TREASURY MANAGEMENT STRATEGY 2023/24

June 2023

1. Introduction

Treasury management is the management of the Council's cash flows, borrowing and investments, and the associated risks.

The Council has 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 prudent financial management.

Treasury risk management 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.

Investments held for service purposes and for commercial profit are considered separately in Annex 2, the Investment Strategy.

2. External Context

Source: Arlingclose

Economic background: The ongoing impact on the UK from Russia's invasion of Ukraine, together with higher inflation, higher interest rates, uncertain government policy, and a weak economic outlook, will be major influences on the Council's treasury management strategy for 2023/24.

The Bank of England (BoE) increased Bank Rate by 0.25% to 4.5% in May 2023. This followed another 0.25% rise in March and a 0.5% hike in February and was the twelfth successive rise since December 2021. The May decision was voted for by a 7-2 majority of the Monetary Policy Committee (MPC), with the two dissenters voting for a no-change at 4.25%.

The May quarterly Monetary Policy Report (MPR) is no longer forecasting a recession but is instead forecasting very low GDP (Gross Domestic Product) growth. CPI inflation is expected to fall in the near future, but this fall is expected to happen over a longer period than previous forecasts.

The UK economy stagnated between October and December 2022, according to GDP data from Office for National Statistics. The UK has avoided the technical recession (two successive quarters of negative growth) that was predicted. The BoE forecasts GDP to be 0.25% in 2023 and 0.75% in 2024 and 2025.

CPI inflation peaked at 11.1% in October 2022 and has now fallen to 10.1%, still well above the 2% target. The Bank of England now expects inflation to fall to 5% by the end of the 2023 calendar year, falling further to its target by late 2024.

The labour market remains tight, with the most recent statistics showing the unemployment rate was 3.8%. Earnings were up strongly in nominal terms by 5.9% for total pay and 6.6% for regular pay. Factoring in inflation meant wages contracted, for total pay the figure was -3.0% and regular pay -2.3%. Looking forward, although the May MPR shows some expected rise in unemployment this is far more muted than previous estimates. Unemployment is expected to reach 4.5% by 2026.

Interest rates have also been rising sharply in the US, with the Federal Reserve increasing the range on its key interest rate by 0.25% in May 2023 to 5.00%-5.25%. This rise follows two 0.25% rises in February and March, a 0.5% rise in December and four successive 0.75% rises. Annual inflation continues to slow in the US, falling to below 5% in May 2023. US GDP grew at an annualised rate of 2.6% between October and December 2022 and 1.1% between January and March 2023.

Inflation rose strongly in the Euro Zone during 2022, hitting a peak annual rate of 10.6% in October 2022, but has since declined over successive months to stand at 6.9% in March 2023. Economic growth has been weakening, and only expanded by 0.1% in the three months to March 2023, down from 0.9% and 0.4% in earlier periods. 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 0.25% in May, and 0.5% in March following five consecutive 0.5% or 0.75% rate hikes. The ECB's main refinancing rate currently stands at 3.75% and its deposit facility rate at 3.25%.

Credit outlook: The relatively high profile failure of two US banks and one Swiss bank in the period of March – May 2023 has been the most significant credit event of late. Silicon Valley Bank, Credit Suisse and First Republic Bank all had their own individual risk factors which lead to their failure, although to an extent the failures were also linked to the ability of making withdrawals quickly in the internet age and to the rising interest rate environment. In all three cases regulators moved swiftly to try to prevent contagion to the wider markets.

Credit default swap (CDS) prices generally followed an upward trend in 2022, although these began to fall again from October 2022 before spiking in March 2023. They have been boosted by recent banking failures, the war in Ukraine, increasing economic and political uncertainty and a relatively weak global and UK outlook, but remain below the levels seen at the beginning of the Covid-19 pandemic and 2008 financial crisis.

CDS price volatility was higher in 2022 compared to 2021. The divergence in prices between ringfenced (retail) and non-ringfenced (investment) banking entities has emerged once again.

The weaker 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. However, since then S&P has revised the outlook to stable once again, citing an improvement to the economic situation compared to last year.

There are competing tensions in the banking sector which could impact bank balance sheet strength going forward. The weaker economic outlook and potential 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.

However, the institutions on 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 (at May 2023): Arlingclose forecasts that Bank Rate will rise from its current 4.5% to 4.75%, probably in June, as the Bank of England attempts to subdue inflation which is significantly above its 2% target. The rate is ultimately expected to fall again as higher interest rates put a strain on the economy. Arlingclose's central case is for rates to begin falling in 2024, reaching a new normal of around 3% by 2025. There are risk to the upside and downside on this central case.

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 3.5%, 3.7%, and 3.9% respectively over the 3-year period to March 2026. 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.

A more detailed economic and interest rate forecast is set out at Appendix 1.

For the purpose of setting the treasury management budget, it has been assumed that new treasury investments will be made at an average rate/yield of 3.3%, and that new short-term loans will be borrowed at an average rate of 4%.

3. Local Context

At 31 March 2023, the Council had £7.0 million short-term borrowing and £16.0 million of treasury investments earning a return of 4.15% (£9.0 million was invested in unsecured bank deposits earning 4.15% and £7.0 million was invested in money market funds earning 4.15%).

Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance sheet summary and forecast	**31.3.22 Actual**	**31.3.23 Estimate**	**31.3.24 Forecast**	**31.3.25 Forecast**	**31.3.26 Forecast**
	£000	**£000**	**£000**	**£000**	**£000**
Capital financing requirement	**76,400**	**89,500**	**53,900**	**53,400**	**52,800**
Less: External borrowing[1]	-	**7,000**	-	-	-
Internal borrowing	**76,400**	**82,500**	**53,900**	**53,400**	**52,800**
Less: Balance sheet resources	(102,300)	(98,500)	(58,600)	(49,000)	(45,800)
(Treasury investments)/ New Borrowing	**(25,900)**	**(16,000)**	**(4,700)**	**4,400**	**7,000**

Notes:
1. Reflects loans to which the Council is committed (excludes optional refinancing).

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while balance sheet resources are the underlying sums available for investment.

The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

The Council has a reducing CFR over the medium term, due to the requirements of the Council's capital programme.

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. Table 1 confirms that the Council expects to comply with this recommendation during 2023/24.

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 table 1 above, but that cash and investment balances are kept to a minimum level of £15.0 million at each year-end. This is comprised of the £10.0 million minimum investment balance that the Council is required to hold at all times to retain a desired 'professional' status when working with financial intermediaries and an additional £5.0 million liquidity buffer to meet any unexpected cash flow shortfalls.

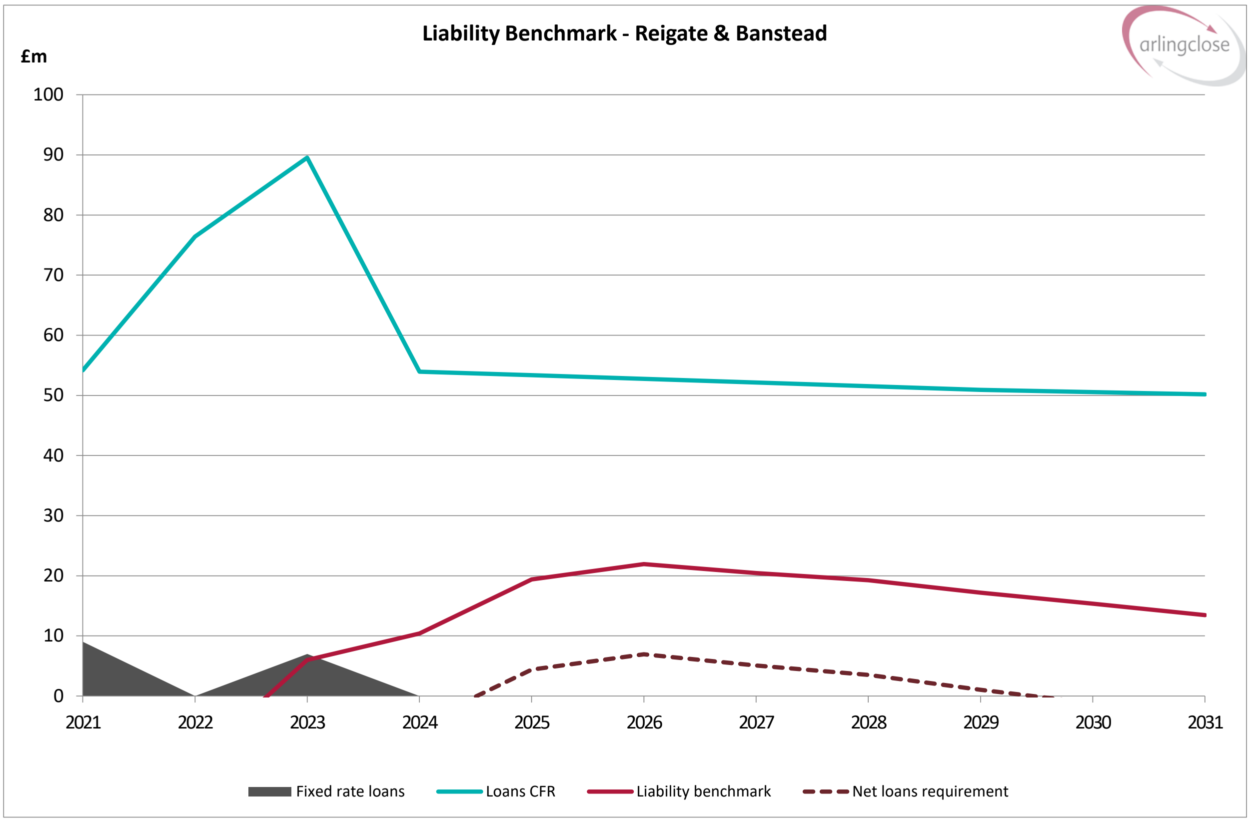
The liability benchmark is an important tool to help establish whether the Council is likely to be a long-term borrower or long-term investor in the future, and so shape its strategic focus and decision making.

The liability benchmark itself represents an estimate of the cumulative amount of external borrowing the Council must hold (if any) to fund its current capital and revenue plans while keeping treasury investments at the minimum level.

Table 2: Prudential Indicator: Liability benchmark	**31.3.22 Actual**	**31.3.23 Estimate**	**31.3.24 Forecast**	**31.3.25 Forecast**	**31.3.26 Forecast**
	£000	**£000**	**£000**	**£000**	**£000**
CFR	76,400	89,500	53,900	53,400	52,800
Less: Balance sheet resources	(102,300)	(98,500)	(58,600)	(49,000)	(45,800)
Net Loans Requirement	**(25,900)**	**(9,000)**	**(4,700)**	**4,400**	**7,000**
Plus: Liquidity allowance	15,000	15,000	15,000	15,000	15,000
Liability benchmark	**(10,900)**	**6,000**	**10,300**	**19,400**	**22,000**

The net loans requirement is negative until 2024/25 meaning the Council is projected to have an investment balance rather than a borrowing need. This became a short-term borrowing requirement (indicated by a positive liability benchmark figure) in 2022/23 in order to maintain the £15.0 million minimum liquidity allowance.

Following on from the medium-term forecasts in table 2 above, the ten-year liability benchmark currently assumes no capital expenditure will be funded by borrowing after 2026 and reserves will increase by 2.5%. This is illustrated in the chart below:



The liability benchmark represents the minimum borrowing required to fund the Council's capital program and maintain minimum balances of £15 million.

The Council had a minimum borrowing requirement of £6.0 million on 31 March 2023 that was covered with short term borrowing.

A borrowing requirement of £10.3million is expected by 31 March 2024 and a maximum borrowing requirement of £19.4 million is expected by 31 March 2025 increasing to £22.0 million by 31 March 2026 and declining thereafter from 2027 onwards.

The net loans requirement on the graph is a lower figure and represents the borrowing that would be required if investment balances were kept at nil.

The graph represents only a snapshot in time at year end when balances are typically at their lowest and borrowing needs are highest. In year balances are expected to fluctuate to up to £35.8 million.

Borrowing is therefore in practice only likely to be required in the short term for some parts of the year.

Borrowing Strategy

The Council held a short-term loan of £7.0 million at 31 March 2023.

The liability benchmark forecast in table 2 above confirms that the Council is only likely to need to borrow modest amounts for short term periods in the coming year.

The Council may opt to borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £40.0 million.

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

Strategy: The Council has historically been largely debt free and has borrowed on a temporary basis to fund short term cash flow shortfalls. This strategy is likely to remain the most effective in future.

Short-term borrowing sourced from other local authorities or housing associations is expected to continue to be the most cost-effective borrowing option but the situation will remain under constant review.

The Council may on occasion arrange forward starting loans, where the interest rate is fixed in advance, but the cash is scheduled to be received at a later point in time.

Sources of borrowing: The approved sources of long-term and short-term borrowing are:

- HM Treasury's PWLB (Public Works Loan Board) lending facility
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- any other UK public sector body
- UK public and private sector pension funds (except Surrey Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues.

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

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 in the event that 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. The Council is unlikely to borrow from this source: if it does any decision to borrow from the Agency will be the subject of a separate report to full Council.

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

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 below. Financial derivatives may be used to manage this interest rate risk (see section below).

4. Treasury Investment Strategy

The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held.

In the past 12 months, the Council's treasury investment balance has ranged between £13.0 million and £50.8 million.

Objectives: The CIPFA Code requires the Council to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council'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. The Council aims to be a responsible investor and will consider environmental, social and governance (ESG) issues when investing.

Strategy: New treasury investments will be made primarily to manage day-to-day cash flows using short-term low risk instruments.

The CIPFA Code does not permit local authorities to both borrow and invest long-term for cash flow management. But the Council 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 and to manage inflation risk by investing usable reserves in instruments whose value rises with inflation.

ESG policy: Environmental, Social and Governance (ESG) considerations are increasingly a factor in global investors' decision making, but the framework for evaluating investment opportunities is still developing and therefore the Council's ESG policy does not currently include ESG scoring or other real-time ESG criteria at an individual investment level.

When investing in banks and funds, the Council will prioritise banks that are signatories to the UN Principles for Responsible Banking and funds operated by managers that are signatories to the UN Principles for Responsible Investment, the Net Zero Asset Managers Alliance and/or the UK Stewardship Code.

Business models: Under the IFRS 9 accounting standard, the accounting for certain investments depends on the Council's "business model" for managing them. The Council aims to achieve value from its 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.

In practice this distinction only applies to tradable investments where repayments are solely of principal and interest (such as bonds, certificates of deposit or T-bills): although allowable within the strategy the Council does not expect to use these products in the upcoming year.

Approved counterparties: The Council may invest its surplus funds with any of the counterparty types in table 3 below, subject to the limits shown.

Table 3: Treasury investment counterparties and limits			
Sector	**Time limit**	**Counterparty limit**	**Sector limit**
The UK Government	50 years	Unlimited	n/a
Local authorities & other government entities	25 years	£10 million	Unlimited
Secured investments[1]	25 years	£6 million	Unlimited
Banks (unsecured)[1]	13 months	£6 million	Unlimited
Building societies (unsecured)[1]	13 months	£3 million	£10 million
Registered providers (unsecured)[1]	5 years	£3 million	£13 million
Money market funds[2]	n/a	£10 million	Unlimited
Strategic pooled funds	n/a	£2 million	£25 million
Real estate investment trusts	n/a	£2 million	£13 million
Other investments[1]	5 years	£2 million	£5 million

Notes:
1. This table must be read in conjunction with the notes below

1. **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 considered.

2. **Minimum credit rating (money market funds):** Investment will only be made in money market whose lowest published credit rating is at least AAA.

   This refers to the overall rating of the fund rather than the weighted average ratings of the fund's investments.

For entities without published credit ratings, investments may be made where external advice indicates the entity to be of similar credit quality.

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

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

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

Registered providers (unsecured): Loans to, and bonds issued or guaranteed by, registered providers of social housing or registered social landlords, formerly known as housing associations. These bodies are regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

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 Council will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

Strategic pooled funds: Bond, equity and property funds that offer enhanced returns over the longer term but are more volatile in the short term. These allow the Council 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 Council's investment objectives will be monitored regularly.

Real estate investment trusts (REITs): Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.

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

Operational bank accounts: The Council may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than A-. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.

The Council's business bank account provider is Lloyds Bank plc. It may be necessary to hold liquid funds in the main business account overnight, for example where grant payments are received prior to allocation. Therefore, there is no limit on amounts that can be held with Lloyds. However, the Council monitors its operational accounts on a daily basis, transferring any surplus funds to investment accounts and there for minimising the amount held in the operational bank account at any time.

Risk assessment and credit ratings: Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. The credit rating agencies in current use are listed in the Treasury Management Practices document. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

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

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as “negative watch”) 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.

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.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. 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.

Investment limits: The Council’s revenue reserves available to cover investment losses are forecast to be £37.3 million on 31 March 2023 and £33.2 million by 31 March 2024. In order that no more than 30.0% 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 £10.0 million A group of entities under the same ownership will be treated as a single organisation for limit purposes.

Limits are also placed on fund managers, investments in brokers’ nominee accounts and foreign countries 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.

Table 4: Additional investment limits	**Cash limit**
Any group of pooled funds under the same management	£10 million per manager
Negotiable instruments held in a broker’s nominee account	£13 million per broker
Foreign countries	£5 million per country

Liquidity management: The Council performs regular cashflow forecasts to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium-term financial plan and cash flow forecast.

Liquid cash will be spread to optimise access to cash in the event of operational difficulties at any one provider (e.g., bank accounts and money market funds).

5. Treasury Management Prudential Indicators

The Council measures and manages its exposures to treasury management risks using the following indicators.

The Council measure its exposure to credit risk by monitoring the overall 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 2023/24 level remains one 'notch' above the Council's minimum individual counterparty rating of A-.

Table 5: Credit risk indicator	Target
Portfolio average credit	A

The Council will measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period, without additional borrowing.

Table 6: Liquidity risk indicator	Target
Total cash available within 3 months	£5.0 million

Interest rate risk indicator is set to measure the Council's exposure to interest rate risk by monitoring the impact that a 1% rise or fall in interest rates would have on the Council's income.

As the Council will not have any borrowing after the 31 March 2023 the only impact will be to investments. This indicator will be affected by the amount of investments held at variable rates of interest; the indicator for 2023/24 reflects the expectation that a majority of the Council's treasury investments will not be held at fixed rates of interest.

Table 7: Interest rate risk indicator	Limit
Revenue impact of a 1% change in rates	£0.078 million pa

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

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:

Table 8: Refinancing rate risk indicator	Upper limit	Lower limit
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%

As the Council has relatively modest and short term overall borrowing requirement there is no significant refinancing risk associated with having all loans maturating within the timescales shown above. At present the Council would wish to retain maximum flexibility as to the periods in which it borrows over. As a debt portfolio becomes established then the indicator will be reviewed to ensure that it remains suitable.

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.

Long-term treasury management investments: The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The prudential limits on the long-term treasury management investments will be:

Table 9: Price risk indicator	2023/24	2024/25	2025/26	No fixed date
Limit on principal invested beyond year end	£10.0m	£10.0m	£10.0m	£10.0m

Long-term investments with no fixed maturity date include strategic pooled funds and real estate investment trusts but exclude money market funds and bank accounts with no fixed maturity date as these are considered short-term.

6. Related Matters

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

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

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 considered when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

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

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

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 without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the Chief Finance Officer believes this to be the most appropriate status. The Council is required to have at least £10.0 million in investments at all times in order to maintain profession status.

7. Financial Implications

The budget for investment income in 2023/24 is £0.8 million, based on an average investment portfolio of £34 million at an interest rate of 2.4%.

The budget for debt interest paid in 2023/24 is £0.5 million, based on an average debt portfolio of £7.0 million at an average interest rate of 4.0%.

If actual levels of investments and borrowing, or actual interest rates, differ from those forecasts, performance against budget will be correspondingly different.

8. Other Options Considered

The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Finance Officer, having consulted the Portfolioholder for Finance & Governance, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Table 10: Options Considered		
Alternative	**Impact on income and expenditure**	**Impact on risk management**
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
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

APPENDIX 1

Arlingclose Economic & Interest Rate Forecast
May 2023

Underlying assumptions:

- *Stubborn inflation and tight labour markets have refocused attention on inflation, even as the economic risks increase. The Federal Reserve raised its policy rate to 5.25% despite the rising risk of a US recession. Similarly, as Germany teeters on the edge of recession, the ECB raised its main policy rate to 3.75% and signalled further rises ahead.*
- *In the UK, with upward revisions to growth and persistent inflation, sticky amid continued solid wage growth, investors are betting on further Bank Rate hikes beyond 4.5%.*
- *The UK economy has surprised with its strength in the first half of 2023. Government support for the cost of living, stronger wage growth and household savings have partly offset the dual headwinds of high inflation and interest rates. Households will also benefit from a likely decline in retail energy bills in H2 2023.*
- *However, the lagged effect of aggressive monetary tightening will increasingly pressure economic activity. Household spending will be affected by increases in mortgage payments, while business investment/spending will fall back due to higher borrowing costs. Diminished spending will inevitably increase unemployment.*
- *The labour market remains tight. Recent signs suggest some loosening, although wage growth has remained solid. As unemployment rises, market imbalances and thus wage growth should ease, but recent data indicates this may take some time.*
- *Inflation will fall sharply from April, as changes in base effects become the driver of the headline rate. Food price inflation should also decelerate soon. However, the MPC will increasingly target core inflation and wage growth, being especially wary about declining inflation rates creating strong real wage growth, thus supporting on-going consumer-led inflation. Rates will therefore remain higher for longer.*
- *Global bond yields remain volatile. Resilience in some economic data has supported central bank hawkishness, but also increased the chance of over-tightening. The Federal Reserve and other central banks see persistently higher policy rates through 2023 as key to dampening domestic inflationary pressure.*
- *However, it is difficult to perceive non-negative growth outcomes from synchronised monetary tightening and slower, perhaps negative, money growth across developed economies. This suggests more significant reductions in policy rates in the future.*

Forecast:

- *The MPC raised Bank Rate by 25bps to 4.5% in May. Due to the current policy of reacting to lagging data, we believe it is more likely than not that Bank Rate rises to 4.75% in June, although we consider further hikes to be unnecessary.*
- *The MPC will cut rates in the medium term to stimulate a stuttering UK economy but will be reluctant to do so until services inflation and wage growth ease. We*

see rate cuts from the first quarter of 2024 to a low of around 3% by 2025, although the timing and extent of rate cuts remains highly uncertain.

- *Arlingclose expects gilt yields to fall from current levels reflecting a lower medium term path for Bank Rate. However, yields will remain relatively higher than in the past, with continued elevated volatility.*
- *Gilt yields face pressures to both sides. While there are fears of a global decline in economic activity and an expectation of falling inflation rates, these downward effects on gilt yields will be partly offset by hawkish-leaning central bankers, BoE bond sales, and high government borrowing.*

	Current	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Average
Official Bank Rate														
Upside risk	0.00	0.50	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	**0.63**
Central Case	**4.50**	**4.75**	**4.75**	**4.75**	**4.25**	**3.75**	**3.50**	**3.25**	**3.00**	**3.00**	**3.00**	**3.00**	**3.00**	**3.73**
Downside risk	0.00	0.25	0.50	0.50	0.50	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	**0.75**
3-month money market rate														
Upside risk	0.00	0.50	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	**0.63**
Central Case	**4.70**	**4.80**	**4.80**	**4.75**	**4.25**	**3.70**	**3.50**	**3.20**	**3.10**	**3.10**	**3.10**	**3.10**	**3.10**	**3.78**
Downside risk	0.00	0.25	0.50	0.50	0.50	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	**0.75**
5yr gilt yield														
Upside risk	0.00	0.60	0.70	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	**0.86**
Central Case	**3.55**	**3.80**	**3.70**	**3.60**	**3.40**	**3.40**	**3.30**	**3.30**	**3.30**	**3.40**	**3.50**	**3.50**	**3.60**	**3.49**
Downside risk	0.00	0.70	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	**0.89**
10yr gilt yield														
Upside risk	0.00	0.60	0.70	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	**0.86**
Central Case	**3.73**	**4.00**	**3.90**	**3.70**	**3.60**	**3.50**	**3.50**	**3.50**	**3.50**	**3.60**	**3.70**	**3.70**	**3.80**	**3.67**
Downside risk	0.00	0.70	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	**0.89**
20yr gilt yield														
Upside risk	0.00	0.60	0.70	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	**0.86**
Central Case	**4.12**	**4.20**	**4.10**	**3.90**	**3.80**	**3.70**	**3.70**	**3.70**	**3.70**	**3.80**	**3.80**	**3.90**	**3.90**	**3.87**
Downside risk	0.00	0.70	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	**0.89**
50yr gilt yield														
Upside risk	0.00	0.60	0.70	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	**0.86**
Central Case	**3.78**	**3.90**	**3.80**	**3.60**	**3.50**	**3.40**	**3.40**	**3.40**	**3.40**	**3.50**	**3.50**	**3.60**	**3.60**	**3.57**
Downside risk	0.00	0.70	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	**0.89**

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%