CONSULTATION REPORT 2024/25 TREASURY STRATEGY

Report of the Deputy Chief Executive (Section 151 Officer)

1. INTRODUCTION AND PURPOSE OF REPORT

1.1 This report seeks the views of the Corporate, Resource Management and Governance (CRMG) Scrutiny Committee on the development of the Council's Treasury Management Strategy Statement (TMSS), Annual Investment Strategy (AIS) and Minimum Revenue Provision (MRP) Policy for 2024/25, to be considered for approval at the Cabinet Meeting on 30 January 2024 and the Council Meeting on 22 February 2024

2. BACKGROUND

2.1 The Local Government Act 2003 and supporting regulations requires the Council to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Management Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent, and sustainable.

2.2 The Act requires the Council to set out its Treasury Management Strategy for borrowing and an Annual Investment Strategy which details the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments; these are submitted to Council for approval ahead of the financial year to which they relate.

2.3 An underlying requirement of the CIPFA Treasury Management in Public Services Code of Practice, among others, is the affirmation of effective management and control of risk as the prime objective of the Council's treasury management activities. The Code further advocates developing lending policies to counteract risk, i.e. use of market data in addition to credit ratings, greater consideration of diversification policy, having regard to country, sector, and group limits. The Code places emphasis on regular reporting on treasury management strategy and performance and scrutiny of treasury management strategy and policy to a specific named body.

2.4 The Council has accordingly delegated the role of ensuring effective scrutiny of its Treasury Management Strategy to the CRMG Scrutiny Committee. In line with the Code, the Cabinet and CRMG receive annual training and updates on Treasury Management.

2.5 The TMSS and AIS is a comprehensive report that identifies specific expected treasury activities for the forthcoming financial year, which is constructed in full compliance with the CIPFA Code. The formulation of the Strategy is made in light of the anticipated movement in both fixed and short-term variable interest rates; the report therefore refers to detailed background information which informs the proposed policies, forward triggers and limits contained in each Strategy based on leading market forecasts.

AGENDA ITEM

2.6 The TMSS, AIS and MRP Policy is developed in conjunction with the Council's treasury management advisers and includes information on the Council's loan and investment portfolio position, forward borrowing requirement, interest rate forecasts and prudential indicators. The report cannot be finalised until February 2024 because it is partially dependent on Cabinet's budget proposals. In addition, the interest rate forecasts and economic outlook which also influence the strategy need to be as up to date as possible and therefore close to publication.

2.7 This consultation is based on the central borrowing and investment activities of the Council for the forthcoming financial year only and does not detail the Capital Plans or the Prudential and Treasury Management Indicators which are required by statute to be set under the CIPFA Code and will form part of the final strategy statement for 2024/25.

2.8 To assist the consultation process, Members may find it useful to refer to the current TMSS, AIS and MRP Policy for 2022/23 approved by the Council Meeting on 23 February 2023 which can be found at this link below:

Current Year - TMSS, AID and MRP Policy 2023/24

2.9 The Treasury Management Mid-Year Update Report for the current year elsewhere on this Agenda provides a further update against the original 2023/24 strategy.

2.10 Subject to the boundaries established by Statute, Regulation and the Code of Practice, this report seeks the views of CRMG on:

- The Council's approach to borrowing.
- The Council's approach to the investment of surplus funds and the management of risk; and
- The Council's MRP Policy and the Council's approach to providing for the repayment of debt.

2.11 Opinions expressed will be given due consideration prior to finalising the Strategy Statements to be considered by the Cabinet Meeting on 30 January 2024. Economic forecasts will be materially updated once we have further updates regarding the current uncertainty in the economy. Section 8 of the report gives some context as to the current economic situation in the UK. Members will be aware that 2023 has been volatile; the UK economy is experiencing renewed signs of stress. While worries about a deep recession have largely gone away, the prospects of high interest rates and low productivity are expected to hold back growth. The UK economy could struggle to keep its head above water in the later stages of 2023 and uncertainty around the upcoming general election and strength of demand suggests that risks are skewed to the downside.

3. LEGISLATIVE FRAMEWORK

3.1 The Local Government Act 2003 (the Act) and supporting regulations requires the Council to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice. The Act also requires the Council to set out specific strategies in relation to key aspects of its treasury management operations before the start of each financial year, specifically for borrowing and investments along with its policy for setting aside MRP to cover debt repayments associated with borrowing to fund capital investment.

3.2 These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, DLUHC MRP Guidance, the CIPFA Treasury Management Code and DLUHC Investment Guidance

3.3 In line with these various requirements this strategy includes:

- The Annual Borrowing Strategy, including the Council's Policy on Borrowing in Advance of Need (TMSS).
- The Annual Investment Strategy (AIS); and
- The Annual MRP statement.

3.4 In conjunction with the Treasury Management Policy Statement and the detailed Treasury Management Practices, these provide the policy framework for the engagement of the Council with the financial markets in order to fund its capital investment programme and maintain the security of its cash balances.

4. CIPFA TREASURY MANAGEMENT CODES AND GUIDANCE

4.1 The CIPFA Prudential and Treasury Management Codes require all local authorities to prepare a capital strategy report which provides:

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

4.2 The aim of the capital strategy is to ensure that all elected members of the Council fully understand the overall long term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

4.3 The Council will provide and update on its Capital Strategy separately from the Treasury Management Strategy and Annual Investment Strategy. The Capital Strategy will build on this year’s strategy and be a high-level corporate document dealing with the key areas of strategic context, corporate priorities, capital investment ambition, available resources, affordability, capacity to deliver, risk appetite, risk management and determination of an appropriate split between non-financial and treasury management investments in the context of ensuring the long-term financial sustainability of the Council.

4.4 The Capital Strategy will also focus on ‘commercial’ (non-treasury) investments, in appropriate detail so that Members can properly assess the particular risks in this area. Commercial non-financial investments for the purposes of the Code are identified as those focused on income generation, whereas the Council would argue none of its commercial type investments have been entered into solely for the purposes of income generation, but rather for the Council’s ambition to redevelop and improve the town centre. The Capital Strategy will be reported to Cabinet on 31 January 2023 alongside the budget reports for 2024/25.

4.5 Investment in commercial non-financial investments, especially in property, do not form part of treasury management activities carried out by the treasury management team of the Council. Accordingly, the TMSS and AIS for 2024/25 will not deal with expenditure on, or investing in, non-financial investments, but solely on treasury management investments. This will give Members the focus to provide for greater critical examination and understanding of the Council's treasury management strategies and policies for 2024/25.

4.6 ROLE OF SECTION 151 OFFICER – DEPUTY CHIEF EXECUTIVE

4.6.1 The specific roles of this officer (the Deputy Chief Executive (Section 151 Officer)) were extended in 2019/20 to include a series of new roles in respect of the Capital Strategy and also a specific role in respect of investment in non-financial assets. CIPFA has extended the definition of treasury management and investments to include non-financial assets, which, at the same time, it terms as being non-treasury investments.

5. TREASURY MANAGEMENT REPORTING 2024/25

5.1 The Council is currently required to receive and approve, as a minimum, three main reports each year:

- **The Treasury Management Strategy Statement (TMSS), Annual Investment Strategy (AIS) and MRP Statement**. A forward-looking report which sets the scene for the forthcoming financial year.

- **The Mid-Year Review Report** on the current strategy which updates Members on the treasury and capital position.

- **The Annual report**. A retrospective review at the end of the financial year.

- In addition to the three major reports detailed above, from 2023/24 **quarterly reporting** (end of June/end of December) was also introduced. These reports however are not taken to full Council but to Cabinet and CRMG. The reports, specifically, should comprise updated Treasury/Prudential Indicators.

6. OBJECTIVES OF THE TREASURY MANAGEMENT STRATEGY

6.1 The Council's Treasury Management Strategy is designed to achieve the following objectives:

- To ensure the security of the principal sums invested which represent the Council's various reserves and balances.
- To ensure that the Council has access to cash resources as and when required.
- To minimise the cost of the borrowing required to finance the Council's Capital Investment programme; and
- To maximise investment returns commensurate with the Council's policy of minimising risks to the security of capital and its liquidity position.

7. SETTING THE TREASURY MANAGEMENT STRATEGY FOR 2024/25

7.1 In setting the treasury management strategy, the Council must have regard to the following factors which will have a strong influence over the strategy adopted:

- Economic forecasts.
- The level of the approved Capital Programme which generates the borrowing requirement.
- The current structure of the Council's investment and debt portfolio; and
- Prospects for interest rates and market liquidity.

8. UK ECONOMIC CONTEXT AND INTEREST RATES

8.1 To assist consideration of the Council’s Borrowing Strategy, a detailed commentary outlining current expectations for the economy is included in the following paragraphs. The final strategy report will reflect the latest information available in January 2024. Economic forecasts in this report are based on those of the Bank of England. At the time of writing, there has been extreme volatility in the financial markets driven by a number of factors.

8.1.1 The Bank of England’s Monetary Policy Committee (MPC) sets monetary policy to meet the 2% inflation target, and in a way that helps to sustain growth and employment. At its meeting ending on 20 September 2023, the MPC voted by a majority of 5-4 to maintain Bank Rate at 5.25%. Four members preferred to increase Bank Rate by 0.25 percentage points, to 5.5%. The Committee also voted unanimously to reduce the stock of UK government bond purchases held for monetary policy purposes, and financed by the issuance of central bank reserves, by £100bn over the next twelve months, to a total of £658bn.

8.1.2 In the MPC’s August most likely, or modal, Monetary Policy Report projections, conditioned on a market-implied path for Bank Rate that averaged just under 5.50% over the three-year forecast period, CPI inflation is expected to return to the 2% target by 2025 Q2 and to fall below the target in the medium term, as an increasing degree of economic slack is expected to reduce domestic inflationary pressures, alongside declining external cost pressures. The Committee had continued to judge that the risks around the modal inflation forecast were skewed to the upside, albeit by less than in May, reflecting the possibility that the second-round effects of external cost shocks on inflation in wages and domestic prices take longer to unwind than they did to emerge. The mean projection for CPI inflation, which incorporated these risks, was 2.0% and 1.9% at the two and three-year horizons respectively.

8.1.3 Since the MPC’s previous meeting, global growth has evolved broadly in line with the August Report projections, albeit with some differences across regions. Spot oil prices have risen significantly, while underlying inflationary pressures have remained elevated across advanced economies.

8.1.4 UK GDP is estimated to have declined by 0.5% in July and the S&P Global/CIPS composite output PMI fell in August, although other business survey indicators remain consistent with positive GDP growth. While some of this news could prove erratic, the Bank of England now expects GDP to rise only slightly in 2023 Q3.

Underlying growth in the second half of 2023 is also likely to be weaker than expected.

8.1.5 There have been some further signs of a loosening in the labour market, although it remains tight by historical standards. The vacancies-to-unemployment ratio has continued to decline, reflecting both a steady fall in the number of vacancies and rising unemployment. The Labour Force Survey unemployment rate rose to 4.3% in the three months to July, higher than expected in the August Report. Indicators of employment have generally softened against the backdrop of subdued activity.

8.1.6 Annual private sector regular Average Weekly Earnings (AWE) growth increased to 8.1% in the three months to July, 0.8 percentage points above the August Report projection. The recent path of the AWE is, however, difficult to reconcile with other indicators of pay growth. Most of these have tended to be more stable at rates of growth that are elevated but not quite as high as the AWE series.

8.1.7 Twelve-month CPI inflation fell from 7.9% in June to 6.7% in August, 0.4 percentage points below expectations at the time of the Committee's previous meeting and triggering the exchange of open letters between the Governor and the Chancellor of the Exchequer that is being published alongside this monetary policy announcement. Core goods CPI inflation has fallen from 6.4% in June to 5.2% in August, much weaker than expected in the August Report. Services CPI inflation rose from 7.2% in June to 7.4% in July but declined to 6.8% in August, 0.3 percentage points lower than expected in the August Report. Some of those movements are linked to services such as airfares and accommodation that tend to be volatile over the summer holiday period. Excluding these travel-related components, services inflation has been more stable at continued high rates, albeit slightly weaker than expected.

8.1.8 CPI inflation is expected to fall significantly further in the near term, reflecting lower annual energy inflation, despite the renewed upward pressure from oil prices, and further declines in food and core goods price inflation. Services price inflation, however, is projected to remain elevated in the near term, with some potential month-to-month volatility.

8.1.9 The MPC's remit is clear that the inflation target applies at all times, reflecting the primacy of price stability in the UK monetary policy framework. The framework recognises that there will be occasions when inflation will depart from the target as a result of shocks and disturbances. Monetary policy will ensure that CPI inflation returns to the 2% target sustainably in the medium term.

8.1.10 Developments in key indicators of inflation persistence have been mixed, with the recent acceleration in the AWE not apparent in other measures of wages and with some downside news on services inflation. There are increasing signs of some impact of tighter monetary policy on the labour market and on momentum in the real economy more generally. Given the significant increase in Bank Rate since the start of this tightening cycle, the current monetary policy stance is restrictive.

8.1.11 The MPC will continue to monitor closely indications of persistent inflationary pressures and resilience in the economy as a whole, including the tightness of labour market conditions and the behaviour of wage growth and services price inflation. Monetary policy will need to be sufficiently restrictive for sufficiently long to return inflation to the 2% target sustainably in the medium term, in line with the

Committee's remit. Further tightening in monetary policy would be required if there were evidence of more persistent inflationary pressures.

8.1.12 The MPC committed in the minutes of its August 2022 meeting to review the reduction in the Asset Purchase Facility annually and, as part of that, to set an amount for the reduction in the stock of purchased UK government bonds over the subsequent 12-month period. At this meeting, the Committee voted to reduce the stock of UK government bond purchases held for monetary policy purposes, and financed by the issuance of central bank reserves, by £100 billion over the period from October 2023 to September 2024, to a total of £658 billion.

8.1.13 Going forward therefore:

- UK growth is expected to slow over the remainder of this year and into 2024.
- With interest rates reaching their potential peak, attention will turn to fiscal policy, however the upcoming general election could prolong the uncertainty for businesses and delay investment.
- Post-pandemic imbalances are starting to normalise, while long-term growth remains a concern.

8.1.14 High interest rates, continued uncertainty and low productivity could see the UK struggle to keep its head above water in the second half of the year.

8.1.15 While the labour market is gradually returning to balance, household excess savings are broadly used up and the effect of higher interest rates is now feeding through to investment intentions, transaction volumes and corporate insolvencies, with the full impact on households and housing sectors yet to be felt.

8.1.16 Inflation continues to ease, although it remains above the levels in many western economies. The resolution of global supply chain bottlenecks and the fall in wholesale energy prices have supported the easing of price pressures, however, domestic influences, supported by strong pay growth, have kept inflation higher for longer. This could see inflation returning to its 2% target only by the latter part of 2024.

8.1.17 Just as the UK faces its own challenges the global economy appears to be losing momentum. Trade volumes are falling, and manufacturing is in retreat, causing headwinds for countries like Germany. There are also growing worries over the rising price of oil and a possible slowdown in China, which could act as a drag on global growth.

8.1.18 While interest rates have now potentially reached their peak in this cycle, uncertainty remains regarding their future path. This coupled with uncertainty around future plans for fiscal policy as the UK heads into an election year, may see businesses choose to further delay investment.

8.1.19 Public finances remain vulnerable to the fragile economic outlook and tighter financing conditions. The upcoming general election could see new spending pledges to address more immediate demands such as safety concerns around school buildings or authority deficits, with a rise in defence spending also likely. However, longer-term headwinds remain, including an ageing population, and slowing growth in workforce participation, while the cost of tackling climate change is also expected to be hefty, making the task for any incoming Chancellor difficult.

8.1.20 As the debate is slowly shifting to the Autumn Statement, the Chancellor will be confronted with a mix of higher borrowing costs and a multitude of spending demands. The temptation might be to address the short-term pressures, however, given the state of public finances and the challenges ahead, the UK economy will be better served by focusing on the longer-term challenges, such as tackling climate change and increasing productivity and long-term growth, together with ensuring a more sustainable public spending path.

8.1.21 Of course, what happens outside of the UK is also critical to movement in gilt yields. The US Federal Reserve has reaffirmed the central bank's dedication to maintaining an extended period of restrictive monetary policy in the United States. The primary goal of this move is to sustain the restrictive policy until there is strong conviction that inflation can be maintained at the desired 2% level over the long term. Despite recent US inflation rates aligning with the Federal Reserve's 2% target, a victory over inflation control has not been declared even though significant inflationary pressures are expected to diminish considerably in the near future. This warning, more stringent than anticipated by investors, contradicts the recent uptick in long-term US interest rates and the tightening of financial conditions following the last Fed rate rise. The Federal Reserve's adoption of a hawkish stance stems from its deep focus on future forecasts and the associated risks, signalling a greater willingness to tolerate an economic downturn over a resurgence of inflation. The central bank's decision-making process is also influenced by economic models, such as the Phillips curve, which suggests an inverse relationship between inflation and unemployment. Critics of the Federal Reserve's approach argue that it may underestimate the time lag between changes in monetary policy and their impact on domestic market variables like inflation, economic growth, and unemployment. They point to the complexity of the relationship between inflation and unemployment, influenced by factors such as labour market dynamics, globalisation, and technological advancements.

8.1.22 The Ukraine/Russian war will also continue to impact the global economy, particularly in Europe. Although the United Kingdom is expected to avoid a recession this year, it faces a challenging economic outlook. The energy price shock due to Russia's war in Ukraine has disrupted the recovery, with growth projected to be modest. The terms of trade shock, amid historically tight labour markets, has also pushed inflation to record levels.

8.1.23 More recently, the tragic conflict between Israel/Gaza and the possible economic repercussions. While the overall reaction of financial markets has been relatively muted so far, the risks of an intensification and broadening of the conflict are material, and their potential fallout could be severe, especially for countries in the region.

8.1.24 From a global economic perspective, energy is the most important short-run issue. Oil prices were already elevated at the time of the attack on Israel, and these developments raise the probability of supply disruptions (particularly if the crisis involves Iran or if unrest takes a toll on production in Iraq) and market nervousness more generally.

8.1.25 Disruptions to gas supplies are also possible (there were some production stoppages in Israel's Tamar field), and we have seen upward pressure on European gas prices. Increased tensions in the Middle East could also reverberate to the supply of European gas from countries in the region. In addition to the negative impact of energy price shocks on economic activity, rising energy prices would further complicate the task of central banks around the world trying to bring inflation back to target. IMF estimates suggest that a 10% increase in global oil prices could increase inflation globally by 0.4 percentage point.

8.1.26 Rising geopolitical tensions generally take a toll on global risk sentiment, widening spreads and putting further upward pressure on the dollar. The ensuing tightening in global financial conditions can have severe repercussions for economies with external vulnerabilities.

8.1.27 In summary, geo-political factors are a variable that it is difficult to discount from impacting UK economic performance and, therein, fiscal and monetary policies during 2024/25.

8.2 **<u>2024/25 PROSPECTS FOR INTEREST RATES</u>**

8.2.1 In planning the treasury management strategy, the Council will consider the prevailing and forecast interest rate situation. Regular forecasts of interest rates are provided by Link Asset Services, treasury management advisors to the Council, who assist the Council in formulating a view on interest rates. The following table provides the current central view for short term (Bank Rate), short-term investment rates and longer fixed interest rates.

		Bank Rate	Average Earnings Rates			PWLB Certainty Borrowing Rates **			
			3-Month	**6-Month**	**1-Year**	**5-Year**	**10-Year**	**25-Year**	**50-Year**
March	2024	5.25%	5.30%	5.50%	5.70%	5.00%	4.90%	5.20%	5.00%
June	2024	5.25%	5.30%	5.40%	5.50%	4.90%	4.80%	5.10%	4.90%
September	2024	5.00%	5.00%	5.10%	5.20%	4.70%	4.60%	4.90%	4.70%
December	2024	4.50%	4.50%	4.60%	4.70%	4.40%	4.40%	4.70%	4.50%
March	2025	4.00%	4.00%	4.10%	4.20%	4.20%	4.20%	4.40%	4.20%
June	2025	3.50%	3.50%	3.60%	3.70%	4.00%	4.00%	4.30%	4.10%
September	2025	3.00%	3.00%	3.10%	3.20%	3.90%	3.80%	4.10%	3.90%
December	2025	2.75%	2.80%	2.90%	3.00%	3.70%	3.70%	4.00%	3.80%
March	2026	2.75%	2.80%	2.90%	3.00%	3.70%	3.60%	3.90%	3.70%
June	2026	2.75%	2.80%	2.90%	3.00%	3.60%	3.60%	3.80%	3.60%
September	2026	2.75%	2.80%	2.90%	3.00%	3.60%	3.50%	3.80%	3.60%

** The rates shown reflect the Public Works Loan Board (PWLB) Certainty rate discount on PWLB loans of 20 basis points[1]. The PWLB lending facility is operated by the UK Debt Management Office (DMO) on behalf of HM Treasury and provides loans to local authorities.

8.2.2 The link in paragraph 2.8 to the current year borrowing strategy and the interest rate forecasts for short and longer-term borrowing therein reflect the original forecasts (from February 2023) for the current year's treasury strategy. Members will be aware that the actual/current forecasts for UK rates detailed in the table above, are now substantially higher than the initial view for interest rates for the 2023/24 financial year.

[1] Basis point (BP) refers to a common unit of measure for interest. One basis point is equal to 1/100th of 1%, or 0.01%, and is used to denote the percentage change in a financial instrument.

8.2.3 The above revised forecasts have been based on several assumptions, all of which are potentially subject to market challenge in due course.

8.2.4 The MPC kept Bank Rate unchanged at its September meeting, breaking a run of fourteen consecutive increases. However, they have signalled that rates will stay sufficiently restrictive for sufficiently long and if there were to be evidence of more persistent pressures further tightening in monetary policy would be required. The aim here is to try to ensure that looser financial conditions do not materialise, which would have the potential to undo much of the work done by the Bank on tightening conditions.

8.2.5 While the MPC has paused, expectations around reducing rates soon would be very premature.

8.2.6 Current expectations are generally that Bank rate has peaked however September inflation was stronger than expected, meaning that November's MPC decision is likely to be another tight affair. In reaction to the September decision to hold, markets had initially eased their own expectations to show no further policy tightening. Subsequent to this initial fall, market pricing edged back higher but more recent signs of increasing economic weakness has trimmed these increases.

8.2.7 On the investment front, the decision to pause had added further downside pressure on longer-term market rates but as with wider market expectations, pricing remains somewhat volatile.

8.2.6 As noted in the table above, Link have fine-tuned their expectations, and while they do not now foresee Bank Rate hitting 5.5%, they do see Bank Rate staying on hold for the best part of a year at 5.25%. However, the pace of any future decreases will very much be determined by the wage and inflation data.

8.207 Regarding PWLB rates, movement in the short part of the curve is expected to be driven by Bank Rate expectations to a large degree, whilst medium to longer-dated PWLB rates will remain influenced not only by the outlook for inflation, but also by the market’s appetite for significant gilt issuance.

8.2.7 Further down the road, it is anticipated that the Bank of England will be keen to loosen monetary policy when the worst of the inflationary pressures are behind us, but that timing will be one of fine judgment: cut too soon, and inflationary pressures may well build up further; cut too late and any downturn or recession may be prolonged.

8.2.8 In the upcoming months, forecasts will be guided not only by economic data releases and clarifications from the MPC over its monetary policies and the Government over its fiscal policies, but the on-going conflicts between Russia and Ukraine and more recently Israel and Gaza also have the potential to have a wider and negative economic impact.

8.3 Investment and borrowing rates 2024/25

8.3.1 Short-term rates

We now expect that Bank rate will remain at 5.25% until September 2024 and then to begin to fall throughout the next two financial years, reaching 2.75% by September 2026. Bank rate should finish 2024/25 at around 4%.

8.3.2 **PWLB rates**

The general situation is for volatility in bond yields to endure as investor fears for inflation and/or recession ebb and flow. The overall longer-run trend is for gilt yields and PWLB rates to remain high in the near-term, given the extent to which market expectations are already priced in and then to fall back once inflation starts to fall through 2024.

8.4 **A Summary Overview of the Future Path of Bank Rate**

8.4.1 Gilt yield curve movements have narrowed, with the short part of the curve seeing yields fall through recent weeks whilst the longer-end continues to reflect inflation concerns. At the time of writing there is <30 basis points difference between the 5 and 50- year parts of the curve. PWLB 5 to 50 years Certainty Rates are, generally, in the range of 5.25% to 5.55% (having reduced more recently). PWLB rates are higher in the range of 1-5 years being similar to the 50-year rate.

8.4.2 Interestingly short-term market levels in the local-to-local authority market have been inflated more recently due to more restricted supply of lenders meaning short term levels from 6 months out to 1 year are similar to the PWLB rates.

8.4.3 The above forecasts, (and MPC decisions), will be liable to further amendment.

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

8.5.1 **Downside risks to current forecasts for UK gilt yields and PWLB rates include:**

- Labour and supply shortages prove more enduring and disruptive and depress economic activity (accepting that in the near-term this is also an upside risk to inflation and, thus, could keep gilt yields high for longer).
- The Bank of England has increased Bank Rate too fast and too far over recent months, and subsequently brings about a deeper and longer UK recession than we currently anticipate.
- Geopolitical risks, for example in Ukraine/Russia, China/Taiwan/US, Iran, North Korea and Middle Eastern countries (Israel/Gaza conflict), which could lead to increasing safe-haven flows.
- A re-emergence of banking sector fragilities, which have been successfully addressed in the near-term by central banks and the market generally, but which may require further intervention if short-term interest rates stay elevated for longer than is anticipated.

8.5.2 **Upside risks to current forecasts for UK gilt yields and PWLB rates:**

- Despite the recent tightening to 5.25%, the Bank of England proves too timid in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to remain elevated for a longer period within the UK economy, which then necessitates Bank Rate staying higher for longer than we currently project.

- The pound weakens because of a lack of confidence in the UK Government's pre-election fiscal policies, resulting in investors pricing in a risk premium for holding UK sovereign debt.

- Longer term US treasury yields rise strongly if inflation remains more stubborn there than the market currently anticipates, consequently pulling gilt yields up higher.

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

9. AN AGILE TREASURY STRATEGY IS REQUIRED FOR 2024/25

9.1 Core to Treasury Management policy in the current times and following into the next financial year, is to be prepared and be organised to be agile, with the premise not to find the Council constrained from acting appropriately when opportunities and threats arise in respect of its integrated treasury management strategy.

9.2 Ever since the Financial Crisis of 2008 we have become more accustomed to more frequent exceptional events. More recently there has been both Brexit and Covid and then, of course, since the turn of the year an exceptional combination of war in Europe, an energy provision crisis, sky-high inflation, record low unemployment and new Governments.

9.3 In particular, at this juncture the Council needs to focus on cashflow, liquidity and having a good estimate as to where its cash backed reserves and balances are going to trend over the coming three to five years. Ideally the Council will also look to maintain a balance of Money Market Fund, notice and deposit accounts liquid investment for cashflow management and also where balances allow, laddered investments with high credit quality counterparties.

9.4 Most pertinent to the Treasury Team will be 'agile' treasury management or operating within a treasury framework which facilities flexibility for treasury strategy. The need to adopt an 'agile' approach, particularly now, has been emphasised in the recent sharp shift in economic conditions, namely the rapid increase in interest rates and gilt yields/PWLB rates.

10. BORROWING STRATEGY 2024/25

10.1 The Council has an extensive capital programme for 2024/25 to 2026/27 and there is a total of £264.146m of planned expenditure on capital schemes over the three years. A significant proportion of the three-year programme, £93.834m, is to be financed by prudential borrowing. There are some major schemes within the three-year programme, including the highways schemes for SEMMMS A6 to Manchester Airport Relief Road (£22.641m) and Cheadle Town (£10.351m), and Regeneration Schemes, Future High Streets Fund (£11.631m), Weir Mill Development (£23.248m) and the Academy of Living Well (£17.673m). Other significant schemes in the three-year programme include: HRA General Capital and New Build Schemes (£101.847m), and the School Estates Capital Programme Schemes (£16.749m).

10.2 These are the latest spending profiles for schemes, but it must be stressed that these are complex projects which are reviewed regularly to ensure that the programme reflects a realistic spending profile as they develop. Based on current forecasts there is clearly a significant amount of funding required to finance the Capital Programme in the next three years and the Council will be unable to do this without taking some form of external borrowing.

10.3 The Council has been maintaining an under-borrowed position for some time. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure.

10.4 With short-term interest rates having been lower than long-term rates in recent years, it has been cost effective for the Council to either use internal resources, or to borrow short-term rather than take long-term borrowing to fully fund its Capital Financing Requirement (CFR). By doing so, the Council has been able to reduce net borrowing costs (and investment income forgone has been negligible due to enduring low short-term rates) and reduce overall treasury risk. This is called maintaining an 'internally borrowed position' and using the Council's cash reserves and balances to fund borrowing as a temporary measure. This strategy has been prudent as investment returns have been low and counterparty risk relatively high. We have now moved into a different situation whereby all interest rates short and long-term have risen substantially and are expected to remain high over the course of 2024/25.

10.5 The Council's chief objective when borrowing money is 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.

10.6 It is clear we are in a position with high short-term and long-term borrowing rates that are converging to some extent but based on the forecasts above it appears to be the next 1 to 2 years that will be very expensive. The Council's spending plans need to remain robust as does the profiling of this spend in the light of the context outlined within the report.

10.7 That said, for new borrowing that needs to go ahead it is clear that avoiding fixing long-term loans at high rates would be a priority, but as a lot of authorities would no doubt also follow this strategy it remains a supply issue as to whether there will be enough liquidity in the short-term markets to sustain the current level of temporary borrowing, and more so any additional borrowing. Moreover, with now five Councils having issued Section 114 notices since 2021, the most recent being Birmingham City Council in September 2023, this has seen some local authorities take lending to other Council's off their lending lists, which may result in a significant reduction in willing lenders should we see this approach spread and more Section 114 notices issued.

10.8 Referring to the interest rate forecasts in 8.2.1, indications are that taking shorter-term PWLB in the next financial year from March 2024 might be slightly cheaper than short-term borrowing on present forecasts, however given the potential for volatility in gilt yields spurred by world events throughout 2024, this may not be the case. It should also be noted that there are usually opportunities to pick up short-term loans at sub-market levels from time to time if liquidity is good.

10.9 The Link long-term (beyond 10 years) forecast for Bank Rate stands at 2.5%. As all PWLB Certainty rates are now above this level, borrowing strategies will need to be reviewed in that context. Better value can generally be obtained at the shorter end of the curve and short-dated fixed LA to LA monies should be considered. Temporary borrowing rates are likely, however, to remain near Bank Rate and may also prove attractive whilst the market waits for inflation, and therein gilt yields, to drop back later in 2024.

10.10 From 15 June 2023, the Government introduced the Housing Revenue Account (HRA) PWLB rate which applies an interest rate of the gilt yield plus 40 basis points (0.40%); in effect this is the PWLB Certainty lending rate less 0.40%. This rate is solely intended for use in the HRA and primarily for new housing delivery, not general housing expenditure. The rate applies to fixed rate loans and will be available for one year, with its continuation subject to review. In the 2024/25 capital programme, there is currently £23.312m prudential borrowing for New Build schemes which are therefore potentially eligible to fund at the PWLB at the HRA rate. This is likely to be cheaper than short-term borrowing rates given where forecasts currently are.

10.11 Ideally the Council will need a very clear picture of what borrowing we require and when, as this is clearly the trickiest time to navigate our financing strategies that we have faced in many years.

10.12 From a practical standpoint when looking to borrow we need to focus on optimising cashflow forecasts and given the elevated level of rates right across the curve at present, seek to fund either temporarily from local authorities or with short-dated loans from the PWLB. Neither option is ideal, but current forecasts expect both short and longer term rates to be somewhat lower over the duration of the forecast, unless inflation proves to be the genie that cannot be put back into the bottle.

10.13 Of course, if we feel more certainty is paramount in our debt management strategy than we will need to consider another approach.

10.14 On the flipside, if we wished (but probably could not afford) to reduce our exposure to long-dated debt, there may be scope to repay loans prematurely (both market and PWLB) whilst high discount rates prevail. When a PWLB loan is repaid early, a settlement calculation is made which represents a ‘discount’ or ‘premium’ on the outstanding principal, according to whether the discount rate is respectively higher or lower than the loan rate, plus interest accrued from the previous scheduled repayment date. The discount rate is the rate in the ‘premature repayment’ set of rates in force when the repayment is agreed for a notional loan for a period equal to the remaining term of, and repayable by the same method as, the loan being repaid prematurely. As PWLB rates have risen over 2023, discount rates are now higher in some cases than the current loan rate and therefore the Council could receive a discount on prematurely repaid debt. However, having said this, repaying PWLB loans with short-term borrowing at its current level and with some shortages envisioned is perhaps not prudent.

10.15 A further consideration with rising rates in 2024/25 is the increased likelihood of the Council having £17.5m of market LOBOs (Lender Option Borrower Option)[2] called because market rates are currently above the interest rate we are paying on those loans. If this should occur the Council will need to consider the new terms offered and whether those levels would be advantageous or whether it could secure cheaper replacement borrowing elsewhere.

10.16 The Council will not look to externalise its entire borrowing requirement during 2024/25 but will aim to maintain a balance between internal and external borrowing.

10.17 Nevertheless, it is expected that volatility in gilt yields and therefore PWLB rates will be present throughout the next financial year, with rates being very reactive to market and world events; rates can rise and fall very quickly in a matter of days as there are so many variables at play. With longer-term rates on a higher trajectory, throughout 2024, the Council expects to avoid long-term borrowing in the next financial year if possible. That said, short-term rates are also expected to be high, but taking higher rated borrowing over a shorter-time frame rather than fixing for many years, would of course be a preference.

10.18 If greater value can be obtained in borrowing for shorter maturity periods, the Council will assess its risk appetite in conjunction with budgetary pressures to reduce total interest costs. Longer-term borrowing could be undertaken for the purpose of certainty, where that is desirable, or for flattening the profile of the maturity profile, or in the absence of liquidity in the short-term markets to sustain the level of borrowing required.

10.19 The Council will reference long-term 'trigger' borrowing rates from PWLB Certainty Rates for its long-term borrowing strategy.

10.20 Borrowing from alternative market lenders could be considered where this can be demonstrated to be cheaper than equivalent PWLB lending rates for the same loan period, however given where long-term rates are expected to be next year this is thought unlikely at this juncture.

10.21 From a borrowing perspective, again its essential to be agile. Markets can be and have been volatile, so the Council needs to be in a position to be able to act when required. Rolling back a year, the Council was benefiting from high internal borrowing positions and utilising internal cash resources in lieu of external borrowing. However, with this scenario now changing and the volatility in gilt yields, which of course drive the cost of PWLB, its vital to ensure that borrowing decisions can be made quickly.

[2] Lender Option Borrower Option ('LOBO') loans are fixed rate loans containing option dates and are an alternative to loans from the Public Works Loan Board ('PWLB'). They involve periodic interest re-fixings, which incorporates two linked options:

- lender's option: option for the lender to set revised (usually higher) interest rates at predetermined interest reset dates such as annually.
- borrower's option: linked option for the borrower (exercisable only if the lender's option is exercised) to pay the revised interest rate or to redeem the loan.

11 TARGET PWLB BORROWING RATES FOR 2024/25

11.1 Target PWLB Certainty rates for new borrowing have been set **two years forward** on the interest rate forecasts in 8.2.1 above, this is because the Council is expected to avoid long-term borrowing throughout the 2024/25 financial year whilst rates are elevated and delay this into 2025/26 to ideally take long-term funding at cheaper levels during 2025. Target rates are as follows:

PWLB Borrowing	Current Certainty Rate (25.09.23 PM)	Target Borrowing Rate (end Q3 2025)
5 years	5.05%	3.90%
10 years	5.10%	3.80%
25 years	5.54%	4.10%
50 years	5.30%	3.90%

11.2 As we have a positive yield curve underpinning the interest rate forecasts at present, those target rates will roll forward in line with the interest rate forecast and will be subject to Link Asset Services 'Longer Interest Rate Strategy Group' meetings held once a quarter in line with the Bank of England Quarterly Inflation Reports (Feb, May, August, November), where forecasts will be reviewed.

11.3 Against this background and the risks within the economic forecast, caution will be adopted with the 2024/25 treasury operations. The Deputy Chief Executive (Section 151 Officer) will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- If it was felt that there was a significant risk of a sharp FALL in borrowing rates, then borrowing will be postponed; and
- If there was a significant risk of a much sharper RISE in borrowing rates than that currently forecast, perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity, or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

12 SUMMARY APPROACH

12.1 Internal borrowing (run down investments) will continue where possible to reduce the amount of expensive external borrowing required.

12.2 Use will be made of the forward Balance Sheet Review to monitor the sustainability of this policy and in the current climate keep this under regular review, i.e. taking into account slippage/reprofiling of capital programme etc.

12.3 Short term/short-dated borrowing from other local authorities is likely to remain favourable.

12.4 There has been significant inter-authority lending during the last few financial years which shows reasonable availability at present, but this needs to be continually monitored within a sensible/manageable balance of short term loans.

12.5 PWLB rates are high so considerable planning is required throughout the forecast period in terms of all borrowing. Rates are volatile so trigger points will be set for long term borrowing activity as opportunities can come and go quickly.

12.6 Consideration of alternative sources of finance will be given where savings can be made, i.e. a Private Placement (PP) and/or Bond Market if appropriate; Municipal Bonds Agency (UKMBA) or other financial institutions (pension funds, banks).

12.7 If the availability of short term loans becomes in short supply or indeed expensive, the Council will first look to take short term PWLB loans at the HRA rate (40 basis points under the Certainty Rate).

12.8 If the Council has qualifying infrastructure projects within the Capital Programme, consideration will be given to applying to the UK Infrastructure Bank (opened in 2021) for a loan. For any infrastructure schemes that the Council may have, they may be eligible for a loan at a rate lower than PWLB levels, however the interest rate is unclear at this stage without making an application for a specific scheme.

12.9 The UK Infrastructure Bank (UKIB) is a new, government-owned policy bank, focused on increasing infrastructure investment across the United Kingdom
The two objectives of the bank are to help tackle climate change, particularly meeting the government’s net zero emissions target by 2050, and to support regional and local economic growth through better connectedness, opportunities for new jobs and higher levels of productivity.

12.10 The Council will also consider short-term loans from the PWLB at Certainty Rate where it is deemed to be cheaper than short-term borrowing or there is an increased risk that short-term loans cannot be raised.

12.11 The Council will consider other types of ‘Green’ Finance. Green Finance is often used to refer to debt funding of green investment. In addition to PWLB funding, councils are starting to see the emergence of new funding sources which can compete with PWLB, in particular Community Investment Bonds and the UKIB. The UKIB, UKMBA, PWLB, CMBs (Community Municipal Bonds)[3] and Salix all have a strong role to play in the financing of councils’ green projects.

13 <u>BORROWING AHEAD OF NEED</u>

13.1 The Council will not borrow more than or in advance of need with the objective of profiting from the investment of the additional sums borrowed. However, borrowing in advance of need can be justified in the following circumstances:

- Where there is a defined need to finance future capital investment that will materialise in a defined timescale of three years or less; and
- Where the most advantageous method of raising capital finance requires the Council to raise funds in a quantity greater than would be required in any one year; or

[3] A community Municipal Bond is a bond issued by a local authority through a crowdfunding platform giving residents the chance to support/invest, for example, in low-carbon projects/Green projects.

- Where in the view of the Deputy Chief Executive (Section 151 Officer), based on external advice, the achievement of value for money would be prejudiced by delaying borrowing to the year in which it falls.

13.2 Having satisfied these criteria any proposal to borrow in advance of need would also need to be reviewed against the following factors:

- Whether the on-going revenue liabilities created, and the implications for the future plans and budgets have been considered and reflected in those plans and budgets, and the value for money of the proposal has been fully evaluated.
- The merits and demerits of alternative forms of funding; and
- The alternative interest rate bases available, the most appropriate periods over which to fund and repayment profiles to use.

13.3 All decisions on whether to undertake new or replacement borrowing to support previous or future capital investment plans will be subject to evaluation against the following criteria:

- **Overall need:** whether a borrowing requirement to fund the capital programme or previous capital investment exists.
- **Timing:** when such a borrowing requirement might exist given the overall strategy for financing capital investment and previous capital spending performance.
- **Market conditions:** to ensure borrowing that does need to be undertaken is achieved at minimum cost, including a comparison between internal and externally financed borrowing; and
- **Scale:** to ensure borrowing is undertaken on a scale commensurate with the agreed financing route.

All long-term decisions will be documented reflecting the assessment of these criteria

14. BORROWING STRATEGY: QUESTIONS FOR CONSIDERATION

Making reference to the forecasts for borrowing rates, expectations for the economy going forward and the current year's borrowing strategy:

1. Does the borrowing strategy outlined above seem reasonable?

2. In the current economic climate do Members feel the policy of maintaining an internally borrowed position is correct?

3. Do Members agree with the view of short, medium and long term interest rates which effectively will be the benchmark levels for borrowing?

4. Do Members have alternative views on the use of long-term and short-term borrowing and borrowing in advance of need (three-year time frame under Prudential Code)?

5. Do Members have alternative views on the duration or type of future borrowing?

15. ANNUAL INVESTMENT STRATEGY (AIS)

15.1 Investment instruments identified for use in the financial year under the ‘Specified’ and ‘Non-Specified’ Investments categories, counterparty limits, creditworthiness policy etc. can be found in the current year’s AIS in the link at paragraph 2.8.

15.2 Investment Policy (management of risk)

15.2.1 The Council’s investment policy has regard to the following:

- DLUHC’s Guidance on Local Government Investments (‘the Guidance’).
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2021 (‘the Code’); and
- CIPFA Treasury Management Guidance Notes 2021.

15.2.2 In accordance with the Code, the Council’s investment priorities are:

- The security of capital. The Council maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security.
- It has sufficient liquidity in its investments. For this purpose, it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council’s prudential indicators covering the maximum principal sums invested; and
- The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of the Council is low in order to give priority to security of its investments. However, this authority will also pursue value for money in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance.

15.2.3 Treasury management investments represent the placement of cash in relation to the s12 Local Government Act 2003 Act investment powers, so the residual cash held in the bank resulting from the Council’s day-to-day activities. These are invested under the SLY (Security, Liquidity and Yield) principles.

15.3 Link Asset Services suggested counterparty list is at the heart of the Council's creditworthiness policy and has always been conservatively constructed to protect the Council against credit risk whilst allowing for efficient and prudent investment activity. In accordance with the above guidance and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which enables diversification and thus avoidance of concentration risk.

15.4 2024/25 INVESTMENT STRATEGY

15.4.1 In-House Funds: Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.
- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

15.4.2 For its cash flow generated balances, the Council will utilise Money Market Funds (MMF) if rates continue to be positive to a degree that makes investing worthwhile, instant access and notice accounts and some short-dated deposits (up to twelve months).

15.4.3 **Investment returns expectations**.
The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows:

Average Earnings in each year	**Target**
2024/25	4.70%
2025/26	3.00%
2026/27	2.80%
2027/28	3.05%

15.4.4 In the event that the Council is in a position to make investments for generally longer than 100 days or in notice accounts at enhanced levels, the budgeted return on investment earnings for 2024/25 and subsequent years will be amended to reflect this in line with average earnings forecasts; indications of 3, 6 and 12-month average earnings rates are provided in paragraph 8.2.1.

15.4.5 Depending on the size of the investment portfolio, at times it is entirely appropriate to hold all investments as instant access, i.e. in liquid deposit accounts or MMFs. This is when investment balances are not particularly high relative to cashflow needs and are predominantly being used to supplement cashflow shortages. This has been the case at certain times in recent years where bank rate has been abnormally low and so investment balances have been kept to a minimum with the objective being to supplement cashflow shortages. Of course, this is no longer the case, with short-term rates now rising progressively.

15.4.6 We had for many years been operating in a low interest rate environment and you could be forgiven for thinking there was little benefit in proactive investment strategies, as there was certainly little scope for achieving investment returns; this is of course has now changed. The Council is overall a net borrower and uses its investments to manage cashflow rather than to invest, for example, as a pension fund would. Other Councils with larger investment portfolios and hence more active investment lines will have seen their investments yields shoot up in recent weeks, where we have seen the yield curve steepen unrelentingly against the backdrop of inflationary pressures. This has resulted in a sharp increase in term deposits and as a result, different investment strategies have come into play.

15.4.7 What is clear for 2024/25 is that the Council needs to gauge what is the appropriate level of investments to hold, over what is required for cashflow needs, which is also dependant on the timing of borrowing and general market liquidity. Money market rates are now higher, so that holding a higher level of liquid investments than is actually required could be costly given Bank rate is now at 5.25% and expected to remain there for a sustained period. The Council will use investment balances to reduce the need to borrow, but at the same time where the opportunity arises to increase returns by fixing investments for a longer duration, the Council will do so. Managing liquidity risk in this regard will be fundamental.

15.4.8 Where capacity allows, it may have significant benefit to the Council to invest longer term and in a wider variety of investment instruments. Simply by creating layers of the Councils investment portfolio in an optimal way based on spending needs.

15.4.9 In this interest rate environment the Council will aim to build-in flexibility to be able to extend the duration of deposits using a laddered investment strategy where possible and the Council's Treasury Framework and Strategy documents will be fit-for-purpose in allowing investments with a broad range of high credit quality counterparties, whilst also being sufficiently robust to also embrace AAA rated Money Market Funds where liquidity needs prevail. To facilitate this approach key areas to consider for the 2024/25 strategy will include:

- Having appropriate approval within the TMSS (Treasury Management Strategy Statement) for the use of a range of appropriate counterparties.
- Having appropriate limits approved for the use of counterparties/different investment instruments and not being overly restrictive.
- Should the Council consider a custodian facility set up to hold certificates of deposit and T-Bills if required. This might be considered but is costly.
- Having appropriate cash flow planning to identify required minimum liquidity levels, thus avoiding excess liquidity.

15.4.10 There is a natural minimum balance that the Council requires to hold in shorter-term investments to supplement cashflow, however the Council may consider the use of Cash-Plus Funds which could be used to pick up additional returns versus usual Money Market Funds in 2024/25, whilst still providing a degree of liquidity should the Council's cash flow forecast not come to fruition as expected. Cash Plus Funds are similar to Money Market Funds however they are designed for investment over a longer duration (3+ months) at an enhanced return so are not as liquid. They are also Variable Net Asset Value funds (VNAV) rather than Constant Net Asset Value funds. The Council would need to fully understand the implications of this and any fund under consideration prior to making an investment.

15.5 **Challenger Banks:** So far challenger banks[4] are not included in the Council's counterparty lists. This is because at present they do not have credit ratings and so would fall outside the Council's investment strategy criteria. However, we expect that some of these entities may get ratings in coming years and will therefore continue to keep this area under review.

15.6 **The Search for Higher Returns**

15.6.1 There are various alternative investment 'opportunities' offered in the market or discussed in the wider press within the area of sterling deposits developed by

[4] A relatively small retail bank set up with the intention of competing for business with large, long-established national banks, specifically designed to compete with the Big Four (HSBC, Lloyds, Barclays and RBS). These newer banks have an online presence rather than a physical one.

financial institutions. Most of these appear to afford similar security of capital to basic sterling deposits but they also offer the possibility, although never of course the certainty, of increased returns.

15.6.2 The Deputy Chief Executive (Section 151 Officer) in liaison with the Council's external advisers, will consider the benefits and drawbacks of these instruments and whether any of them are appropriate for the Council. Due to their relative complexity compared to straightforward term deposits and length, most of them would fall within the definition of non-specified investments. Decisions on whether to utilise such instruments would be taken after an assessment of whether their use achieves the Council's objectives in terms of reduction in overall risk exposure as part of a balanced portfolio.

15.6.3 The Council will not solely look at return but more importantly the product, particularly when considering pooled investment vehicles. This will apply to any investment opportunity. It is not enough to rely on the fact that other councils may be investing in such schemes already. The Council is tasked through market rules to understand the product and appreciate the risks before investing.

15.6.4 There are varying degrees of risks associated with different investments or asset classes and these need comprehensive appreciation. It is not just credit risk that needs to be understood, but liquidity and interest rate/market risk as well, although these can often be intertwined. Any option in which an investor hopes to generate an elevated rate of return will almost always introduce a greater level of risk. By carefully considering and understanding the nature of these risks, an informed decision can be taken.

15.6.5 The particular asset classes the Council may consider include Ultra Short Dated Bond Funds, Corporate Bonds, Property Funds, Equity Funds and Multi Asset Funds. However, given the longer-term nature of some of these funds, it is highly unlikely the Council will have the capacity to commit funds for investment over the number of years these types of investments require, i.e. property funds.

15.7 The Council may consider extending their list of approved counterparties to include housing associations which have credit ratings that meet their minimum credit rating requirements.

15.8 **ESG Investments**

15.8.1 The Council has set out more fully its current approach to ESG investments in the Mid-Year Treasury Management Strategy Review Report for 2023/24, which outlines the present difficulties the Council has in assigning ratings to ESG investments and which is perhaps the Council's key issue in managing treasury risk.

15.8.2 The Council will consider ESG investments as part of its investment portfolio going forward. However, investment guidance, both statutory and from CIPFA, makes clear that all investing must adopt SLY principles; Security, Liquidity and Yield. As such, ethical issues, i.e. the green agenda, must play a subordinate role to those priorities.

15.8.3 Link Asset Services are looking at ways in which to incorporate these factors into their creditworthiness assessment service, but with a lack of consistency, as well as coverage, this is not straightforward. At the present time this is still under consideration. Members will be updated on the progress of this and the feasibility of including these investments as part of the Council's investment portfolio in the 2024/25 financial year.

15.8.2 In terms of measuring ESG ratings/metrics which is by far the biggest issue for Treasury incorporating ESG into its investment process. Link are continuing to review the market in terms of providers, their methodologies and outputs, as well as waiting on the outcome of the FCA consultation process, which could conceivably have a material impact on the market going forwards. As such Link are having to approach things somewhat more reticently than they originally envisaged, as circumstances could change markedly and they do not want to be in a situation where they begin providing information to clients, only to then have to change it all at some stage in the relatively near future. It is frustrating, but when they provide a new service, first and foremost, it has to be 'right' and of the greatest benefit to clients, not simply 'new'.

15.8.3 Link are also looking at how to provide an overall rating and also something that would address key areas clients have specific interest in. One option would be to simply give clients access to the output of a provider, explain how this output is put together, so clients can easily understand what it reflects, and then overlay this with their own requirements to allow it to be an appropriate part of their investment decision-making process. The other option is to take the raw data from a provider, and then work with clients as to how they wish to frame this in terms of their own views on ESG. This way, you get a far more bespoke assessment of the ESG factors and can then work them to your own needs, rather than simply accept what a provider thinks is the correct balance. The former would likely be cheaper and easier to implement, but it has its shortfalls compared to the latter. Another aspect to consider is practicalities, i.e. how do present this information? Link operate a web based 'Passport system' which is currently used by the Council to access all sorts of information and specifically credit ratings. There is only so much space on a page to provide information, and if you are adding in fresh elements related to ESG to sit along credit rating metrics, then how does it all come together in an easy to digest way for the Council to be able to make prompt decisions. It might be that they have to work in the background, i.e. Link have the Council's pre-determined 'ESG criteria' that can be applied to potential counterparties that already meet the Council's credit rating criteria and the output simply provides those entities that meet both credit and ESG metrics as outlined in our Investment Strategy.

15.8.4 Also, bear in mind that not all entities are necessarily assessed by any/all providers, a bit like CDS prices, but worse especially if not a full-blown mainstream bank.

15.8.5 The aim therefore is to provide a direct feed to clients, ideally working alongside ratings. Part of this may also be about how the Council wants to use the information. Will it be in terms of 'red lines', i.e. entities that fail a part of our requirements are automatically excluded, or would it be used to show something like the 'carbon impact' of our portfolio and how this has changed over time? etc. Discussions are still afoot on the level of the detail provided and whether it is simply a 'rating', or access for us to develop our own individual 'score' etc. In terms of the providers, Link have had discussions with all the main suppliers and as to what the final decision will be, will depend to some extent on the outcome of the

FCA consultation as well as what services each provider offers, making sure that it is actually appropriate for what the Council wants.

15.8.6 The Treasury Team outlined in the Mid-Year Treasury Management Strategy Review report 2023/24 that they will look to develop use of CDP scores or Carbon Disclosure Ratings as this seems most appropriate to align with the Council's Climate Change Strategy. CDP was established as the 'Carbon Disclosure Project' in 2000, asking companies to disclose their climate impact. Since then, the scope of environmental disclosure has been broadened to incorporate deforestation and water security. The CDP Scoring Methodology is designed to incentivise jurisdictions' transition towards resilience and net-zero through equitable environmental action.

15.8.7 Link can access CDP scores via their Bloomberg terminal but are prevented from distributing them to clients due to licensing requirements. They have included them in some prototype work they have done in this area as they do provide an assessment point that the Council will want to consider. Again, highlighting issues that the FCA are trying to address, these scores are based on the response by an entity to a questionnaire that CDP send out (and they do not necessarily send it out to everyone, and not everyone who does get it will respond). In terms of other providers, they have something similar where you can put names in and then you get a whole host of climate-related information (it only covers listed entities, but not necessarily all of them, so, for example, building societies are not covered). This is something that Link would potentially look to provide to clients on a direct feed basis as part of their service moving forward, as this may actually be somewhat more relevant to what Councils are trying to achieve that simply focussing on ESG scores/ratings.

15.8.8 Overall, the whole process is somewhat delayed and, unfortunately, somewhat more complicated than providing things like credit ratings. The objectivity and focus are key as not only do different providers have a different bias as well as basis to their approach each Council may also have a different objective in incorporating 'ESG' into their investment process. Link are working away in the background and hope to have a service provision in place, but as to the timing of that, is very difficult for us to say at this stage with any certainty.

15.8.9 In the meantime, the Council will look to further develop its own approach and what decide what considerations it should or would like to take into account as we look to incorporate such factors into our investment processes. Key here is to make sure that there is a full understanding of what the data signifies and importantly, what it does not. The danger is in imposing red lines on who to deal with that then runs contra to security, liquidity and yield, with the unintended consequence of actually increasing the overall (financial) risk profile of the investment portfolio.

15.9 Summary Investment Approach

15.9.1 The Council will retain focus on Security, Liquidity and then Yield.

15.9.2 Investing is all about 'appropriateness' and this depends on both internal (fundamental) and external (overlay) circumstances, i.e. cashflow, risk appetite, interest rate outlook. The Council's Investment Strategy will reflect both internal and external factors, with a strong emphasis on risk management across legislation.

15.9.3 It is difficult to 'actively' invest if you have limited notion on the nature of your balances. The Council will look to both cash flow and longer-term forward balance sheet projections to establish investment balances for 2024/25.

15.9.4 The Council will maintain a reasonable level of liquid investments to counter the need to take temporary borrowing.

15.9.5 The Council will consider 'laddering' approach to investments where appropriate. Natural liquidity is established with a 'ladder' of monthly investments done in a progressive way (where balances permit). This would be worked within the Council's Investment Strategy limitations, i.e. time limits, but still allows the Council to take advantage of steeper yield curve and provides a level of liquidity and ability to flex if circumstances change again.

15.9.6 The Council will continue to develop its approach to ESG investing.

16 INVESTMENT STRATGY: QUESTIONS FOR CONSIDERATION

Making reference to the current year's Investment Strategy and supporting schedules, current expectations for the economy and likely investment rates available in 2024/25 given above:

1. Is the Council's current lending criteria too strict, too lax or about right? Does it have due regard to risk, but also practical operational considerations and access to counterparties of appropriate financial standing?

2. Do you consider that the Council is adequately controlling credit risk? Is the Council's risk appetite reasonable?

3. Do you think that the approach to the selection of approved counterparties is suitable to both manage risk and optimise returns, but with priority on the former? Is the pool of available investment instruments appropriate?

4. Do you think that the Council should or should not use non-specified investments, e.g. investments in excess of one year?

5. Have limits, i.e. individual and Group, Country and Sovereign been given due consideration?

6. Does the overall Investment Strategy appear sound?

17. MINIMUM REVENUE PROVISION (MRP) POLICY

17.1 The Council is required to settle an element of its non-HRA Capital Financing Requirement (CFR) each year by way of a revenue charge (the Minimum Revenue Provision, 'MRP'). Local Authorities may also provide additional 'Voluntary Revenue Provision' if they wish to do so.

17.2 DLUHC guidance recommends the preparation of an annual statement of policy on making MRP for submission to the Council Meeting for approval. The terms of the original statement may be revised during the year subject to the revised statement being approved by the Council Meeting at that time. The guidance presents four 'ready-made' options for calculating MRP, but other options are not ruled out provided they are consistent with the statutory duty to make prudent provision.

17.3 The Council's MRP Policy was updated in the 2015/16 financial year so that provision for General Fund Borrowing previously supported through the RSG system would be in equal instalments over a 50-year period starting 1 April 2015, as opposed to the 4% on the outstanding balance previously provided.

17.4 In November 2021, the DLUHC proposed changes to the MRP Regulations to address the concern that some authorities are not fully compliant with the duty to make a prudent revenue provision resulting in underpayment of MRP. The original consultation contained a proposal stating that capital receipts could not be used in place of the revenue charge. There was serious opposition raised in response and a subsequent consultation to address these was issued in June 2022, allowing capital loans to be exempt from the need to charge MRP with the proviso that authorities should make MRP equal to any loss recognised with respect to a capital loan. There has since been no update on this as DLUHC are yet to issue a response to this second consultation. Members will be informed if there are any relevant changes to the Council's MRP Policy in the next treasury management report following an outcome from the DLUHC.

17.5 The current MRP Policy for 2023/24 explains how the Council currently sets aside revenue budget provision for the repayment of debt which has been used to fund capital expenditure.

18 MRP POLICY: QUESTIONS FOR CONSIDERATION

Making reference to the current year's MRP Policy in paragraph 2.8 above:

1. Does the Committee believe that the Council's current MRP policy is sufficiently prudent?

19. INTERNAL CONSIDERATIONS

19.1 FINANCIAL AND RISK ASSESSMENT CONSIDERATIONS

The financial implications are covered in the body of the report.

There are no further financial and risk considerations arising from the report. This report is produced as a finance report and discusses in detail risk mitigation processes which are at the heart of Treasury Management Policy. Treasury Management Risk Management is the practice of planning for unexpected expenditures. It is primarily about mitigating and avoiding the impact of the changing financial environment on the Council's cash flow objectives.

19.2 LEGAL CONSIDERATIONS

19.2.1 There are no Legal and Governance implications to consider as a result of the report and recommendations.

19.2.2 The Council will ensure that all its treasury management activities comply with its statutory powers and regulatory requirements. In framing its credit and counterparty policy under Treasury Management Practice (TMP1) *Counterparty credit risk management*, it will ensure that there is evidence of counterparties' powers, authority and compliance in respect of the transactions they may effect with the Council, particularly with regard to duty of care and fees charged.

19.2.3 The Council recognises that future legislative or regulatory changes may impact on its treasury management activities and, so far as it is reasonably able to do so, will seek to manage the risk of these impacting adversely on the Council.

19.3 HUMAN RESOURCES IMPACT

19.3.1 There is no impact to the workforce or the workforce of partner organisations as a result of the report and recommendations.

19.3.2 The Council recognises the importance of ensuring that all staff involved in the treasury management function are fully equipped to undertake the duties and responsibilities allocated to them. It will therefore seek to appoint individuals who are both capable and experienced and will provide training for staff to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills.

19.3.3 The Council will also ensure that Members tasked with treasury management responsibilities, including those responsible for scrutiny, have access to training relevant to their needs and those responsibilities.

19.3.4 The present arrangements, including a knowledge and skills schedule, are detailed in the relevant Treasury Management Practice (TMP). This *Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes* (the TM Code) revision for 2021 introduces strengthened requirements for skills and training.

19.4 EQUALITIES IMPACT

19.4.1 A full Equalities Impact Assessment is undertaken as part of the Council's Treasury Management Strategy Statement, Annual Investment Strategy and Minimum Revenue Provision Policy report submitted to Council ahead of the forthcoming financial year (in February each year).

19.4.2 This report is a Consultation with Members to assist in the formulation of the Treasury Management Strategy Statement for the next financial year (for the Consultation)

19.5 ENVIRONMENTAL IMPACT

19.5.1 Part of the revisions to the Treasury Management Code in December 2021, (that will be incorporated into the Council's Treasury Management Policy Statement and Treasury Management Practices (TMPs)), was to provide further clarification of the way the Council is looking to incorporate environmental considerations in the Council's Investment Strategy. This requirement and approach is high level in the 2023/24 Treasury Strategy.

19.5.2 Environmental, Social and Governance (ESG) issues are increasingly significant for investors and investment managers. This is better developed in equity and bond markets than for short-term cash deposits and there is a diversity of market approaches to ESG classification and analysis.

19.5.3 This means that a consistent and developed approach to ESG for the Council in its treasury management dealings is challenging. The Treasury Management Strategy and Annual Investment Strategy, Mid-Year Review Report 2023/24 elsewhere on this Agenda outlines in detail in Section 15 current considerations, thinking and approach as the Council develops its ESG treasury policy further. Section 15.8 of this Consultation also discusses how to establish ESG ratings further as this is the most prevalent issue to resolve in embodying ESG within Treasury Management in 2024/25.

19.5.4 ESG investment policies and treasury management practices will be consistent with the Council's own relevant policies where possible, for example, climate change policies.

20. CONCLUSIONS AND RECOMMENDATIONS

20.1 To assist the consultation process and the underlying requirements of the CIPFA Treasury Management in Public Services Code of Practice, which places emphasis on effective scrutiny of the Council's treasury management strategy and policy to a specific named body; this report provides a comprehensive picture of the economic and political factors that are likely to influence short and longer term interest rates and therefore the Council's strategies for borrowing and investing during the 2024/25 financial year.

20.2 It is recommended that CRMG give due consideration to the above questions so that their views can be taken into account in the development of the Council's 2024/25 Treasury Management Strategy Statement.

BACKGROUND PAPERS

There are none.

Anyone wishing to inspect the above background papers or requiring further information should contact Lorna Soufian on telephone number Tel: 0161 474 4026 or alternatively email lorna.soufian@stockport.gov.uk