

## Bolsover District Council

### Treasury Management Strategy 2023/24 - 2026/27

#### 1 Strategy Details

- 1.1 Treasury risk management at the Authority 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 Authority to approve a Treasury Management Strategy before the start of each financial year. This strategy fulfils the Authority's legal obligation under the *Local Government Act 2003* to have regard to the CIPFA Code.
- 1.2 The strategy outlines the Authority's Treasury Management Strategy for the years 2023/24 to 2026/27 for consideration and approval by Council.
- 1.3 Investments held for service purposes or for commercial profit are considered in a different strategy, the Corporate Investment Strategy.
- 1.4 A further strategy, the Capital Strategy, sets out the Authority's Capital Expenditure programme and Minimum Revenue Provision policy (MRP).

#### Introduction

- 1.5 Treasury management is the management of the Authority's cash flows, borrowing and investments, and the associated risks. The Authority 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 Authority's prudent financial management.

#### External Context

- 1.6 **Economic background:** 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.
- 1.7 The Bank of England (BoE) increased Bank Rate by 0.5% to 3.5% in December 2022. This followed a 0.75% rise in November which was the largest single rate hike since 1989 and the ninth successive rise since December 2021. The December decision was voted for by a 6-3 majority of the Monetary Policy Committee (MPC), with two dissenters voting for a no-change at 3% and one for a larger rise of 0.75%.

- 1.8 The November quarterly Monetary Policy Report (MPR) forecast a prolonged but shallow recession in the UK with Consumer Price Index (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 to remain higher for longer over the forecast horizon and the economic outlook remains weak, with unemployment projected to start rising.
- 1.9 The UK economy contracted by 0.3% between July and September 2022 according to the Office for National Statistics, and 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.
- 1.10 CPI inflation is expected to have peaked 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 at the time of the November MPR (a peak of 5.25%). However, the BoE stated it considered 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.
- 1.11 The labour market remains tight for now, with the most recent statistics showing the unemployment rate was 3.7%. Earnings were up strongly in nominal terms by 6.1% for both total pay and for regular pay but factoring in inflation means real pay for both measures was -2.7%. Looking forward, the November 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.
- 1.12 Interest rates have also been rising sharply in the United States, 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 four successive 0.75% rises 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.
- 1.13 Inflation rose consistently in the Euro Zone since the start of the year, hitting a peak 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 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 0.50% in December, following two consecutive 0.75% rises, taking its main refinancing rate to 2.5% and deposit facility rate to 2.0%.
- 1.14 **Credit outlook:** 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.

- 1.15 CDS price volatility has been higher in 2022 compared to 2021 and this year has seen a divergence in prices between ring-fenced (retail) and non-ring-fenced (investment) banking entities once again. 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 to negative from stable.
- 1.16 There are competing tensions in the banking sector which could impact bank balance sheet strength in the future. 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. 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.
- 1.17 **Interest rate forecast:** 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.
- 1.18 While interest rate expectations reduced during October and November 2022, multiple interest rate rises are still expected over the forecast horizon despite the 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 remain persistently higher.
- 1.19 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%, 3.5%, and 3.85% respectively over the 3-year period to December 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.
- 1.20 A more detailed economic and interest rate forecast provided by Arlingclose is attached at **Appendix 1A**.
- 1.21 For the purpose of setting the budget, it has been assumed that new treasury management investments will be made at an average rate of 3.31%.

### **Local Context**

- 1.22 On 31<sup>st</sup> December 2022, the Authority held £89.4m of borrowing and £37.0m of treasury investments. This is set out in further detail at **Appendix 1B**. Forecast changes in these sums are shown in the balance sheet analysis in **table 1** below.

**Table 1: Balance sheet summary and forecast**

	<b>31.3.22 Actual £m</b>	<b>31.3.23 Estimate £m</b>	<b>31.3.24 Forecast £m</b>	<b>31.3.25 Forecast £m</b>	<b>31.3.26 Forecast £m</b>	<b>31.3.27 Forecast £m</b>
General Fund CFR	6.2	5.7	9.0	9.4	9.1	8.8
HRA CFR	110.1	112.2	120.5	129.0	134.0	134.0
<b>Total CFR</b>	<b>116.3</b>	<b>117.9</b>	<b>129.5</b>	<b>138.4</b>	<b>143.1</b>	<b>142.8</b>
Less: Actual External borrowing *	(93.4)	(89.4)	(86.0)	(78.8)	(76.8)	(73.8)
<b>Internal borrowing</b>	<b>22.9</b>	<b>28.5</b>	<b>43.5</b>	<b>59.6</b>	<b>66.3</b>	<b>69.0</b>
<b>New external borrowing</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>(4.8)</b>	<b>(11.6)</b>	<b>(13.2)</b>
Less: Balance sheet resources	(65.4)	(64.9)	(64.9)	(64.8)	(64.7)	(66.1)
<b>Treasury Investments (net of new borrowing)</b>	<b>42.5</b>	<b>36.4</b>	<b>21.4</b>	<b>10.0</b>	<b>10.0</b>	<b>10.3</b>

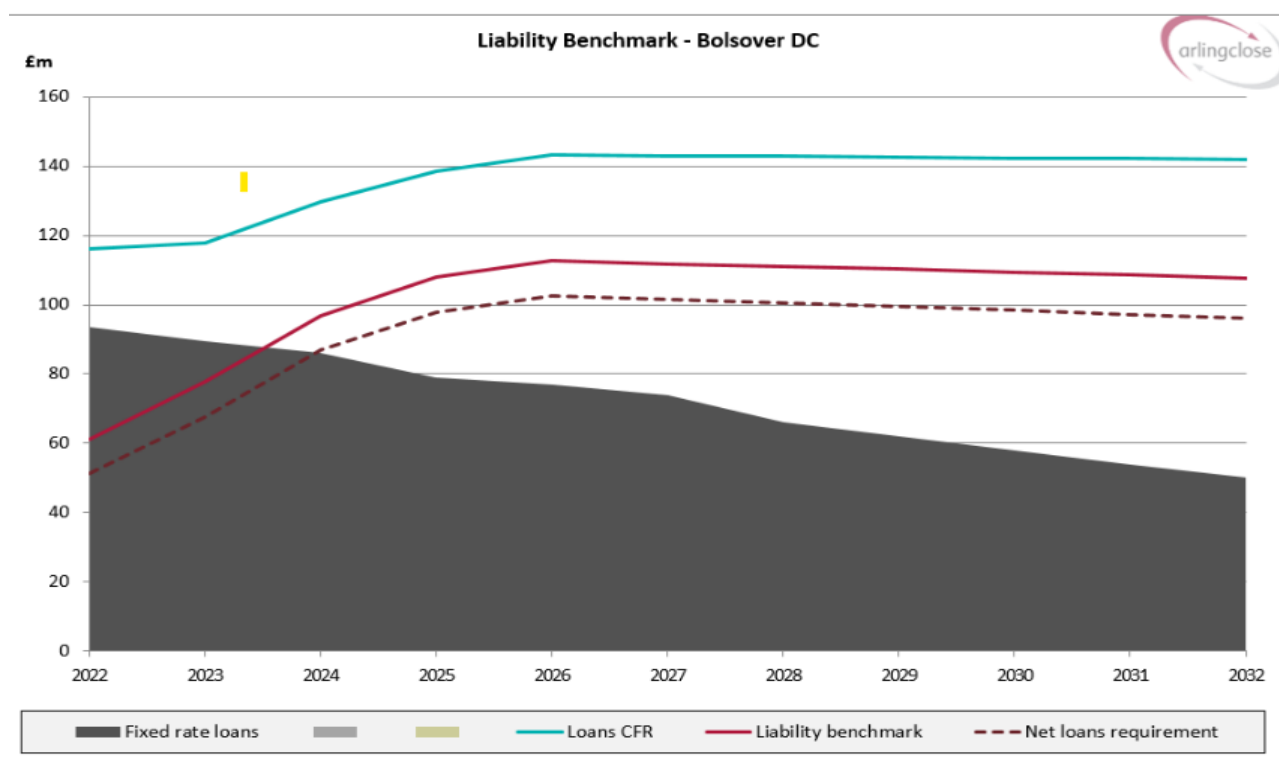
- 1.23 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while balance sheet resources are the underlying sums available for investment. The Authority has an increasing CFR due to the capital programme and will therefore be required to borrow up to £30m over the forecast period. CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Authority expects to comply with this recommendation during 2023/24.
- 1.24 **Liability benchmark:** To compare the Authority's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing (**table 2**). This assumes the same forecasts as **table 1** 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.
- 1.25 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.

**Table 2: Liability benchmark**

	31.3.22 Actual £m	31.3.23 Estimate £m	31.3.24 Forecast £m	31.3.25 Forecast £m	31.3.26 Forecast £m	31.3.27 Forecast £m
<b>CFR</b>	<b>116.3</b>	<b>117.9</b>	<b>129.5</b>	<b>138.4</b>	<b>143.1</b>	<b>142.8</b>
Less: Balance sheet resources	(65.4)	(64.9)	(64.9)	(64.8)	(64.7)	(66.1)
Net loans requirement	<b>50.9</b>	<b>53.0</b>	<b>64.6</b>	<b>73.6</b>	<b>78.4</b>	<b>76.7</b>
Plus: Liquidity allowance	10.0	10.0	10.0	10.0	10.0	10.0
<b>Liability Benchmark</b>	<b>60.9</b>	<b>63.0</b>	<b>74.6</b>	<b>83.6</b>	<b>88.4</b>	<b>86.7</b>

1.26 Following on from the medium-term forecasts in table 2 above, the long-term liability benchmark assumes capital expenditure funded by borrowing of £2.1m 22/23; £11.8m 23/24; £10m 24/25; £5m 25/26; minimum revenue provision on new capital expenditure based on a 5 to 50 year asset life and income, expenditure and reserves all increasing by inflation of 2.5% a year.

This is shown in the chart below together with the maturity profile of the Authority's existing borrowing:



### **Borrowing Strategy**

1.27 The Authority currently holds £89.4m of loans, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 1 shows that the Authority may utilise the approval to undertake both General Fund and HRA borrowing during the period 2023/24 to 2026/27 to fund Bolsover Homes and the Crematorium at Shirebrook.

- 1.28 **Objectives:** The Authority's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Authority's long-term plans change, is a secondary objective.
- 1.29 **Strategy:** Given the significant cuts to public expenditure and in particular to local government funding, the Authority'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 likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.
- 1.30 By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Authority with this 'cost of carry' and breakeven analysis. Its output may determine whether the Authority 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.
- 1.31 The Authority has previously raised all of its long-term borrowing from the PWLB but will consider long-term loans from other sources including banks, pensions and local authorities, and may investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. 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.
- 1.32 Alternatively, the Authority may arrange forward starting loans during 2023/24, 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. In addition, the Authority may borrow short-term loans to cover unplanned cash flow shortages.
- 1.33 **Sources of borrowing:** The approved sources of long-term and short-term borrowing are:
- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
  - 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 Derbyshire County Council Pension Fund)
  - capital market bond investors
  - UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues
- 1.34 **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
- 1.35 The Authority has previously raised all of its long-term borrowing from the PWLB but it continues to investigate other sources of finance, such as local authority loans and bank loans that may be available at more favourable rates.
- 1.36 **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. Any decision to borrow from the Agency will therefore be the subject of a separate report to Council.
- 1.37 **LOBOs:** The Authority doesn't hold or intend to hold any LOBO (Lender's Option Borrower's Option) loans.
- 1.38 **Short-term and variable rate loans:** These loans leave the Authority 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.
- 1.39 **Debt rescheduling:** The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. The Authority may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk. The recent rise in interest rates means that more favourable debt rescheduling opportunities should arise than in previous years.

### **Treasury Management Investment Strategy**

- 1.40 The Authority holds an average of £35m invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Authority's investment balance has ranged between £30.5m and £42.5m, and levels are expected to reduce in the forthcoming years.
- 1.41 **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.
- 1.42 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.

- 1.43 **Strategy:** Given the increasing risk and very low returns from short-term unsecured bank investments, the Authority may wish to diversify into more secure and higher yielding asset classes during 2023/24. This is especially the case for the estimated £10m that is available for longer-term investment. The majority of the Authority’s surplus cash is currently invested in short-term unsecured bank deposits, short term fixed deposits with local authorities and money market funds. This diversification would represent a substantial change in strategy.
- 1.44 **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 Authority does not currently include ESG scoring or other real-time ESG criteria at an individual investment level. When investing in banks and funds, the Authority will prioritise banks that are signatories to the United Nations Principles for Responsible Banking and funds operated by managers that are signatories to the United Nations Principles for Responsible Investment, the Net Zero Asset Manager’s Alliance and/or the UK Stewardship Code.
- 1.45 **Business models:** Under IFRS 9, the accounting for certain investments depends on the Authority’s “business model” for managing them. The Authority 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.
- 1.46 **Approved counterparties:** The Authority may invest its surplus funds with any of the counterparty types in **table 3** below, subject to the cash limits (per counterparty) and the time limits shown.

**Table 3: Approved 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	£5m	Unlimited
Secured investments *	25 years	£5m	Unlimited
Banks (unsecured) *	13 months	£5m	Unlimited
Building societies (unsecured) *	13 months	£5m	£5m per society
Registered providers (unsecured) *	5 years	£5m	£10m
Money market funds *	n/a	£5m	Unlimited
Strategic pooled funds	n/a	£5m	£10m per manager
Real estate investment trusts	n/a	£5m	£5m
Other investments *	5 years	£5m	£5m



- 1.47 **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.
- 1.48 **Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities, Parish Councils 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.
- 1.49 **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.
- 1.50 **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.
- 1.51 **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.
- 1.52 **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.
- 1.53 **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.

- 1.54 **Real estate investment trusts:** 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.
- 1.55 **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 Authority's investment at risk
- 1.56 **Operational bank accounts:** The Authority may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £5m per bank. 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 Authority maintaining operational continuity.
- 1.57 **Risk assessment and credit ratings:** Credit ratings are obtained and monitored by the Authority'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.
- 1.58 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.
- 1.59 **Other information on the security of investments:** The Authority 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 Authority'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.
- 1.60 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 Authority 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 Authority's cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

- 1.61 **Investment limits:** In order to minimise investments that 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 £5m. A group of entities 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.

**Table 4: Additional Investment limits**

	<b>Cash limit</b>
Any group of pooled funds under the same management	£10m per manager
Negotiable instruments held in a broker's nominee account	£10m per manager
Foreign countries (excluding MMF where there are no limits)	£10m per country
Lloyds Bank (as providers of operational banking services)	£5m overnight

- 1.62 **Liquidity management:** The Authority uses its own cash flow forecasting techniques 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 Authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Authority's medium-term financial plan and cash flow forecast. The Authority will spread its liquid cash over at least four providers (e.g. bank accounts and money market funds) to ensure that access to cash is maintained in the event of operational difficulties at any one provider

### **Treasury Management Prudential Indicators**

- 1.63 The Authority measures and manages its exposures to treasury management risks using the following indicators:
- 1.64 **Interest rate exposures:** This indicator is set to control the Authority'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:

<b>Interest rate risk indicator</b>	<b>Limit each year</b>
Upper limit on one-year revenue impact of a 1% <u>rise</u> in interest rates	£303,412
Upper limit on one-year revenue impact of a 1% <u>fall</u> in interest rates	(£303,412)

- 1.65 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.
- 1.66 **Maturity structure of borrowing:** This indicator is set to control the Authority's exposure to refinancing risk. This indicator used to be for fixed rate borrowing only but now includes all borrowing. The upper and lower limits on the maturity structure of borrowing will be:

<b>Refinancing rate risk indicator</b>	<b>Upper limit</b>	<b>Lower limit</b>
Under 12 months	20%	0%
12 months and within 24 months	40%	0%
24 months and within 5 years	60%	0%
5 years and within 10 years	80%	0%
10 years and above	100%	0%

- 1.67 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.
- 1.68 **Principal sums invested for periods longer than a year:** The purpose of this indicator is to control the Authority'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:

<b>Price risk indicator</b>	<b>2022/23</b>	<b>2023/24</b>	<b>2024/25</b>	<b>2025/26</b>
Limit on principal invested beyond year end	£5m	£4m	£3m	£2m

### **Related Matters**

- 1.69 The CIPFA Code requires the Authority to include the following in its treasury management strategy.
- 1.70 **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).
- 1.71 The Authority 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 Authority 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 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.

- 1.72 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.
- 1.73 **Housing Revenue Account:** The Authority completed the HRA self-financing settlement in March 2012 which resulted in an increase in housing debt of £94.386m. Interest payable and other costs/income arising from long-term loans which existed prior to this settlement (e.g. Premiums and discounts on early redemption) will be charged / credited to the respective revenue account based on the average CFR of the General Fund and HRA. Loans taken out as part of the self-financing settlement are assigned to the HRA loans pool and interest and other costs are payable from the HRA. Any new long-term loans borrowed will be assigned in their entirety to either the General Fund or HRA, there will be no single loans pool.
- 1.74 **Markets in Financial Instruments Directive:** The Authority 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 Authority's treasury management activities, the Chief Financial Officer believes this to be the most appropriate status.
- 1.75 **Financial Implications:** The budget for investment income in 2023/24 is £655,443, based on an average investment portfolio of £25 million at an interest rate of 4.125%. The budget for debt interest paid in 2023/24 is £3.366 million, based on an average debt portfolio of £105.0 million at an average interest rate of 3.71%. If actual levels of investments and borrowing, or actual interest rates, differ from those forecast, performance against budget will be correspondingly different.
- 1.76 **Other Options Considered:** The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Financial Officer, 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.

<b>Alternative</b>	<b>Impact on income and expenditure</b>	<b>Impact on risk management</b>
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

<b>Alternative</b>	<b>Impact on income and expenditure</b>	<b>Impact on risk management</b>
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