Treasury Management Strategy 2023/24

Introduction

1. In 2018 the Ministry of Housing, Communities & Local Government (MHCLG) produced new Investment Guidance including the requirement to produce an Investment Strategy.

2. The County Council's Capital and Investment Strategy (Appendix 7) sets out the Council's broad approach to investment, including its capital programme, how this is funded, and investments held for service purposes or for commercial profit.

3. This Treasury Management Strategy Statement (TMSS) supports the Capital and Investment Strategy in setting out the arrangements for the management of the County Council's cash flows, borrowing and investments, and the associated risks.

4. The County Council has borrowed and invested 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 County Council's prudent financial management.

5. Treasury risk management at the County Council is conducted within the framework of the CIPFA Code which requires the County Council to approve a Treasury Management Strategy Statement (TMSS) before the start of each financial year. This Strategy fulfils the County Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

6. Investments held for service purposes or for commercial profit are considered separately in the Capital and Investment Strategy.

External Context

7. The following paragraphs explain the economic and financial background against which the TMSS is being set.

Economic background

8. The ongoing impact on the UK from the war in Ukraine, together with higher inflation, higher interest rates, uncertain government policy, and a

deteriorating economic outlook, will be major influences on the Authority's treasury management strategy for 2023/24.

9. The Bank of England (BoE) increased Bank Rate by 0.75% to 3.0% in November 2022, the largest single rate hike since 1989 and the eighth successive rise since December 2021. The decision was voted for by a 7:2 majority of the Monetary Policy Committee (MPC), with one of the two dissenters voting for a 0.50% rise and the other for just a 0.25% rise.

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

Credit outlook

11. 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.

12. 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.

Interest rate forecast

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

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

15. Yields are expected to remain broadly at current levels over the medium-term, with 5-, 10- and 20-year gilt yields expected to average around 3.6%, 3.7%, and 3.9% respectively over the 3-year period to September 2025.

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

Balance Sheet Summary and Forecast

17. On 31 December 2022, the County Council held £225.0m of borrowing and £721.5m of investments. This is set out in further detail at Annex B.

18. Forecast changes in these sums are shown in the balance sheet analysis in Table 1.

Table 1: Balance sheet summary and forecast

	31/03/22 Actual £m	31/03/23 Estimate £m	31/03/24 Forecast £m	31/03/25 Forecast £m	31/03/26 Forecast £m
Capital Financing Requirement	784	771	768	777	752
New Capital Financing Requirement					
Less: Other debt liabilities*:					
- Leases**	0	0	0	(15)	(14)
- Street Lighting PFI	(90)	(87)	(83)	(79)	(75)
- Waste Management Contract	(42)	(38)	(34)	(30)	(25)
Loans CFR	**652**	**646**	**651**	**653**	**638**
Less: External borrowing***:					
- Public Works Loans Board	(208)	(188)	(180)	(170)	(167)
- Other Loans (incl. LOBOs)	(20)	(12)	(12)	(12)	(12)
- Other short-term borrowing	(21)	(21)	(21)	(21)	(21)
Total external borrowing	**(249)**	**(221)**	**(213)**	**(203)**	**(200)**
Internal borrowing	**403**	**425**	**438**	**450**	**438**
Less: Balance sheet resources:					
- Usable Reserves	(883)	(826)	(776)	(752)	(775)
- Allowance for Working Capital	(169)	(243)	(243)	(243)	(243)
Balance sheet resources	**(1,052)**	**(1,069)**	**(1,019)**	**(995)**	**(1,018)**
Treasury investments	**(649)**	**(644)**	**(581)**	**(545)**	**(580)**

* Leases and PFI liabilities that form part of the County Council's debt

** IFRS 16 requires the County Council to change how it recognises its leases from 1 April 2023.

*** shows only loans to which the County Council is committed and excludes optional refinancing

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

20. It is forecast that the County Council will continue to take advantage of internal borrowing, which will increase through 2023/24, whilst paying off Public Works Loan Board (PWLB) debt as maturities arise.

21. Reserves and balances are due to reduce over the forecast period due to the anticipated funding of the Capital Programme and use of the Budget Bridging Reserve (BBR) to balance the budget in the next two years pending further savings to be planned and delivered. The County Council's investment balances are however due to initially rise over the forecast period and then fall during 2023/24, as shown in Table 1. This is because the County Council's employer's LGPS pension contributions were paid early in April 2020 for the period to March 2023, and subject to any unforeseen cash flow requirements the County Council plans to prepay its employer's LGPS pension contributions for three years again on 1 April 2023.

22. CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the County Council's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the County Council expects to comply with this recommendation during 2023/24.

Liability benchmark

23. To compare the County Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as Table 1, but that cash and investment balances are kept to a minimum level of £10m at each year-end to maintain sufficient liquidity but minimise credit risk.

24. 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

25. external borrowing the Council must hold to fund its current capital and revenue plans while keeping treasury investments at the minimum level required to manage day-to-day cash flow.

Table 2: Prudential Indicator: Liability benchmark

	31/03/22 Actual £m	31/03/23 Estimate £m	31/03/24 Forecast £m	31/03/25 Forecast £m	31/03/26 Forecast £m
Loans CFR	652	646	651	653	638
Less: Balance sheet resources	(1,052)	(1,069)	(1,019)	(995)	(1,018)
Net loans requirement	**(400)**	**(423)**	**(368)**	**(342)**	**(380)**
Plus: Liquidity allowance	10	10	10	10	10
Liability benchmark	**(390)**	**(413)**	**(358)**	**(332)**	**(370)**

26. At the start of the period, 31 March 2022, the County Council had a Loans CFR of £652m, external borrowing of £249m, balance sheet resources of £1,052m and a liability benchmark of 390m. The difference of £403m between the CFR and external borrowing is internal borrowing which is where the County Council has used its own resources to fund its borrowing requirement.

27. The liability benchmark is the lowest level of debt the County Council could hold if it used all of its balances, reserves and cash flow surpluses to fund its CFR. The County Council expects a negative liability benchmark across the forecast period, which means that currently there is not a requirement to borrow, and that the County Council could potentially repay its current external borrowing and still fund the planned capital programme. The County Council would like to reduce its external borrowing further, although the recent reductions in expectations for future interest rate increases have made the premium charged to repay debt look less attractive. The County Council will continue to monitor opportunities to repay debt with its advisors Arlingclose.

Borrowing Strategy

28. The County Council held £225.0m of loans as at 31 December 2022, which is £73m lower than the previous year. As interest rates have risen the opportunity has been taken to repay £12m of PWLB loans and £29m of other loans (including some LOBOs). This has locked-in a future rate of return for the Council on the use of resources used to repay debt, and reduced overall treasury risk by reducing overall cash balances.

29. The loans are predominantly as a result of the County Council's strategy for funding previous years' capital programmes, but also includes amounts held on behalf of others for governance or administrative purposes. The balance sheet forecast in Table 1 shows that the County Council does not expect to need to take on new external borrowing in 2023/24. The County Council has the option to borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £780m, but does not currently expect to do so.

Objectives

30. The County 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 County Council's long-term plans change is a secondary objective.

Strategy

31. Given the significant cuts to public expenditure and in particular to local government funding, the County Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, the County Council expects to continue its approach of internally borrowing instead of taking on additional external borrowing.

32. By internally borrowing, the County Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. Arlingclose will assist the County Council in regularly monitoring the benefits of this approach against taking on short term external borrowing and the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly.

33. The County Council has previously raised the majority of its long-term borrowing from the PWLB. The County Council does not expect to take on any new long-term borrowing in 2023/24, however should the County Council need to borrow any long-term amounts it will consider long-term loans from other sources including banks, pension funds 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, however the County Council's investment strategy does not support this activity and so will retain its access to PWLB loans.

34. The County Council may also 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.

35. In addition, the County Council may borrow short-term loans (normally for up to one month) to cover unplanned cash flow shortages.

Sources of borrowing

36. 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
- Any other bank or building society authorised to operate in the UK.
- Any other UK public sector body.
- UK public and private sector pension funds (except Hampshire Pension Fund).
- 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

37. 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 (PFI)
- sale and leaseback.

LOBOs

38. The County Council holds £4.0m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the County Council has the option to either accept the new rate or to repay the loan at no additional cost.

39. All of these loans have options during 2023/24, and with interest rates having risen recently, there is now a greater possibility that lenders will exercise their options. If they do, the Authority will take the option to repay LOBO loans to reduce refinancing risk in later years. Total borrowing via LOBO loans will be limited to the current level of £12m.

Short-term and variable rate loans

40. These loans leave the County Council exposed to the risk of short-term interest rate rises. This risk is monitored through the indicator on interest rate exposure in the treasury management indicators in this report.

Debt rescheduling

41. 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 County 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

42. The County Council holds invested funds representing income received in advance of expenditure plus balances and earmarked reserves held. In the past 12 months, the County Council's treasury investment balance has ranged between £670.5m and £865.7m.

43. Over the last 12 months the investment balance has risen due to a number of factors. The increase in investment balances partly reflects the difference in timing between income and expenditure and is typical of this time of year. Also, investment balances have been impacted by the decision to pay employer's LGPS pension contributions in advance on 1 April 2020 for the three-year period to March 2023 at a cost of approximately £225m. A further pre-payment for the three-year period to March 2026 is to be made on 1 April 2023 at a cost of approximately £250m.

Objectives

44. The CIPFA Code requires the County Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before

seeking the highest rate of return, or yield. The County Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. The County Council aims to be a responsible investor and will consider environmental, social and governance (ESG) issues when investing.

Strategy

45. The County Council aims to continue to hold a diversified investment portfolio, including investments in more secure and/or higher yielding asset classes. This is especially the case for the estimated funds that are available for longer-term investment.

46. At 31 December 2022 approximately 55.7% of the County Council's investment balances were invested so that they were not subject to bail-in risk (that investors funds are taken to sure a failing bank), as they were invested in Government investments, secured bank bonds and pooled property, equity and multi-asset funds.

47. Of the 44.3% of investment balances that were subject to bail-in risk at 31 December 2021, 12.8% was held in very short-term notice accounts providing a comparatively favourable rate of interest in exchange for a short notice period within the 100-day maximum recommended by Arlingclose, 73.5% was held in overnight money market funds and cash plus funds which are subject to a reduced risk of bail-in due to the high level of diversification within these investments, and the remainder was held in overnight bank call accounts for liquidity purposes.

48. Unfortunately, the availability of appropriate longer term investment opportunities has been reduced in comparison to previous years due to an uncertain economic market, and the local authority market has been much reduced due to the amount of funding that has been supplied to the sector from Central Government.

49. Further detail is provided at Annex B. This diversification is a continuation of the strategy adopted in 2015/16.

Business models

50. Under the new IFRS 9, the accounting for certain investments depends on the 'business model' for managing them. The County Council aims to achieve value from its internally managed treasury investments through 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.

Environmental, social and governance factors

51. 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 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.

Investments targeting higher returns

52. The County Council agreed in 2021 to increase the amount of its cash balances earmarked for investments targeting higher yields of around 4% to £250m. It is now recommended that this maximum allocation to higher yielding investments is increased to £320m, within the overall limit on principal invested beyond a year (see Table 9 below) of £400m. These amounts are not targets but allow the Council to take advantage of any increase in the levels of its core balances. The Council's expected forecast cashflows will continue to be monitored and longer terms investments identified accordingly if appropriate.

53. The CIPFA Code requires the County Council to invest its funds prudently and to have regard to the security and liquidity of its investments before seeking the highest yield. As a result, the County Council's investments targeting higher yields have been made from its most stable balances and with the intention that they will be held for at least the medium term. This means that the initial costs of any investment and any periods of falling capital values can be overcome and mitigates the risk of having to sell an asset for liquidity purposes, helping to ensure the long-term security of the County Council's investments.

54. Higher yields can be targeted through longer term cash investments and by investing in asset classes other than cash. Following advice from Arlingclose, the County Council has constructed an investment portfolio that is diversified across asset classes and regions. This has been achieved by investing in pooled investment vehicles (pooled funds) alongside long term lending to other local authorities and loans relating to the Manydown development project. This diversification helps to mitigate the risk of overexposure to a single event affecting a specific asset class.

55. The use of pooled funds also enables the County Council to achieve a greater degree of diversification than could effectively be achieved by directly owning individual assets. Pooled funds are managed by specialist external fund managers who are best placed to select and manage investments, for example with property investments in selecting appropriate buildings and then managing the relationship with tenants and the maintenance of those buildings.

56. Diversification in itself does not guarantee positive outcomes. The selection of pooled funds is carefully managed to target funds with a strong performance track record and objectives that are well aligned to the County Council's aim of achieving income returns of around 4% per annum (pa) without putting its initial investment at undue risk over the longer term. The County Council is therefore currently invested in pooled funds that specialise in providing income returns to support the revenue budget. As a result of their income focus these funds may not achieve the same capital growth and therefore total return, as other more general investment funds, however they are likely to deliver significantly greater income returns than cash investments, particularly in the current interest rate environment.

57. The investible universe for pooled funds is vast and part of the service provided by Arlingclose as treasury advisors is to conduct research and suitable due diligence on pooled funds prior to making recommendations to their clients.

58. Past performance does not guarantee that funds can replicate successful outcomes in future and knowing which funds will perform well is not an exact science. The County Council will therefore continue to conduct its own ongoing review and scrutiny of the performance of its pooled fund investments. The County Council will also discuss these investments regularly with Arlingclose, who provide advice based on regular meetings with representatives from the pooled funds and their own ongoing due diligence on areas such as performance and investment style, strategy and process.

59. £207.7m of the allocation to higher yielding investments has now been invested, with the remaining balance earmarked, the majority that remains outstanding relates to the Manydown development. Of the total, £184.7 is invested in pooled funds, including £10.7m invested on behalf of the Thames Basin Heaths Joint Strategic Partnership Board (TBH JSPB), where the County Council acts as the administrative body. Any investments made from cash held on behalf of the TBH JSPB are made with the agreement that the TBH JSPB has received its own financial advice and assumes all risks associated with these investments.

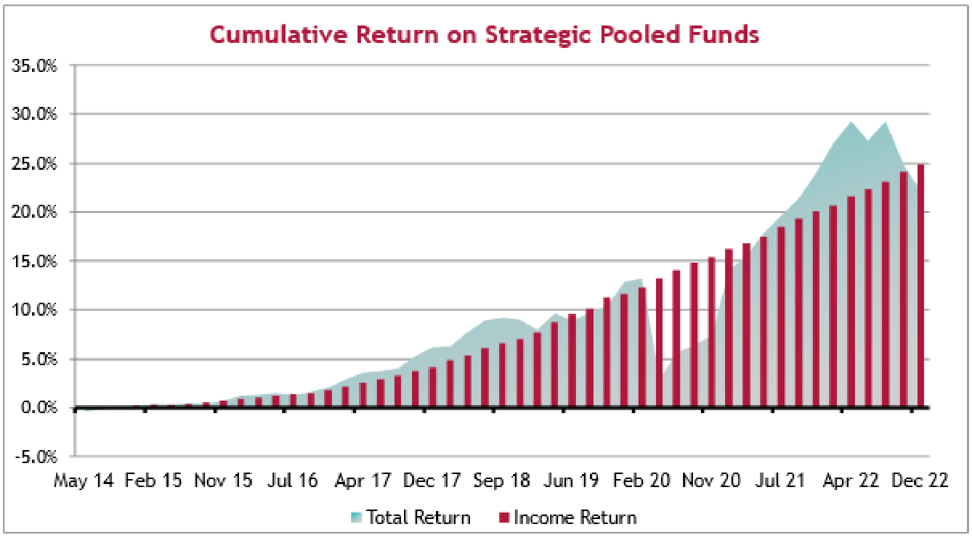
60. The current portfolio of pooled funds investments targeting higher yields is summarised in Table 3.

Table 3: Investments targeting higher yields portfolio

Investment type*	Amount invested	Market value at 31/12/2022	Gain/(fall) in capital value	
			Since purchase	One year
	£m	£m	£m	£m
Long-term loans	23.0	23.0	-	-
Pooled property funds	75.0	71.5	(3.5)	(8.3)
Pooled equity funds	51.0	52.8	1.8	(0.9)
Pooled multi-asset funds	48.0	44.1	(3.9)	(6.1)
Total	**197.0**	**191.4**	**(5.6)**	**(15.3)**

* Excludes £10.7m invested in pooled funds on behalf of TBH JSPB

61. The County Council's investments in pooled funds bring significant benefits to the revenue budget, with over £7.5m of dividends earned in the last 12 months. Capital values have struggled in the past 12 months due to market conditions and total pooled funds are showing capital below the amount originally invested, however, with the dividends earned, the total return is positive. The total return for pooled funds since purchase was 22.2% at 31 December 2022.



Note: the graph above excludes the performance related to £10.7m invested on behalf of Thames Basin Heaths JSPB

62. At the current time, given the medium to long term nature of the investments, it is unlikely that a capital loss would ever be realised, since the County Council would avoid selling investments that realised a capital loss.

63. In addition to the risk of realising a capital loss, changes to IFRS 9 mean that capital gains and losses on investments need to be reflected in the revenue account on an annual basis, although there is currently a statutory override in place for local authorities that exempts them from complying with this requirement for the next year.

64. The County Council is aware of the risks involved with investing in pooled funds that hold underlying investments in bonds, equities, property and other financial instruments. When the County Council began to specifically target higher returns from a proportion of its investments, it also established an Investment Risk Reserve to mitigate the risk of an irrecoverable fall in the value of these investments. The balance held in this reserve is currently £6.25m. This equates to 2.5% of the total earmark of the current £250m threshold. The recommended increase to £320m would require the reserve to increase by £1.75m to £8m.

65. Table 4 provides an example of the difference in the annualised average income return from the higher yielding strategy at 31 December 2022 and the returns being achieved on the County Council's other investments for the 12 months to that date. Recent rises in interest rates are likely to reduce the gap between investments returns on pooled funds and cash, therefore the Council is unlikely to make further investments in pooled funds beyond its current commitments.

Table 4: Weighted Average Returns and Indicative Annualised Income

	Cash Balance 31/12/2022 £m	**Weighted Average Return %**	**Annualised Income £m**
Short-term and Long-term Cash Investments	533.8	2.7	14.2
Investments Targeting Higher Yields	196.9	4.3	8.47
Total	**730.7**	**3.1**	**22.67**

Investment Limits

66. The maximum that will be lent to any one organisation (other than the UK Government) will be £90m, which is an increase in comparison to the previous TMSS due to temporarily increased investment balances. Although over the longer term it is expected that the County Council's cash balances will reduce, the ongoing pandemic has resulted in world supply issues and so the delivery of elements of the agreed capital programme has been delayed, which may result in raised investment balances for a short time. Increased limits allow the flexibility to ensure that all of the County Council's cash can be invested in accordance with this TMSS.

67. A group of entities under the same ownership will be treated as a single organisation for limit purposes. Limits are also placed on fund managers as shown in Table 5.

Table 5: Investment Limits

	Cash Limit
Any single organisation, except the UK Central Government	£90m each
UK Central Government	Unlimited
Any group of pooled funds under the same management	£225m per manager

Approved Counterparties

68. The County Council may invest its surplus funds with any of the counterparty types in Table 6, subject to the limits shown:

Table 6: Sector and counterparty limits

Sector	Time limit	Counterparty limit	Sector limit
The UK Government	30 years	Unlimited	n/a
Local authorities & other government entities	25 years	£90m	Unlimited
Secured investments *	25 years	£90m	Unlimited
Banks (unsecured) *	13 months	£45m	Unlimited
Building societies (unsecured) *	13 months	£45m	£90m
Registered providers (unsecured) *	5 years	£45m	£90m
Money market funds *	n/a	£90m	Unlimited
Strategic pooled funds	n/a	£90m	£450m
Real estate investment trusts	n/a	£45m	£90m
Other investments *	5 years	£45m	£90m

This table must be read in conjunction with the notes below

*** Minimum credit rating**

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

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

Government

71. Loans, 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 30 years.

Secured investments

72. 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)

73. 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)

74. Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and 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

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

Strategic pooled funds

76. Shares or units in diversified investment vehicles consisting of bond, equity and property investments. These funds offer enhanced returns over the longer term but are more volatile in the short term and allow the County Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. This sector also includes

cash plus funds which are also a type of pooled fund, but are used for short-term funds, with a lower risk appetite. Because strategic pooled funds have no defined maturity date, but are available for withdrawal after a notice period; their performance and continued suitability in meeting the County Council's investment objectives will be monitored regularly.

Real estate investment trusts (REITs)

77. 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

78. 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 County Council's investment at risk.

79. In addition the County Council can invest in an unrated corporate where it owns an interest in the corporation that gives participation in the company's governance, in which case a limit of £45m for an investment of up to 20 years will apply.

Operational bank accounts

80. The County Council may incur operational exposures, for example through current accounts, 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 low. The County Council's operational bank account is with National Westminster and aims to keep the overnight balances held in current accounts positive, and as close to zero as possible. 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 County Council maintaining operational continuity.

Risk assessment and credit ratings

81. Short and long-term credit ratings from the three main providers (Fitch Ratings, Moody's and Standard and Poor's) are obtained and monitored by the County Council's treasury advisers, who will notify changes in ratings

as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- 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.

82. 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

83. The County 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 and reports in the quality financial press and analysis and advice from the County Council's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

84. 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 County Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the County Council's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office, or invested in government treasury bills for example, or with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

Liquidity management

85. The County Council has due regard for its future cash flows when determining the maximum period for which funds may prudently be committed. Historic cash flows are analysed in addition to significant future cash movements, such as payroll, grant income and council tax precept. Limits on long-term investments are set by reference to the County Council's medium term financial position (summarised in Table 1) and forecast short-term balances.

86. The County Council will spread its liquid cash over at least four providers (e.g. bank accounts and money market funds) to ensure that access to cash is maintained in the event of operational difficulties at any one provider, except in cases of extreme market stress whereby the County Council will be able to invest all of its liquid cash in one provider only, being the Debt Management Office.

Treasury Management Indicators

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

Interest rate exposures

88. The following indicator shows the sensitivity of the County Council's current investments and borrowing to a change in interest rates. Fixed rate investments maturing during the year are assumed to be variable for the remainder of the year.

Table 7: Interest rate risk indicator

	31 December 2022	Impact of +/- 1% interest rate change
	£m	£m
Sums subject to variable interest rates:		
Investment	481.6	+/- £48.2m
Borrowing	12.0	+/- £1.2m

Maturity structure of borrowing

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

Table 8: Refinancing rate risk indicator

	Upper	Lower
Under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	75%	0%
10 years and within 20 years	75%	0%
20 years and within 30 years	75%	0%
30 years and above	100%	0%

90. 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.

Principal sums invested for periods longer than a year

91. The purpose of this indicator is to control the County Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

Table 9: Price risk indicator

	2023/24	2024/25	2025/26
Limit on principal invested beyond year end	£400m	£400m	£400m

Related Matters

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

Financial derivatives

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

94. The County 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 County Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds 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.

95. 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.

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

Investment training

97. The needs of the County Council's treasury management staff for training in investment management are assessed annually as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.

98. Staff regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA, and other appropriate organisations.

99. CIPFA's Code of Practice requires that the County Council ensures that all members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities.

Investment advisers

100. The County Council has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues. The quality of this service is controlled through quarterly review meetings with the Director of Corporate Operations, his staff and Arlingclose.

Markets in Financial Instruments Directive

101. The County Council has opted up to professional client status with its providers of financial services, including advisers, 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 County Council's treasury management activities, the Section 151 Officer believes this to be the most appropriate status.

Other Options Considered

102. The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Director of Corporate Operations 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 in Table 10.

Table 10: Alternative strategies and their implications

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

Table 10: Alternative strategies and their implications

Alternative	Impact on income and expenditure	Impact on risk management
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

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

Underlying assumptions:

- UK interest rate expectations have eased following the mini-budget, with a growing expectation that UK fiscal policy will now be tightened to restore investor confidence, adding to the pressure on household finances. The peak for UK interest rates will therefore be lower, although the path for interest rates and gilt yields remain highly uncertain.

- Globally, economic growth is slowing as inflation and tighter monetary policy depress activity. Inflation, however, continues to run hot, raising expectations that policymakers, particularly in the US, will err on the side of caution, continue to increase rates and tighten economies into recession.

- The new Chancellor dismantled the mini-budget, calming bond markets and broadly removing the premium evident since the first Tory leadership election. Support for retail energy bills will be less generous, causing a lower but more prolonged peak in inflation. This will have ramifications for both growth and inflation expectations.

- The UK economy is already experiencing recessionary conditions, with business activity and household spending falling. Tighter monetary and fiscal policy, alongside high inflation will bear down on household disposable income. The short- to medium-term outlook for the UK economy is bleak, with the BoE projecting a protracted recession.

- Demand for labour remains strong, although there are some signs of easing. The decline in the active workforce has fed through into higher wage growth, which could prolong higher inflation. The development of the UK labour market will be a key influence on MPC decisions. It is difficult to see labour market strength remaining given the current economic outlook.

- Global bond yields have steadied somewhat as attention turns towards a possible turning point in US monetary policy. Stubborn US inflation and strong labour markets mean that the Federal Reserve remains hawkish, creating inflationary risks for other central banks breaking ranks.

- However, in a departure from Fed and ECB policy, in November the BoE attempted to explicitly talk down interest rate expectations, underlining the damage current market expectations will do to the UK economy, and the probable resulting inflation undershoot in the medium term. This did not stop the Governor affirming that there will be further rises in Bank Rate.

Forecast:

- The MPC remains concerned about inflation but sees the path for Bank Rate to be below that priced into markets.

- Following the exceptional 75bp rise in November, Arlingclose believes the MPC will slow the rate of increase at the next few meetings. Arlingclose now expects Bank Rate to peak at 4.25%, with a further 50bp rise in December and smaller rises in 2023.

- The UK economy likely entered into recession in Q3, which will continue for some time. Once inflation has fallen from the peak, the MPC will cut Bank Rate.

- Arlingclose expects gilt yields to remain broadly steady despite the MPC's attempt to push down on interest rate expectations. Without a weakening in the inflation outlook, investors will price in higher inflation expectations given signs of a softer monetary policy stance.

- Gilt yields face pressures to both sides from hawkish US/EZ central bank policy on one hand to the weak global economic outlook on the other. BoE bond sales will maintain yields at a higher level than would otherwise be the case.

	Current	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25
Official Bank Rate													
Upside risk	0.00	0.25	0.50	0.75	1.00	1.00	1.00	1.25	1.50	1.75	1.50	1.25	1.25
Arlingclose Central Case	3.00	3.50	4.00	4.25	4.25	4.25	4.25	4.00	3.75	3.50	3.50	3.50	3.50
Downside risk	0.00	0.25	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00
3-month money market rate													
Upside risk	0.00	0.25	0.50	0.75	1.00	1.00	1.00	1.25	1.50	1.75	1.50	1.25	1.25
Arlingclose Central Case	3.00	3.90	4.40	4.40	4.40	4.35	4.30	4.25	4.00	3.75	3.75	3.75	3.75
Downside risk	0.00	0.25	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00
5yr gilt yield													
Upside risk	0.00	0.60	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.36	3.65	3.90	3.90	3.90	3.90	3.80	3.70	3.60	3.50	3.40	3.30	3.20
Downside risk	0.00	0.70	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
10yr gilt yield													
Upside risk	0.00	0.60	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.46	3.70	3.75	3.75	3.75	3.70	3.70	3.70	3.70	3.70	3.70	3.70	3.70
Downside risk	0.00	0.70	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
20yr gilt yield													
Upside risk	0.00	0.60	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.88	4.00	4.00	4.00	4.00	4.00	3.90	3.90	3.90	3.90	3.90	3.90	3.90
Downside risk	0.00	0.70	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
50yr gilt yield													
Upside risk	0.00	0.60	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.24	3.40	3.40	3.40	3.40	3.40	3.30	3.30	3.30	3.30	3.30	3.30	3.30
Downside risk	0.00	0.70	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00

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%

Annex B - Existing Investment & Debt Portfolio Position at 31 December 2022

Treasury investments position

Investments	**31/08/2022 Balance £m**	**Net movement £m**	**31/12/2022 Balance £m**	**31/12/2022 Income return %**	**31/12/2022 Weighted average maturity years**
Short term investments					
Banks and building societies:					
- Unsecured	152.0	(59.9)	92.1	2.5%	0.08
- Secured	46.1	(29.1)	17.0	0.5%	0.26
Money Market Funds	153.2	(11.6)	141.6	3.2%	0.00
Government:					
- Local Authorities	78.0	(2.0)	76.0	2.6%	0.48
- UK Treasury Bills	73.0	21.9	94.9	2.9%	0.21
- UK Gilts	25.0	0.0	25.0	0.1%	0.09
- DMO	0.0	25.0	25.0	3.8%	0.24
Cash Plus Funds	10.0	0.0	10.0	1.2%	0.01
	537.3	**(55.7)**	**481.6**	**2.7%**	**0.16**
Long term investments					
Banks and building societies:					
- Secured	0.0	7.2	7.2	4.3%	2.19
Government:					
- Local authorities	5.0	20.0	25.0	3.3%	9.21
Supranational Banks	21.0	(1.0)	20.0	1.3%	2.97
	26.0	**26.2**	**52.2**	**2.7%**	**5.85**
Long term investments – higher yielding strategy					
Government:					
- Local authorities	22.9	(19.9)	3.0	9.4%	4.49
Pooled funds:					
- Pooled property*	75.0	0.0	75.0	3.5%	N/A
- Pooled equity*	51.0	0.0	51.0	5.3%	N/A
- Pooled multi-asset*	48.0	0.0	48.0	4.3%	N/A
	196.9	**(19.9)**	**177.0**	**4.3%**	**4.49**
Total Investments	**760.2**	**(49.4)**	**710.8**	**3.1%**	**0.56**
Thames Basin Heath pooled fund investments	10.7	0.0	10.7		
Total	**770.9**	**(49.4)**	**721.5**		

* The rates provided for pooled fund investments are reflective of annualised income returns over the year to 31 December 2022 based on the market value of investments 12 months earlier.

Treasury management position	**31/12/2022 Balance £m**	**31/12/2022 Rate %**
External Borrowing:		
- PWLB Fixed Rate	(192.0)	9.7%
- Other Loans (including LOBO Loans)	(12.0)	0.3%
- Other Short-term Borrowing*	0.0	0.0%
Total External Borrowing	**(204.0)**	**4.7%**
Other Long-Term Liabilities:		
- Street Lighting PFI	(90)	
- Waste Management Contract	(42)	
- Leases	0	
Total Other Long-Term Liabilities	(132)	
Total Gross External Debt	**(336.0)**	
Investments	**721.5**	
Net (Debt) / Investments	**385.5**	

* includes balances held by the County Council on behalf of others for governance or administrative reasons