AGENDA ITEM NO:

28th February 2023

TREASURY MANAGEMENT STRATEGY 2023/2024

Purpose of the Report

1. This report discusses and asks the Commissioner to approve:

   a) The proposed Prudential (PrIs) and Treasury (TrIs) Indicators for the next three years (Appendix A).

   b) The proposed Annual Investment Strategy for 2023/2024; and

   c) Other treasury management decisions required for 2023/2024 that do not form part of the PrIs/TrIs.

Background

2. The Codes of Practice require the Commissioner to consider and approve a Treasury Management Strategy (TMS), which incorporates the Prudential and Treasury Indicators and an Annual Investment Strategy. This is required under the provisions of the latest CIPFA Code of Practice on Treasury Management in the Public Services (the CIPFA Code) and the Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

3. CIPFA published revised codes of practice on 20th December 2021, these have been adopted for the 2023/24 financial year.

4. This Treasury Management Strategy is closely linked to both the current Capital Strategy and the Capital Financing Strategy as agreed in the Mid Term Financial Strategy.

5. Before looking at the TMS for 2023/2024 I need to review the current year's treasury management activity.

Treasury Management Strategy - Review of 2022/2023

6. A detailed analysis of the 2022/2023 activities will be made in the Annual Treasury Report.

7. In January 2023 the revised forecast cash flow surplus for the year was £3.3 million (Original forecast £6.1m surplus). A higher level of officer retirements than expected and therefore increased commutation payments have decreased the expected surplus for the year. These additional costs will be offset by Government pensions grant received in July 2023/24. The actual cash flow position for 2022/2023 will be reported in the Annual Treasury Report.

8. Surplus funds invested at 31 January 2023 stood at £23.08 million, as follows,

   - £20.00 million invested in the market
   - £2.52 million invested in the BNP Money Market Fund
   - £0.14 million invested in the Handelsbanken Call Account
   - £0.42 million invested in the HSBC

9. At this date, the total funds invested in the market (£20.00 million) were all in fixed term deposits (for under 1 year). This money is being invested directly by our local treasury managers (Wiltshire Council) in short-term, approved investments or overnight as BNP, Handelsbanken or HSBC deposits. By doing this the PCC benefits from the rising market interest rates, for example 4.4% return on current investments where previous rates were under 1%. An analysis of the annual return is given in the Annual Treasury Report.

<u>Main Considerations for the Commissioner – Treasury Management Strategy</u>

<u>Prudential and Treasury Indicators</u>

10. The Capital Strategy sets out a need for borrowing to finance future Capital plans. The Prudential and Treasury Indicators have increased relevance to the PCC with a borrowing strategy, he is responsible for calculating and formally approving these indicators in line with the Prudential Code.

11. Issues of affordability, prudence and sustainability of borrowing are of increased relevance to the PCC now that he is borrowing to finance the future capital expenditure plan. The PrIs/TrIs for borrowing limits, interest rate exposures and maturity structures have to be considered.

12. The PCC is required to approve an annual MRP Policy Statement. This mirrors the existing requirements to report on the prudential borrowing limit and investment policy. If it is ever proposed to vary the statement during the year, a revised statement will be brought to the PCC for approval at that time.

13. The PCC has responsibilities under the Prudential Code to ensure value for money (robust option appraisal) and practicality of capital investment, proper stewardship of assets (asset management planning) and sound links to service objectives.

14. The proposed Prudential and Treasury Indicators are set out in Appendix A, together with a brief summary on each one.

15. The latest Capital Financing Strategy sets out a requirement to borrow over future years. There is no new borrowing planned for 2021/22. For the next three years planned borrowing is £4.7m (23/24), £11.5m (24/25) and £16.1m (25/26) totaling a cumulative £32.3m. PrI3 considers borrowing requirements against capital expenditure. As borrowing does not exceed the capital expenditure the so called ‘Golden Rule’ is not broken.

16. The key indicator is PrI2, this forecasts the percentage of the organisations net revenue stream being spent on borrowing (this excludes other Capital funding sources used to fund the Capital plan such as RCCO). Appendix A shows this increasing in future years in line with the increasing requirement for borrowing. The question to be asked is can the organisation afford the repayment cost. Whilst in 2023/24 the organisation can afford -0.28% this is planned to increase during the 10 year life of the capital plan. It is forecast that in 2026/27 this could grow to 1%. Whilst this is not high compared to other organisations it is the year on year impact that needs to be considered. On review these increases can be afforded as long as the gradual increase in revenue costs occurred due to the borrowing is planned over a period of years to ease the impact.

17. Appendix A of this paper sets out new operational limits and authorised limits for borrowing with consideration for these amounts.

Cash Deficits and Surpluses

Short Term Deficits and Surpluses

18. Short term cash surpluses and deficits will arise regularly during the year. It is anticipated that the majority of these surpluses will only be available on a very temporary basis. Short term deposits are the most cost effective investment for such cash surpluses. Therefore, investments will normally be made through short term deposits at fixed rates to specific dates, with reference to the cash flow requirements.

19. Temporary loans (where both the borrower and lender have the option to redeem the loan within twelve months) are occasionally used to cover short term revenue cash deficits, where this is more cost effective than temporarily withdrawing funds from call accounts, pending the receipt of, for example, grant income.

20. I therefore recommend that the PCC continues to utilise temporary loans and deposits to manage these cash flows.

Longer Term Cash Balances

21. The longer term balances are managed by Wiltshire Council and are currently held, partly in longer term (above three and up to 12 months) investments and partly in call accounts.

22. It may be beneficial to utilise notice accounts at times as these can provide for a better return on investments then the current options. It is recommended that notice accounts are compared alongside the other longer term solutions for investments.

23. The rate of return of the 3 month longer term investments (only) is currently 2.5%, which has increased from 1.5% in October 2022. Throughout the year Bank Rate has been increasing, from 1.0% to 1.25% in June 2022, then 1.75% in August, 2.25% in September, 3.0% in November, 3.5% in December and finally 4.0% in February 2023. Link Group Treasury Advisors are currently forecasting Bank Rate to hit 4.5% by May 2023. Therefore, it is likely that fixed term deposit rates will improve further during 2023/2024.

24. A comparative benchmark, (the compounded Sterling Overnight Index Average - SONIA), reflecting the rate at which a bank is willing to borrow from other banks, is currently 1.7%.

Risk

25. The Prudential Code has been implemented to allow authorities' and PCC's freedom to invest if they consider it is affordable and prudent, this reduces risk. This paper reviews the indicators and suggests that as long as the MTFS includes the increase in borrowing costs and RCCO then the levels are affordable.

26. In 2023/2024 external advice is being provided by Link Asset Services, this will be surrounding where to lend and how to borrow. The intention is to borrow from the Public Works Loan Board (PWLB) at a fixed interest rate. The PWLB is a statutory body that issues loans to local authorities, and other specified bodies, from the National Loans Fund. As they are a public body rates are often lower than private enterprises. The PWLB is used by most local authorities and PCCs which borrow.

27. The Bank of England has increased its interest rates to 4.0% as it continues to tackle rising inflation. While this may have a positive impact to the PCC through increases in

interest on investments, as we now look to borrow funds, increased rates will have a negative impact to the overall finances as the cost of borrowing starts to exceed the return from investments.

28. For transparency, the PCC will not be lending to Russian banks as they have been given NR (Not Rated) status. The PCC also has no current borrowing from Russia and will not be borrowing from Russian banks in the near future.

29. The PCC's Capital Financing Strategy is solely focused on financing assets which are essential for the PCC's objectives hence borrowing for commercial purposes is not undertaken.

30. The Liability Benchmark shows the PCC how much he needs to borrow and guides the PCC to consider use of cashflow before deciding to borrow. The Liability Benchmark will be considered before any long-term loans are entered into.

Monitoring and Reporting of the Prudential Indicators

31. Wiltshire Council staff and the finance staff of the PCC will monitor progress against the PrIs/TrIs throughout the year. The PCC will be kept informed of any issues that arise, including potential or actual breaches, within 7 days of occurrence as these could be ultra-vires. I will normally update the PCC every six months in the Interim and Annual Treasury Reports.

32. The Code of Practice requires the responsible officer to ensure that board members tasked with treasury management responsibilities, including those responsible for scrutiny, have access to training relevant to their needs and those responsibilities.

Collaboration

33. The day to day Treasury Management function is outsourced to Wiltshire Council. Using their skills and contacts with market experts it is believed that value for money is achieved alongside good returns.

Diversity

34. No diversity issues have been identified

Recommendations

35. The Commissioner is asked to:

    a) adopt the Prudential and Treasury Indicators set out in Appendix A;

    b) approve the MRP Policy Statement set out in Appendix A;

    c) adopt the Investment Strategy set out in Appendix B;

    d) agree that short term cash deficits and surpluses continue to be managed through temporary loans and deposits (paragraphs 18 to 20); and

    e) agree that, for longer term cash balances, the Chief Finance Officer continues to be delegated to negotiate the terms and conditions of any external arrangement.

Clive Barker
Chief Finance Officer to the PCC

PRUDENTIAL (PrIs) AND TREASURY (TrIs) INDICATORS 2022/2023 - 2024/2025

Prudential Indicators

PrI 1 - Capital Expenditure

1. The capital expenditure plans are set out in the Capital Plan, but under the Prudential Code, the PCC is required to confirm this as a Prudential Indicator. Capital expenditure plans for the years 2022/2023 to 2025/2026 are as follows (assuming 80% of spend occurs in the year with carry forward):

	2021/2022 Actual £million	2022/2023 Estimate £million	2023/2024 Estimate £million	2024/2025 Estimate £million	2025/2026 Estimate £million
Capital Expenditure	4.0	6.3	13.4	17.5	19.7

PrI 2 – Ratio of Financing Costs to Net Revenue Stream

2. This indicator expresses the net costs of financing as a percentage of the funding receivable from the Government and council tax payers. The net cost of financing includes interest and principal repayments for long and short term borrowing, as well as other credit-like arrangements, netted off by interest receivable in respect of cash investments. The indicator does not include the revenue contribution to capital expenditure.

3. The table below shows an increasing percentage in line with the increasing requirement for borrowing to fund capital expenditure. The costs of borrowing are expected to exceed the interest received.

	2021/2022 Actual %	2022/2023 Estimate%	2023/2024 Estimate %	2024/2025 Estimate %	2025/2026 Estimate %
Ratio of Financing Costs to Net Revenue Stream	0.04	-0.29	-0.28	-0.08	0.38

PrI 3 – Gross Borrowing to Capital Financing Requirement

4. This indicator measures the so-called “Golden Rule” and focuses on prudence. To meet the ‘Golden Rule’ capital expenditure needs to exceed borrowing.

5. The Capital Financing Requirement (CFR) normally increases year-on-year by the amount of capital expenditure that is not funded from sources other than borrowing (i.e. government capital grant, capital receipts, developer contributions, direct revenue), reduced by the amount set-aside from the revenue budget and capital receipts for the repayment of debt. The CFR is equivalent to Gross Borrowing and is the PCC’s long and short term external debt.

	2021/2022 Actual £million	2022/2023 Estimate £million	2023/2024 Estimate £million	2024/2025 Estimate £million	2025/2026 Estimate £million
Capital Expenditure	4.005	6.316	13.443	17.449	19.732
Financing (other than borrowing)	-3.876	-5.739	-8.774	-5.946	-3.675
Gap to fund from borrowing	0.129	0.577	4.669	11.503	16.057
MRP (repayments of borrowing)	-0.045	-0.045	-0.045	-0.121	-0.312
Movement in CFR	**0.084**	**0.532**	**4.624**	**11.382**	**15.745**
Total Capital Financing Requirement	**1.283**	**1.815**	**6.439**	**17.821**	**33.566**

Minimum Revenue Provision (MRP) Policy Statement

6. The PCC is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP). Regulations have been issued which require the PCC to approve an MRP Statement in advance of each year. A variety of options are available, so long as there is a prudent provision.

7. For all unsupported borrowing (including PFI and finance leases) the MRP policy will be:

   - Asset life method – MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction).

   This option provides for a reduction in the borrowing over the approximate lifetime of the asset.

8. Statutory guidance sets out that, for the purpose of MRP, the maximum useful life should be considered as 25 years or the period of the loan if longer. To date the PCC's loans have been taken over a 30 year period resulting in a useful life for MRP purposes of 30 years. The PCC's strategy for borrowing results in a revenue provision that is equivalent to the principal repayment amount of the loan. The interest element of the cost of borrowing is charged direct to revenue as it is incurred and forms part of the annual budget build process.

9. Repayments included in annual PFI or finance leases are applied as MRP. In the case of finance leases (or, when applicable, leases where a right-of-use asset is on balance sheet) and on balance sheet PFI contracts, the MRP requirement would be regarded as met by a charge equal to the element of the charge that goes to write down the balance sheet liability.

10. Where a lease (or part of a lease) or PFI contract is brought onto the balance sheet, having previously been accounted for off- balance sheet, the MRP requirement would be regarded as having been met by the inclusion in the charge for the year in which the restatement occurs, of an amount equal to the write-down for that year plus retrospective writing down of the balance sheet liability that arises from the restatement.

<u>PrI 4 – External debt</u>

11. Under the Prudential Code, three limits must be set by the PCC for External Debt:

    a) Actuals for last year and an estimate for the end of the current year
    b) An Operational boundary for the next three years
    c) An Authorised limit for the next three years.

12. The Operational boundary is based on the most likely, prudent, but not worst case scenario of borrowing for the year. The Authorised limit is based on the Operational limit but with an additional margin (in the PCC's case a 15% allowance for temporary borrowing and a consideration for the possibility of Capital financing brought forward) to allow for unusual or unexpected cash movements. These borrowing limits are to be set gross of investments.

	31/03/2022 Actual	**31/03/2023 Estimated**
Short Term Borrowing (Temporary)	£1.00m	£0.00m
Long Term Borrowing	£1.86m	£1.82m
Other Long Term Liabilities	£0.00m	£0.00m
TOTAL	**£2.86m**	**£1.82m**

13. There was £1.0m temporary borrowing outstanding as at 31 March 2022. This was due to the timing of cashflow items, the loan was taken for a period of 1 week at an

interest cost of £32.88. It is estimated that there will be no temporary borrowing outstanding at the end of the current financial year.

14. The PCC's Capital Strategy sets out a ten year spending and funding plan. This plan incorporates new long term borrowing of £4.7m for 2023/24 and £11.5 million for 2024/25 in support of significant new Estates and ICT investments. There is no new borrowing planned to be taken during 2022/23.

15. The PCC's long term contract surrounding the provision of Estate in Swindon is a PFI. This leads to, in accounting terms, a long term liability which is essentially a form of borrowing. Whilst included as a revenue payment in budgets, accounting practise requires us to split the capital element and report it separately in the Statement of Accounts. The unitary payment will include an amount for interest and capital repayment.

16. The PCC holds its surplus monies in approved investments in sufficient levels to finance its annual cash flow forecasts. However, during each year there are fluctuations in cash flow, the highest deficits are forecast as approximately £6.5 million (2023/2024), £6.5 million (2024/2025) and £6.5 million (2025/2026). There may also be a need to pay out capital expenditure prior to receipt of capital income, although previous experience shows that this is unlikely.

17. Invested cash could be reduced to cover these temporary deficits but this may not be the most cost effective approach for the PCC. Limits for temporary borrowing are therefore proposed, to allow flexibility to use borrowing as an alternative way of financing such temporary deficits, if this is in the PCC's best interest. The following limits should be authorised to deal with possible in-year cash flow shortfalls and to cover the levels of long term borrowing as set out in the latest Capital Financing Strategy.

Operational Boundary	**2023/2024**	**2024/2025**	**2025/2026**
Annual gross borrowing	£6.4m	£17.8m	£33.6m
Temporary borrowing	£6.5m	£6.5m	£6.5m
Total operational boundary	**£12.9m**	**£24.3m**	**£40.1m**

Authorised Limit	**2023/2024**	**2024/2025**	**2025/2026**
Annual gross borrowing	£6.9m	£18.3m	£34.1m
Temporary borrowing	£7.5m	£7.5m	£7.5m
Total authorised limit	**£14.4m**	**£25.8m**	**£41.6m**

Treasury Management Indicators within the Treasury Management Code

Trl 1 – Liability Benchmark

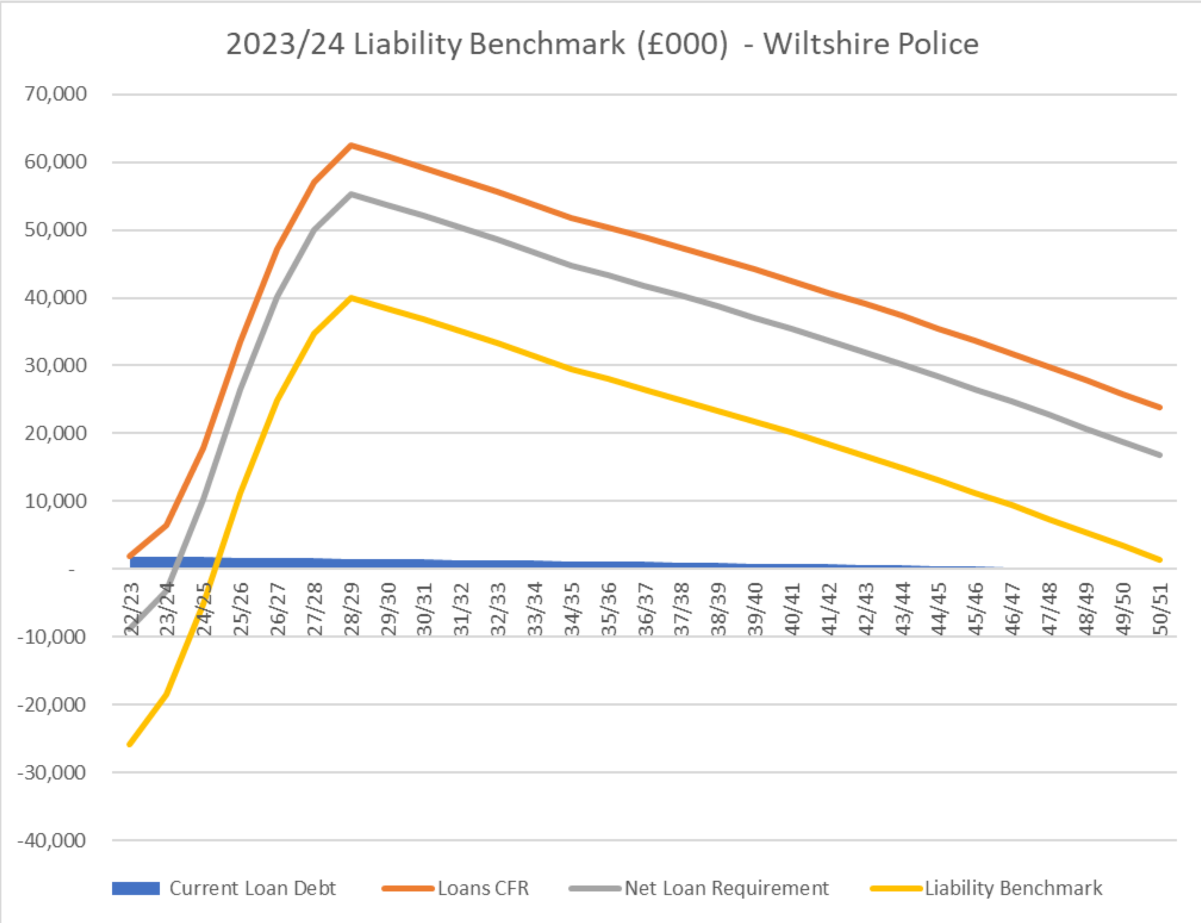
18. The liability benchmark is a measure of how well the existing loans portfolio matches the PCC's planned borrowing needs.

19. There are four components to the liability benchmark:

- Existing loan debt outstanding: the PCC's existing loans that are still outstanding in future years.
- Loans CFR: calculated in accordance with the loans CFR definition in the Prudential Code and projected into the future based on approved prudential borrowing and planned MRP

- Net loans requirement: the PCC's gross loan debt less treasury management investments at the last financial year-end, projected into the future and based on its approved prudential borrowing, planned MRP and any other major cash flows forecast.
- Liability benchmark: (or gross loans requirement) this equals net loans requirement plus short-term liquidity allowance

20. The purpose of this prudential indicator is to compare the PCC's existing loans outstanding against its future need for loan debt, or liability benchmark. If the current loan debts are below the liability benchmark it indicates the PCC will need to borrow to meet the shortfall. If the current loan debts are above the liability benchmark, the excess will be invested until the planned capital spend is incurred. The chart therefore tells the PCC how much he needs to borrow, when, and guides the PCC to seek maturities to match the planned borrowing needs.



<u>TrI 2 – Interest Rate Exposures</u>

21. This TrI relates to net borrowing (i.e. borrowing less investments). As the PCC's long term borrowing will be at fixed rate there is no risk to borrowing costs of a change in interest rates over the term of the loan. There is however a risk of the rates increasing prior to the date that the borrowing is planned. The PCC does rely partly on returns from invested funds in order to finance revenue and capital expenditure.

22. Future returns will be affected by inflation and the Bank of England's decisions on interest rates. The Bank of England increased Bank Rate for a tenth consecutive meeting in February 2023, taking the rate to 4.0%. Although Link Treasury

Advisors are suggesting that the peak in rates might be close. The impact of the increased rates is that, although return on investments have improved, borrowing costs are also higher.

23. However, it is likely that these forecasts will need changing within a relatively short timeframe for a number of reasons including the following: -

  a) Labour and supply shortages could prove more enduring and disruptive and depress economic activity.
  b) The Bank of England acts too quickly, or too far, over the next two years to raise bank rate and causes UK economic growth, and increases in inflation to be weaker than is currently anticipated.
  c) UK / EU trade arrangements – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.
  d) Geopolitical risks, for example Ukraine/Russia, China/Taiwan/US, Iran/North Korea and Middle Eastern Countries, which could lead to increasing safe haven flows.

In summary, with the high level of uncertainty prevailing on several different fronts, it is likely that the forecasts will be revised.

24. Reflecting the increases to Bank of England interest rates the PCC's budget in 2023/2024 for investments is set on returns of £500k.

25. All funds are internally managed by Wiltshire Council and returns will be maximised whichever way interest rates move. The control of the investments is subject to the approved Annual Investment Strategy and the limits set in this TrI.

26. Any temporary or long term borrowing, as authorised in TrI 1 above, should be taken on a fixed interest rate. Investments on HSBC Bank Treasury and other financial institutions should also be taken at fixed interest rates.

The PCC's upper limit for fixed interest rate exposure for the period 2022/2023 to 2024/2025 is 100% of net outstanding principal sums.

The PCC's upper limit for variable interest rate exposure for the period 2022/2023 to 2024/2025 is 0% of net outstanding principal sums.

TrI 3 – Maturity Structure of Borrowing

27. A £1.1m loan was taken out in 2019/20 and £0.8m in 2020/21; these were borrowed over a thirty year period to reflect the estimated useful operational life of the Estates asset in ownership of the PCC. There was no new borrowing requirement during 2021/22 or 2022/23. Further borrowing of £4.7 million is planned for 2023/24, this relates to significant Estates projects which will be taken over a period of 30 years to reflect the lifespan of the property assets and in line with policy.

TrI 4 – Total Principal Sums invested for periods longer than 365 days

28. This TrI is covered by the Annual Investment Strategy.

INVESTMENT STRATEGY FOR 2022/2023

1. The PCC will have regard to the Department for Communities and Local Government's (DCLG's) Guidance on Local Government Investments ("the Guidance") issued in March 2004, any revisions to that guidance, the Audit Commission's report on Icelandic investments and the 2021 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The general investment policy of the PCC will be the prudent investment of its surplus cash balances, priorities being:
    a) the security of capital and
    b) the liquidity of its investments.

2. Only in so far as is consistent with the priority of security and liquidity, the PCC will aim to achieve the optimum return on its investments.

3. The PCC will not borrow monies purely to invest or lend-on and make a return.

4. All investments of the PCC will be in sterling, as it does not wish to hold investments that are subject to foreign exchange rate risks.

5. All investments made other than those through an External Cash Investment Manager (where applicable – currently no PCC funds are managed by an External Cash Investment Manager) or certain investments placed with local authorities and other public bodies, subject to professional advice will be Specified Investments, as prescribed in the DCLG's Guidance on Local Government Investments (the "Guidance").

6. The investments identified in 5. above are the only non specified investments authorised for use and will only be:

    a) in Sterling;
    b) for investments in excess of 12 months, limited to £10 million; and
    c) not invested for a period exceeding five years.

7. Credit ratings will be monitored on a daily basis, by the PCC's treasury management providers (Wiltshire Council). The Council uses the creditworthiness service provided by Link Systems Ltd. This service is based on a sophisticated modelling approach, with credit ratings from all three rating agencies (Fitch, Moody's and Standard and Poor's), forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following as overlays:

    a) credit watches and credit outlooks from credit rating agencies;
    b) CDS spreads to give early warning of likely changes in credit ratings; and
    c) sovereign ratings to select counterparties from only the most creditworthy countries.

“High Credit Quality” Policy

In accordance with DCLG Guidance on Local Government Investments for selecting the creditworthiness of counterparties with whom investments are placed, the Police and Crime Commissioner will comply with the minimum requirements below.

All banks and building societies must be part of the credit list provided by Link Asset Services. The PCC will only invest with institutions on the list for the durations as specified by the colour coding used by Link and they must not be shown as out of range (with no colour) on the credit default swap analysis.

All Local Authorities and public bodies (ratings are not issued for most of these bodies).

Money Market Funds (MMF), must have been awarded the highest possible rating (AAA) from at least one of the credit rating agencies, Standard and Poor’s, Moody’s Investor Services Ltd and Fitch Ratings Ltd. (Deposits will only be placed with MMFs subject to individual signed management agreements.)

Limits are applied to the amount of money that can be lent to any of these institutions or groups of institutions using the ratings of Fitch Rating Agency as follows:

£8 million

UK incorporated banks with a short term credit rating of at least F1+ and a long term credit rating of at least AA

Overseas banks that have a long term credit rating of at least AA+

Local Authorities and other public bodies

£5 million

Other UK Incorporated banks

Other overseas banks

Building Societies

Money Market Funds