:** The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Executive Head of Finance continues to believe that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain

Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

Arlingclose Economic and Interest Rate Forecast – December 2022

Underlying assumptions:

- The influence of the mini-budget on rates and yields continues to wane following the more responsible approach shown by the new incumbents of Downing Street.
- Volatility in global markets continues, however, as investors seek the extent to which central banks are willing to tighten policy, as evidence of recessionary conditions builds. Investors have been more willing to price in the downturn in growth, easing financial conditions, to the displeasure of policymakers. This raises the risk that central banks will incur a policy error by tightening too much.
- The UK economy is already experiencing recessionary conditions and recent GDP and PMI data suggests the economy entered a technical recession in Q3 2022. The resilience shown by the economy has been surprising, despite the downturn in business activity and household spending. Lower demand should bear down on business pricing power – recent data suggests the UK has passed peak inflation.
- The lagged effect of the sharp tightening of monetary policy, and the lingering effects of the mini-budget on the housing market, widespread strike action, alongside high inflation, will continue to put pressure on household disposable income and wealth. The short- to medium-term outlook for the UK economy remains bleak.
- Demand for labour appears to be ebbing, but not quickly enough in the official data for most MPC policymakers. The labour market remains the bright spot in the economy and persisting employment strength may support activity, although there is a feeling of borrowed time. The MPC focus is on nominal wage growth, despite the huge real term pay cuts being experienced by the vast majority. Bank Rate will remain relatively high(er) until both inflation and wage growth declines.
- Global bond yields remain volatile as investors price in recessions even as central bankers push back on expectations for rate cuts in 2023. The US labour market remains tight and the Fed wants to see persistently higher policy rates, but the lagged effects of past hikes will depress activity more significantly to test the Fed's resolve.
- While the BoE appears to be somewhat more dovish given the weak outlook for the UK economy, the ECB seems to harbour (worryingly) few doubts about the short-term direction of policy. Gilt yields will be broadly supported by both significant new bond supply and global rates expectations due to hawkish central bankers, offsetting the effects of declining inflation and growth.

Forecast:

- The MPC raised Bank Rate by 50bps to 3.5% in December as expected, with signs that some members believe that 3% is restrictive enough. However, a majority of members think further increases in Bank Rate might be required. Arlingclose continues to expect Bank Rate to peak at 4.25%, with further 25bps rises February, March and May 2023.
- The MPC will cut rates in the medium term to stimulate a stuttering UK economy but will be reluctant to do so until wage growth eases. We see rate cuts in the first half of 2024.
- Arlingclose expects gilt yields to remain broadly steady over the medium term, although with continued volatility across shorter time periods.
- Gilt yields face pressures to both sides from hawkish US/EZ central bank policy on one hand to the weak global economic outlook on the other. BoE bond sales and high government borrowing will provide further underlying support for yields.

PWLB Standard Rate (Maturity Loans)

	Current	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
Official Bank Rate													
Upside risk	0.00	0.50	0.75	1.00	1.00	1.00	1.25	1.50	1.75	1.50	1.25	1.25	1.25
Arlingclose Central Case	3.50	4.00	4.25	4.25	4.25	4.25	4.00	3.75	3.50	3.25	3.25	3.25	3.25
Downside risk	0.00	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00
3-month money market rate													
Upside risk	0.00	0.50	0.75	1.00	1.00	1.00	1.25	1.50	1.75	1.50	1.25	1.25	1.25
Arlingclose Central Case	3.00	4.40	4.40	4.40	4.35	4.30	4.25	4.00	3.75	3.50	3.40	3.40	3.40
Downside risk	0.00	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.00
5yr gilt yield													
Upside risk	0.00	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.43	3.60	3.80	3.80	3.80	3.70	3.60	3.50	3.40	3.30	3.30	3.30	3.30
Downside risk	0.00	0.80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
10yr gilt yield													
Upside risk	0.00	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.47	3.50	3.60	3.60	3.60	3.60	3.50	3.50	3.50	3.50	3.50	3.50	3.50
Downside risk	0.00	0.80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
20yr gilt yield													
Upside risk	0.00	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.86	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85
Downside risk	0.00	0.80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
50yr gilt yield													
Upside risk	0.00	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.46	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60
Downside risk	0.00	0.80	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00

PWLB Standard Rate (Maturity Loans) = Gilt yield + 1.00%
PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%
UKIB Rate (Maturity Loans) = Gilt yield + 0.60%

ANNUAL NON-TREASURY INVESTEMENT STRATEGY 2023-24

1 INTRODUCTION

1.1 The Council invests its money for three broad purposes:

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

1.2 This investment strategy meets the requirements of statutory guidance issued by the government in January 2018 and focuses on the second and third of these categories.

2 SERVICE IMPROVEMENTS: LOANS

2.1 **Contribution:** The Council lends money to its subsidiaries, local businesses, and its employees to support local public services and stimulate local economic growth. The Council is a funding partner of Farnborough International Limited. The loans have enabled the development of the Farnborough International exhibition and conference centre. Expanding the exhibition and conferencing capabilities in Farnborough brings increased economic capacity to the Borough and is a reinvestment in local business. The Council established a Wholly Owned Company (WOC) subsidiary, Rushmoor Homes Limited (RHL), in April 2020. The Council will lend to RHL at a commercial rate to enable procurement of property.

2.2 **Security:** The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to limit this risk, and ensure that total exposure to service loans remains proportionate to the size of the Council, upper limits on the outstanding loans to each category of borrower have been set as follows:

Loans for service purposes in £ millions

Category of Borrower	2021-22 Actual £m	2022-23 Forecast £m	2023-24 Estimate £m
Local businesses	6.7	6.7	6.7
Subsidiaries & Partnerships	0.7	1.2	3.0
Employees	0.1	0.1	0.1
Total	**7.5**	**8.0**	**9.8**

2.3 Accounting standards require the Council to set aside loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Council's statement of accounts are shown net of this loss allowance. However, the Council makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments.

2.4 **Risk assessment:** The Council assesses the risk of loss before entering into lending agreements and whilst holding service loans by assessing the counterparty's resilience, the service users' needs that the loan is designed to help meet and how these will evolve over-time. During the life of the loan any change in original assumptions will be monitored. The Council will use external advisors if felt appropriate by the Executive Head of Finance. All loans will be subject to contract agreed by the Corporate Manager – Legal Services. All loans must be approved by full Council and will be monitored by the Executive Head of Finance.

2.5 **FIL loan interest deferral:** The Council has two loan agreements with FIL. As reported to members in the Revenue Budget Monitoring Report for P1 (FIN2115) the Council and the other funding consortium funding partners as part of the original FIL loan agreed to defer interest payments to provide cashflow support to Farnborough International Limited (FIL) following the cancellation of the 2020 Airshow. A revised Intercreditor Agreement was signed during 2021 that includes the capitalisation of interest and deferral of repayments to the public sector funding partners by 2 years. The first loan repayments will now de due in June 2026 with a further payment in June 2028. Therefore, the Council will not receive the full payment of interest covering the period from March 2020 to March 2022 until March 2024 subject to the covenant agreements within the agreement being met.

3 SERVICE INVESTMENTS: SHARES

3.1 **Contribution:** The Council invests in the shares of its subsidiary Rushmoor Homes Limited and holds a financial share in a development partnership, Rushmoor Development Partnership (RDP), as vehicles which can be used to support development in housing and regeneration and support local public services and stimulate local economic growth.

3.3 The Rushmoor Development Partnership (RDP) was established to assist the Council to redevelop sites in Farnborough and Aldershot. In particular, it directly contributes to the delivery of the following Place Making strategic objective which underpins the Vision: "Great Places to Live – to make Aldershot and Farnborough town centres great places to live with a wide variety of quality new homes attractive to a diverse range of people"

3.4 **Security:** One of the risks of investing in shares is that they fall in value meaning that the initial outlay may not be recovered. In order to limit this risk, upper limits on the sum invested in each category of shares have been set as follows:

Shares held for service purposes in £'s

Category of company	2022-23 Forecast £	2023-24 Estimate £
Subsidiaries and Partnerships	100	100

3.5 **Risk assessment:** The Council assesses the risk of loss before entering into and whilst holding shares in line with paragraph 41 of *Capital Finance: Guidance on local government investment (third edition)*

3.6 The Council has good knowledge of the RDP intended developments. RDP is effectively a closed market, and it will provide development in accordance with agreement between the Council and the developer. Competition has effectively been evaluated at the time of the creation of RDP. The Council considers that RDP (an LLP) is an appropriate mechanism to undertake development. Hence, the barriers to entry have been lifted (by creation of RDP) and barriers to exit are eliminated because RDP has a specific set of defined initiatives and project plans from the RDP need to be agreed by the Council.

3.8 The Council used three external advisors regarding the potential for creation and development of the WOC and development of the RDP. These three advisors are Freeths (legal and financial advice), Regenco (housing and economic advice) and Arlingclose (treasury management and financial advice).

3.9 The Council observes strict procedure regarding its procurement of external advisors. They are appointed utilising specific competitive tendering procedure processes, relevant to the category of advice and guidance that is sought. Maintenance of the quality of advice is reviewed within the relatively frequent tender engagement process.

3.10 In the circumstances of RDP no credit ratings have been used.

3.11 The RDP Investment Team will monitor developments undertaken by the RDP to ensure minimisation of risk. Developments would not be agreed if there were considerations that insufficient financial return would be delivered. The developer would not participate in any venture that did not deliver financial return. Both partners are insistent on the creation of specific and clearly defined development plans for all sites. Experience and advice from the developer is paramount to assess and monitor risk for each development.

3.12 **Liquidity:** RDP funds will be committed for an estimated period of 10 years.

3.13 **Non-specified Investments:** Shares are the only investment type that the Council has identified that meets the definition of a non-specified investment in the government guidance. The limits above on share investments are therefore also the Council's upper limits on non-specified investments. The Council has not adopted any procedures for determining further categories of non-specified investment since none are likely to meet the definition.

4 COMERCIAL INVESTMENTS: PROPERTY

4.1 **Contribution:** The Council has investments in local and regional commercial and residential property with the intention of making a profit that will be spent on local public services.

4.2 In November 2020 the Public Works and Loan Board (PWLB) issued new lending terms (subsequently clarified in August 2021) making it conditional that Local Authorities have no intention to buy investment assets primarily for yield in the current and follow two financial years. To access this facility the Council revised its capital programme and will not be acquiring any further investment assets primarily for yield.

Property held for investment purposes in £millions

Property by type	31-Mar-22 Actual Purchase Cost £m	Gains / (Losses) £m	Value in Accounts £m
Industrial Units	51.8	7.5	59.3
Offices	36.6	(3.9)	32.7
Retail	31.6	(4.9)	26.7
Caravan Park	0.3	3.1	3.4
Petrol Stations	2.3	0.3	2.6
Waste Recycling	1.0	0.2	1.2
Mixed Use	0.2	0.2	0.4
Other	0.3	-	0.3
Total	**124.1**	**2.5**	**126.6**

Property by type	31-Mar-23 Expected Purchase Cost £m	Gains / (Losses) £m	Value in Accounts £m
Industrial Units	51.8	-	59.3
Offices	35.9	-	32.1
Retail	31.6	-	26.7
Caravan Park	0.3	-	3.4
Petrol Stations	2.3	-	2.6
Waste Recycling	1.0	-	1.2
Mixed Use	0.2	-	0.4
Other	0.3	-	0.3
Total	**123.9**	-	**126.0**

The change in office purchase cost and value in the accounts relates to the sale of Wellesley House in December 2022

4.4 **Security:** In accordance with government guidance, the Council considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs.

4.5 *Where value in accounts is at or above purchase cost:* A fair value assessment of the Council's investment property portfolio has been made within the past twelve months, and the underlying assets provide security for capital investment.

4.6 Should the 2021/22 year-end accounts preparation and audit process value these properties below their purchase cost, then an updated investment strategy will be presented to Full Council detailing the impact of the loss on the security of investments and any revenue consequences arising therefrom.

4.7 *Where value in accounts is below purchase cost:* The fair value of the Council's investment property portfolio is no longer sufficient to provide security against loss, and the Council will therefore take mitigating actions to protect the capital invested. These actions include:

- Quarterly review of the portfolio
- Consideration of advice from the Council's commercial property advisers by the Council's Property Investment Advisory Group (PIAG). Currently is agreed that the best course of action is to hold the majority of the assets as values will increase over the long term and most assets within the portfolio are considered sound with strong covenants/dependable income streams. Assets identified for disposal will be taken forward to market.

4.8 **Risk assessment:** The Council assesses the risk of loss before entering and whilst holding property investments by:

- Assessment of the relevant market sector(s) including the level of competition, barriers to entry/exit, future market prospects
- Assessment of exposure to particular market segments to ensure adequate diversification
- Use of external advisors if considered appropriate by the Executive Head of Finance
- Full and comprehensive report on all new investments to Cabinet
- Continual monitoring of risk across the whole portfolio and specific assets

4.9 **Liquidity:** Compared with other investment types, property is relatively difficult to sell and convert into liquid asset at short notice and will be subject to market conditions in terms of timescales involved. However, to ensure that invested sums could be accessed when they are needed the portfolio will be regularly reviewed and prioritised to ensure that commercial property could be sold as a going concern within a period of six months.

5 LOAN COMMITMENTS AND FINANCIAL GUARANTEES

5.1 Although not strictly counted as investments, since no money has exchanged hands yet, loan commitments and financial guarantees carry similar risks to the Council and are included here for completeness.

5.2 The Council has contractually committed £6.8m of loans to RHL for 2023-24 and £2.9m for 2023/24.

6 PROPORTIONALITY

6.1 The Council has become increasingly dependent on profit generating investment activity to achieve a balanced revenue budget. Table 4 below shows the extent to which the expenditure planned to meet the service delivery objectives and/or place making role of the Council is dependent on achieving the expected net profit from investments over the lifecycle of the Medium Term Financial Strategy. Should it fail to achieve the expected net profit, the Council has earmarked reserves available to cover any immediate shortfall in income. The Head of Service resposnisble for the Council's property and estates functions would review the cause of any shortfall and identify any actions needed to ensure the income shortfall is mitigated or remidied.

6.2 With the introduction the revised PWLB lending terms, the Council has no intention to purchase investment assets primarily for yield in the current and following two financial years. With no further expenditure planned on investment assets primarily for yield the proportion of investment to Gross service expenditure will fluctuate as a result of changes in investment income from existing holdings and changes in Gross service expenditure.

7 BORROWING IN ADVANCE OF NEED

7.1 Government guidance is that local authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed.

7.2 The Council may, in supporting the delivery of the Council's Capital Programme, borrow in advance of need where it is expected to demonstrate the best longer-term value for money position. 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 (ie: the cost of holding does not outweigh the benefits of early borrowing) and that the Council can ensure the security of such funds.

7.3 The Council is aware that it will be exposed to the risk of loss of the borrowed sums, and potential interest rate changes. These risks will be managed as part of the Council's overall management of its treasury risks and will be reported through the standard reporting method.

8 CAPACITY, SKILLS AND CULTURE

8.1 **Elected members and statutory officers:** The Council recognises that those elected Members and statutory officers involved in the investment decision making process must have appropriate capacity, skills and information to enable them to:

- take informed decisions as to whether to enter into a specific investment;

- to assess individual assessments in the context of the strategic objectives and risk profile of the Council; and
- to enable them to understand how new decisions have changed the overall risk exposure of the Council.

The Council will ensure that the relevant officers and the Members of Cabinet have appropriate skills, providing training and advisor support where there is a skills gap.

8.2 **Agents:** Lambert Smith Hampton Investment Management (LSHIM) were appointed as the Council's external investment advisor during 2019/20. LSHIM manage property investment portfolios for institutions, local authorities, and private family offices. The LSHIM investment team are all RICS qualified and have significant combined commercial experience. The assigned investment team can call on the wider expertise and resource of the parent company (Lambert Smith Hampton-LSH) that have offices throughout the UK

8.3 **Commercial deals:** The Council will ensure that the Cabinet, officers and agents negotiating commercial deals are aware of the core principles of the prudential framework and of the regulatory regime within which local authorities operate.

8.4 **Corporate governance:** Any investment decisions will be scrutinised by Executive Leadership Team, Property Investment Activity Group (PIAG) and Cabinet before final approval. The Overview and Scrutiny committee review all decisions made by the Cabinet. Although after the event the Committee can make any recommendations to the Council if it sees fit.

9 INVESTMENT INDICATORS

9.1 The Council has set the following quantitative indicators to allow elected members and the public to assess the Council's total risk exposure as a result of its investment decisions.

9.2 **Total risk exposure:** The first indicator shows the Council's total exposure to potential investment losses. This includes amounts the Council is contractually committed to lend but have yet to be drawn down and guarantees the Council has issued over third-party loans.

Total Investment Exposure £m	31-Mar-22 Actual	31-Mar-23 Forecast	31-Mar-24 Forecast
Treasury Management Investments	36.1	27.9	27.9
Service Improvement: Loans	7.8	7.9	7.9
Service Improvement: Shares	-	-	-
Commercial Investments: Property	126.6	126.0	126.0
Total	**170.5**	**161.8**	**161 .8**

9.3 **How investments are funded:** Government guidance is that these indicators should include how investments are funded. Since the Council does not normally associate particular assets with particular liabilities, this guidance is difficult to comply with. However, the following investments could be described as being funded by borrowing. The remainder of the Council's investments are funded by usable reserves and income received in advance of expenditure.

Investments funded by borrowing £m	31-Mar-22 Actual	31-Mar-23 Forecast	31-Mar-24 Forecast
Treasury management investments	-	-	-
Service investments: Loans	7.8	27.8	27.8
Service investments: Shares	-	-	-
Commercial investments: Property	92.2	92.2	92.2
Total	**100.0**	**120.0**	**120.0**

9.4 **Rate of return received:** This indicator shows the investment income received less the associated costs, including the cost of borrowing where appropriate, as a proportion of the sum initially invested. Note that due to the complex local government accounting framework, not all recorded gains and losses affect the revenue account in the year they are incurred.

Investments net rate of return £m	2021-22 Actual	2022-23 Forecast	2023-24 Forecast

Treasury management investments[1]	2.97%	4.35%[2]	4.35%
Service investments: Loans[3]	0%	0%	0%
Commercial investments: Property	5.2%	5.2%	5.2%
All Investments	4.63%	5.1%	5.1%

9.5 Treasury management returns are forecast to continue to recover in 2022-23 due to increased interest rates. Service investment loan returns are forecast to remain low during 2023-24 due to the interest deferral on Farnborough International Limited loan, which the Council entered into as part of a funding consortium.

1 This is income only return, uncrystallised capital gain is excluded
2 Based on return 31st December 2022
3 Due to the renegotiation of the Farnborough International loan, meaning interest is not due until later years

MINIMUM REVENUE PROVISION STATEMENT 2023-24

1.1 Where the Authority finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the Authority to have regard to the former Ministry of Housing, Communities and Local Government's Guidance on Minimum Revenue Provision (the MHCLG Guidance) most recently issued in 2018.

1.2 The broad aim of the MHCLG Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

1.3 The MHCLG Guidance requires the Council to approve an Annual MRP Statement each year and recommends a number of options for calculating a prudent amount of MRP. This statement only incorporates options recommended in the Guidance.

1.4 For any unsupported capital expenditure incurred after 31 March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant assets, starting in the year after the asset becomes operational. MRP on purchases of freehold land will be charged over 50 years. MRP on expenditure for all other assets or on capital expenditure not related to fixed assets but which has been capitalised by regulation or direction (revenue expenditure financed by capital under statute), will be charged over the useful economic life (UEL) of the asset up to a maximum of 50 years. MRP will be applied in the year following expenditure was incurred.

1.5 For assets acquired by finance lease or private finance initiative, MRP will be determined as being equal to the element of the rent or charge that goes to write down the balance sheet liability.

1.6 Where former operating leases have been brought onto the balance sheet on 1st April 2022 due to the adoption of the IFRS 16 Leases accounting standard, and the asset values have been adjusted for accruals, prepayments, premiums and/or discounts, then the annual MRP charges will be adjusted so that the total charge to revenue remains unaffected by the new standard

1.7 Where loans are made to other bodies and designated as capital expenditure, no MRP will be charged. However, the capital receipts generated by the repayments on those loans will be set aside to repay debt instead.

1.8 At the commencement of 2022-23 the Council had, a Capital Financing Requirement (CFR) of £121.9m in relation to a specific elements of capital expenditure incurred in the previous financial year (2021-22). The Council has incurred further amounts of capital expenditure in 2022-23 and will need to engage in an element of Prudential Code borrowing in that financial year to achieve total financing of its capital programme. It is inevitable therefore that the borrowing that is required in 2022-23 will require MRP to be charged to the Council's General Fund Revenue Account in 2023-24 and future years.

1.9 Capital expenditure incurred during 2023-24 will not be subject to MRP charge until 2024-25

1.10 Based on the Council's latest estimate of its capital financing requirement (CFR) on 31 March 2023, the MRP budget for 2023-24 has been set at (£2.0m).

1.11 **Overpayments:** In earlier years, the Authority has made voluntary overpayments of MRP that are available to reduce the revenue charges in later years. No further overpayment is planned.

MRP Overpayments	£m
Actual balance 31-Mar-22	0.45
Approved overpayment 2022-23	nil
Expected balance 31-Mar-23	0.45
Planned overpayment 2023-24	nil
Forecast balance 31-Mar-24	0.45