WEST SUFFOLK COUNCIL

Treasury Management Strategy Statement 2023 to 2024

Introduction

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

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

Investments held for service purposes or for commercial profit are considered in a different report, the Investment Strategy.

External Context

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 to 2024.

The Bank of England (BoE) increased Bank Rate by 0.50 per cent to 3.50 per cent in December 2022, the ninth successive rise since December 2021. The decision was voted for by a 6-3 majority of the Monetary Policy Committee (MPC), with one of the three dissenters voting for a 0.75 per cent rise and the other two for no rise at all.

UK Demand & Output

According to the Official National Statistics (ONS) first quarterly estimate, Gross Domestic Product (GDP) had fallen by 0.2 per cent in quarter 3 of 2022, a smaller decline than the expectation in the November Monetary Policy Report of a 0.5 per cent fall. Within the expenditure components, household consumption and business investment had both fallen by 0.5 per cent, while government spending was estimated to have risen by 2.1 per cent. Underlying output, defined as market sector output adjusted for the estimated effects of recent additional bank holidays, was estimated by Bank staff to have fallen by a similar amount as headline GDP. Monthly GDP had risen by 0.5 per cent in October, following a 0.6 per cent fall in September, and marginally stronger than had been expected by Bank staff immediately prior to the release. Bank staff now expected GDP to decline by 0.1 per cent in quarter 4 of 2022, 0.2 percentage points stronger than had been expected in the November Report.

Labour market

The UK employment rate increased by 0.2 per cent to 75.6 per cent on the quarter and remains lower than pre-coronavirus pandemic levels. Over that quarter, the number of employees increased, while self-employed workers decreased. Although labour demand has begun to ease, the labour market remains tight. The unemployment rate rose slightly to 3.7 per cent in the three months to October. The annual growth of private sector pay has seen an increase, to 6.9 per cent within the last three months since October. This was 0.5 per cent higher than expected at the time of the November report.

Inflation

Year-on-year CPI decreased from 11.1 per cent in October to 10.7 per cent in November, which was slightly under expectations than the November report. Transport was the largest downward contributing factor to CPI in November, more than double the next largest downward contribution. Although the introduction of the Energy Price Guarantee (EPG) in October has limited the rise in CPI inflation, the contribution of household energy bills to inflation has risen further. Since the MPC's previous meeting, core goods price inflation has fallen back, while annual food and services price inflation have strengthened.

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.

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

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

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

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

Interest rate forecast (December 2022)

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 per cent target.

While interest rate expectations reduced during October and November 2022, multiple interest rate rises are still expected over the forecast horizon despite looming recession. Arlingclose expects Bank Rate to rise to 4.25 per cent by June 2023 under its central case, with the Monetary Policy Committee cutting rates in the medium term to stimulate a stuttering UK economy. They expect rate cuts in the first half of 2024.

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 3.30 per cent, 3.50 per cent, and 3.85 per cent 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.

A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix A.

For the purpose of setting the budget, it has been assumed that new treasury investments will be made at an average rate of 3.25 percent, and that new long-term loans will be borrowed at a budgeted rate of 4.50 percent on our existing cash flow forecast.

Local Context

On 31 December 2022, the Council held £13.75 million of external borrowing, £42.31 million of internal borrowing and £71.50 million of treasury investments. This is set out in further detail at Appendix B.

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR). The table below details the forecast for the councils Capital Financing Requirement over the next 3 years.

Table 1: Capital Financing Requirement

	31 March 22 Actual £million	31 March 23 Estimate £million	31 March 24 Forecast £million	31 March 25 Forecast £million	31 March 26 Forecast £million
Capital Financing Requirement	55.49	59.14	93.42	142.50	168.45

The Council's current strategy is to maintain borrowing and investments below their underlying levels, known as internal borrowing, whilst also looking to secure long term certainty of interest rates by fixing some borrowing externally when it is advantageous to do so. The Council will continue to monitor this strategy in order to decide whether externally borrowing to pre-fund future years requirements would better meet its borrowing objectives.

The Council has an increasing CFR due to the capital programme. Consequently, investment levels will continue to fall in future years, as capital receipts and revenue reserves are used to finance capital expenditure and the revenue budget.

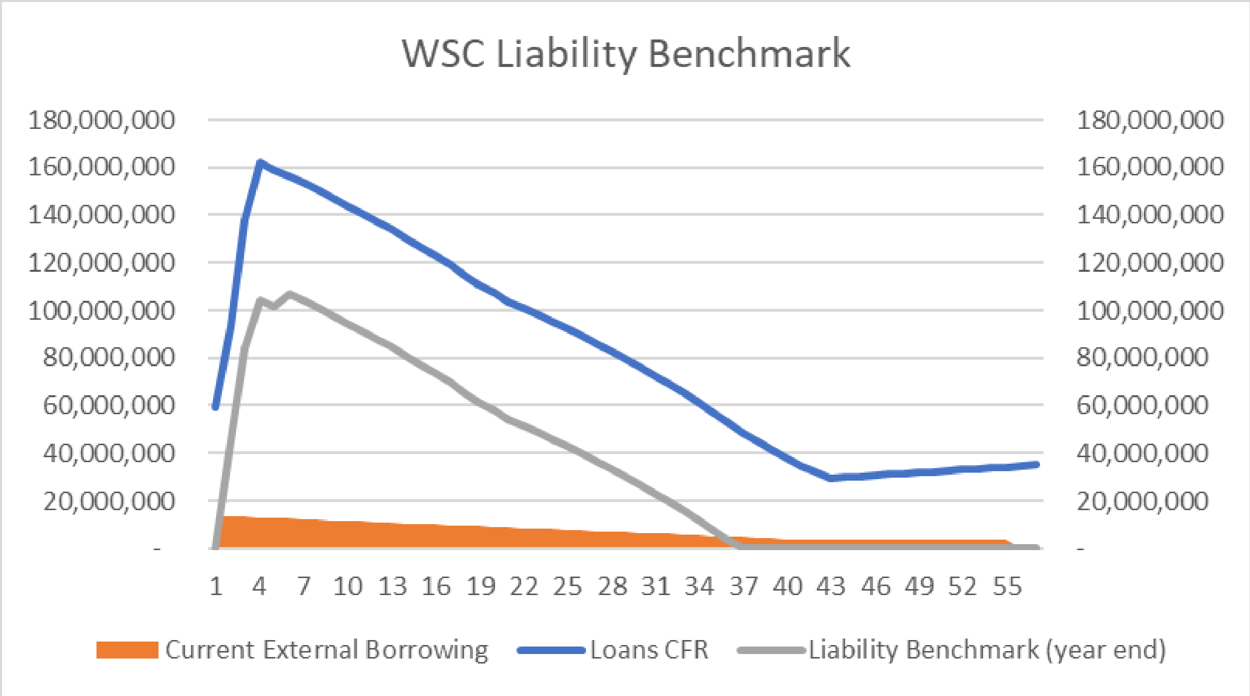
External borrowing is expected to take place in 2023 to 2024, as the amount of capital expenditure is forecast to outweigh the amount of remaining cash reserves the council holds.

CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. Table 1 above shows that the Council expects to comply with this recommendation during 2023 to 2024.

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

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-today cash flow.

The long-term liability benchmark assumes capital expenditure funded by borrowing of £0.5 million a year, minimum revenue provision on new capital expenditure based on a 40 year asset life and reserves maintaining their current levels. This is shown in the chart below together with the maturity profile of the Council's existing borrowing.



Borrowing Strategy

The Council currently holds £13.75 million of loans, a £0.25 million decrease on previous years, as part of its strategy for funding previous years' capital programmes. The Council expects to externally borrow in 2023 to 2024. The Council may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £99.71 million

Objectives: The Council'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 Council's long-term plans change is a secondary objective.

Strategy: Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. It is likely to be more cost effective in the short-term to use internal borrowing, however opportunities to fix longer term external borrowing will be explored in order to achieve long-term security at advantageous interest rates.

By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal and/or short-term 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 Council with this 'cost of carry' and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2023 to 2024 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

The Council's default position is to raise the majority of its long-term borrowing from the PWLB but will consider long-term loans from other sources including banks, pensions and local authorities, and will 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 Council intends to avoid this activity in order to retain its access to PWLB loans.

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

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

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 including local authorities
- UK public and private sector pension funds
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

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

Local Authority Lending: The Council has the ability to invest with any other UK Local Authority. However, no investments will take place with any local authority that are subject to a current S114 notice. Further due diligence will also be undertaken to ensure that the local authority is unlikely to be subject to such a notice for the duration of any investment.

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 full Council.

Lender's Option Borrower's Option Loans (LOBOs): The Council entered into a 70 year, £4 million LOBO loan on 31 March 2008, where the lender had an option to propose an increase in the interest rate at set dates, following which the Council had the option to either accept the new rate or repay the loan at no additional cost. However, in 2016 to 2017 Barclays wrote to the Council confirming their decision to waive their right to change the applicable interest rate of this loan, effectively changing it to a fixed rate loan.

Short-term and variable rate loans: These loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below. Financial derivatives may be used to manage this interest rate risk (see section below).

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. Other lenders may also be prepared to negotiate premature redemption terms. The Council 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 Investment Strategy

The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council's treasury investment balance has ranged between £44 million and £76 million. During 2023 to 2024 and in future years, these levels are expected to fall due to the Council's Capital Programme.

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

Strategy: As demonstrated by the liability benchmark above, the Council expects to be a long-term borrower and new treasury investments will therefore be made primarily to manage day-to-day cash flows using short-term, low risk instruments.

The CIPFA Code does not permit local councils to both borrow and invest long-term for cash flow management. But the Council may make long-term investments for treasury risk management purposes, including to manage interest rate risk by investing sums borrowed in advance for the capital programme for up to three years.

ESG policy: Environmental, social and governance (ESG) considerations are increasingly a factor in global investors' decision making, but the framework for evaluating investment opportunities is still developing and therefore the Council's ESG policy does not currently include ESG scoring or other real-time ESG criteria at an individual investment level. When investing in banks and funds, the Council will prioritise banks that are signatories to the UN Principles for Responsible Banking and funds operated by managers that are signatories to the UN Principles for Responsible Investment, the NET Zero Asset Managers Alliance and/or the UK Stewardship Code.

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

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

Table 3: Treasury investment counterparties and limits

Credit Rating	Banks Unsecured	Banks Secured	Pooled Funds
AAA	£6 million 5 years	£12 million 20 years	£12 million 20 years
AA+	£6 million 5 years	£12 million 10 years	£12 million 15 years
AA	£6 million 4 years	£10 million 5 years	£10 million 15 years
AA-	£6 million 3 years	£10 million 4 years	£10 million 10 years
A+	£6 million 2 years	£8 million 3 years	£8 million 5 years
A	£6 million	£8 million	£8 million

	13 months	2 years	5 years
A-	£6 million 6 months	£6 million 13 months	£6 million 5 years
None	£6 million 6 months	n/a	£1 million 5 years
UK Government	Unlimited, 50 Years		
Other UK Local Authorities	Using Arlingclose Rating Formula (Per iDeal trade platform) Gold - £12 million - 5 years Silver - £10 million - 5 years Bronze - £8 million - 5 years		

This table must be read in conjunction with the notes below

*** Minimum credit rating:** Treasury investments 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.

For entities without published credit ratings, investments may be made either (a) where external advice indicates the entity to be of similar credit quality; or (b) to a maximum of £6 million per counterparty as part of a diversified pool e.g. via a peer-to-peer platform.

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

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

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

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

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

Strategic pooled funds: Bond, equity and property funds that offer enhanced returns over the longer term but are more volatile in the short term. These allow the 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.

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.

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.

Operational bank accounts: The Council may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than 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 £1 million 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.

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

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

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

Other information on the security of investments: The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the 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.

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, or with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

Investment limits: The Council's revenue reserves available to cover investment losses are forecast to be £38.7 million on 31 March 2023. In order that no more than 40 per cent of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £12 million. A group of entities under the same ownership will be treated as a single organisation for limit purposes.

Credit risk exposures arising from non-treasury investments, financial derivatives and balances greater than £1.50 million in operational bank accounts count against the relevant investment limits.

Limits are also placed on fund managers, investments in brokers' nominee accounts and foreign countries as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Investment limits

	Cash limit
Any single organisation, except the UK Central Government	£12 million each
UK Central Government	Unlimited
Any group of organisations under the same ownership	£12 million per group
Any group of pooled funds under the same management	£12 million per manager
Negotiable instruments held in a broker's nominee account	£12 million per broker
Foreign countries	£3 million per country
Unsecured investments with building societies	£6 million each
Money market funds	£12 million in total

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

The Council will spread its liquid cash over available 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

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

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

Credit risk indicator	Target
Portfolio average credit score	6.0

This target of 6.0 represents an average credit rating score across the portfolio of A, on the scale of AAA to unsecured.

Liquidity: The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments on instant access, without additional borrowing.

Liquidity risk indicator	Target
Total cash available on instant access	£5m

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

Refinancing rate risk indicator	Upper limit	Lower limit
Under 12 months	100%	0%
12 months and within 24 months	20%	0%
24 months and within 5 years	20%	0%
5 years and within 10 years	20%	0%
10 years and above	100%	%

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

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

Price risk indicator	2023 to 2024	2024 to 2025	2025 to 2026
Limit on principal invested beyond year end	£30m	£30m	£30m

Related Matters

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

Financial derivatives: Local councils 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 councils' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the 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.

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

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

Markets in Financial Instruments Directive: The Council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Authority's treasury management activities, the Chief Financial Officer believes this to be the most appropriate status.

Financial Implications

The budget for investment income in 2023 to 2024 is £715,000, based on an average investment portfolio of £22 million at an interest rate of 3.25 percent. The budget for debt interest paid in 2023 to 2024 is £1.51 million. Please note, these figures are provisional budget figures and may be subject to change during the budget setting approval process.

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

Where investment income exceeds budget, e.g. from higher risk investments including pooled funds, or debt interest paid falls below budget, e.g. from cheap short-term borrowing, then the revenue savings may be transferred to a treasury management reserve to cover the risk of capital losses or higher interest rates payable in future years.

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.

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

		term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

Appendix A – Arlingclose Economic & Interest Rate Forecast - December 2022

Underlying assumptions:

- The influence of the mini-budget on rates and yields continues to wane following the more responsible approach shown by the new incumbents of Downing Street.
- Volatility in global markets continues, however, as investors seek the extent to which central banks are willing to tighten policy, as evidence of recessionary conditions builds. Investors have been more willing to price in the downturn in growth, easing financial conditions, to the displeasure of policymakers. This raises the risk that central banks will incur a policy error by tightening too much.
- The UK economy is already experiencing recessionary conditions and recent GDP and PMI data suggests the economy entered a technical recession in quarter 3 of 2022. The resilience shown by the economy has been surprising, despite the downturn in business activity and household spending. Lower demand should bear down on business pricing power – recent data suggests the UK has passed peak inflation.
- The lagged effect of the sharp tightening of monetary policy, and the lingering effects of the mini-budget on the housing market, widespread strike action, alongside high inflation, will continue to put pressure on household disposable income and wealth. The short- to medium-term outlook for the UK economy remains bleak.
- Demand for labour appears to be ebbing, but not quickly enough in the official data for most MPC policymakers. The labour market remains the bright spot in the economy and persisting employment strength may support activity, although there is a feeling of borrowed time. The MPC focus is on nominal wage growth, despite the huge real term pay cuts being experienced by the vast majority. Bank Rate will remain relatively high(er) until both inflation and wage growth declines.
- Global bond yields remain volatile as investors price in recessions even as central bankers push back on expectations for rate cuts in 2023. The US labour market remains tight and the Fed wants to see persistently higher policy rates, but the lagged effects of past hikes will depress activity more significantly to test the Fed's resolve.
- While the Bank of England appears to be somewhat more dovish given the weak outlook for the UK economy, the ECB seems to harbour (worryingly) few doubts about the short term direction of policy. Gilt yields will be broadly supported by both significant new bond supply and global rates expectations due to hawkish central bankers, offsetting the effects of declining inflation and growth.

Forecast:

- The Monetary Policy Committee (MPC) raised Bank Rate by 50 basis points to 3.5 per cent in December as expected, with signs that some members believe that 3 per cent is restrictive enough. However, a majority of members think further increases in Bank Rate might be required. Arlingclose continues to expect Bank Rate to peak at 4.25 per cent, with further 25 basis point rises in February, March and May 2023.

- The MPC will cut rates in the medium term to stimulate a stuttering UK economy, but will be reluctant to do so until wage growth eases. We see rate cuts in the first half of 2024.
- Arlingclose expects gilt yields to remain broadly steady over the medium term, although with continued volatility across shorter time periods.
- Gilt yields face pressures to both sides from hawkish US and Euro Zone central bank policy on one hand to the weak global economic outlook on the other. Bank of England bond sales and high government borrowing with provide further underlying support for yields.

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

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

Appendix B – Existing Investment & Debt Portfolio Position

Investments held as at 31 December 2022				
Counterparty	**Principal Amount (£)**	**Interest Rate**	**Date Loaned**	**Date Returned**
Lloyds 95 Day Account	Nil			
Santander 365 Day	8,000,000	2.21%	01/04/22	365 day Notice
Santander 95 Day	500,000	1.13%	01/04/22	95 day Notice
Lloyds Treasury Account	9,500,000	0.08%	01/04/22	On call availability
Barclays Deposit Account	6,000,000	0.01%	01/04/22	On call availability
CCLA Money Market Fund	4,000,000	Variable	01/04/22	On call availability
HM Debt Man. Office	2,500,000	1.800%	12/07/22	10/01/23
HM Debt Man. Office	5,000,000	1.960%	19/07/22	17/01/23
HM Debt Man. Office	5,000,000	1.935%	01/08/22	30/01/23
HM Debt Man. Office	3,000,000	2.110%	12/08/22	10/02/23
HM Debt Man. Office	4,000,000	2.535%	01/09/22	28/02/23
HM Debt Man. Office	4,000,000	3.080%	01/11/22	28/04/23
HM Debt Man. Office	6,000,000	2.970%	01/11/22	15/03/23
HM Debt Man. Office	3,000,000	2.990%	01/11/22	23/03/23
HM Debt Man. Office	3,000,000	3.160%	15/11/22	15/05/23
HM Debt Man. Office	6,000,000	3.010%	01/12/22	16/01/23
HM Debt Man. Office	2,000,000	3.570%	19/12/22	19/06/23
Total	**71,500,000**			

Please note: The interest rates above are the rates as at 31 December 2022. The current market volatility could cause the actual rates going forward to fluctuate.

External Borrowings and Temporary Loans					
Lender	**Balance – 1 April 2022 (£)**	**Movement (£)**	**Balance - 31 December 2022 (£)**	**Interest Rate**	**Maturity date**
Barclays Bank	4,000,000	0	4,000,000	4.24%	31 March 2078
PWLB	10,000,000	(250,000)	9,750,000	1.84%	1 December 2061