SOUTH STAFFORDSHIRE COUNCIL

FULL COUNCIL – 27 JUNE 2023

TREASURY MANAGEMENT STRATEGY AND PRUDENTIAL INDICATORS 2023/24 – 2027/28

REPORT OF THE CORPORATE DIRECTOR FINANCE & RESOURCES

PART A – SUMMARY REPORT

1. SUMMARY OF PROPOSALS

1.1 The Council is required to annually approve a Treasury Management Strategy that, in light of the Council's approved budget, establishes investment and borrowing policies for the Council for the current and future financial years. The Strategy also includes the Council's Prudential Indicators and sets out the expected treasury operations for the period 2023/24 – 2027/28. Prudential Indicators are designed to demonstrate that the Council has a prudent, affordable and sustainable approach to financing its capital spending plans. It fulfils four key legislative requirements:

- The reporting of the **prudential indicators** setting out the expected capital activities (as required by the CIPFA Prudential Code for Capital Finance in Local Authorities - Appendix A);
- The Council's **Minimum Revenue Provision (MRP) Policy**, which sets out how the Council will pay for capital assets through revenue each year (as required by Regulation under the Local Government and Public Involvement in Health Act 2007 – Also Appendix A);
- The **Treasury Management Strategy** which sets out how the Council's treasury service will support the capital decisions taken above, the day to day treasury management and the limitations on activity through treasury prudential indicators. The key indicator is the **Authorised Limit**, the maximum amount of debt the Council could afford in the short term, but which would not be sustainable in the longer term. This is the Affordable Borrowing Limit required by s3 of the Local Government Act 2003. This is in accordance with the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code and shown at Appendix A;
- The **Investment Strategy** which sets out the Council's criteria for choosing investment counterparties and limiting exposure to the risk of loss. This strategy is in accordance with the sector's Investment Guidance and also shown in Appendix A.

2. RECOMMENDATIONS

2.1 Full Council is asked to approve:

1) The Prudential Indicators and Limits for 2023/24 - 2027/28 contained within Appendix A of the report.
2) The Minimum Revenue Provision (MRP) Statement contained within Appendix A (paragraph 2.3) which sets out the Council's policy on MRP.
3) The Treasury Management Strategy 2023/24 - 2027/28 contained within Appendix A.
4) The Authorised Limit Prudential Indicator contained within Appendix A (para 3.2).
5) The Investment Strategy 2023/24 contained in the Treasury Management Strategy (Appendix A), and the detailed criteria (included in Appendix B)

3. SUMMARY IMPACT ASSESSMENT

POLICY/COMMUNITY IMPACT	Do these proposals contribute to specific Council Plan objectives?	
	Yes	Maximising investment income whilst managing risks and minimising borrowing costs helps to support the council's overall financial position and therefore the delivery of all policy objectives.
	Has an Equality Impact Assessment (EqIA) been completed?	
	No	The setting of a Treasury Management Strategy does not impact on equalities.
SCRUTINY POWERS APPLICABLE	No (Council decision)	
KEY DECISION	No (Council decision)	
TARGET COMPLETION/ DELIVERY DATE	May 2023	
FINANCIAL IMPACT	Yes	Where appropriate these are detailed in the body of the report.
LEGAL ISSUES	Yes	The Council's Treasury Strategy has to comply with the relevant statue, codes and guidance which are set out both in the main body of this report and Appendix A. The Corporate Director Finance & Resources (Section 151 Officer) has responsibility for the administration of the financial affairs of the Council. In providing this report the Corporate Director Finance & Resources is meeting one of the key responsibilities of the post.
OTHER IMPACTS, RISKS & OPPORTUNITIES	Yes	The key opportunities and risks associated with treasury management activities are set out in the body of the report and in the Treasury Management Strategy and Policy approved by Council and will be regularly monitored throughout the year.
IMPACT ON SPECIFIC WARDS	No	

PART B – ADDITIONAL INFORMATION

4.1 The Prudential Code operates by the provision of prudential indicators which highlight particular aspects of capital expenditure planning. Each indicator has been updated and provided for the next three years and included in Appendix A section 2. This is in accordance with the Prudential Code which requires that the Council approves as a minimum, certain mandatory prudential indicators.

4.2 The purpose of the indicators is to provide a framework for capital expenditure decision-making. It is intended to highlight, through the prudential indicators, the level of capital expenditure, the impact on investment levels and the overall controls in place to ensure the activity remains affordable, prudent and sustainable.

4.3 The Treasury Management Strategy outlined in detail in Appendix A sets the Council's **operational boundary limit** for external debt at £42 million and the **authorised limit** at £45 million. These limits are based on prior years spend on the capital programme as well as the planned capital programme of £20.556 million as approved by Council on 21 February 2023. Should these plans change, these limits will be revisited.

4.4 Within this overall capital expenditure framework there is a clear impact on the Council's treasury management activity through the application of investment balances. As a consequence, the Treasury Management Strategy for 2023/24 is also included at Appendix A (section 3) to the report to draw out the expected treasury activity. This report also includes the treasury prudential indicators. The production of the Treasury Management Strategy covers the requirements of the Local Government Act 2003, the CIPFA Prudential Code, the CIPFA Treasury Management Code and the sector's MRP and Investment Guidance.

4.5 The Treasury Management Strategy requires the formulation of an Annual Investment Strategy. In accordance with guidance, and in order to minimise the risk to investments, the Council has clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The detailed criteria utilised are included in Appendix B.

4.6 Security, Liquidity and Yield has always been at the forefront of the councils thinking when making investment decisions, however we will now also consider non-financial factors when making investment decisions, these include any ethical considerations as well as any environmental, social and governance (ESG) factors, this is detailed further in Appendix A 4.1.

4.7 The above policies and parameters provide an approved framework within which officers undertake the day-to-day capital and treasury activities.

4.8 It should be noted that this strategy is closely aligned to the Councils Capital Strategy with the Capital Programme being the main determinant of the councils borrowing need.

4.9 It should also be noted that at the time of writing this report, there are various geo-political events taking place both nationally and internationally that are impacting financial markets. The impacts of these are continuously monitored and any political or economic shocks that require any adjustment to the Treasury Management Strategy will be reported back to the Audit and Risk Committee (and Council) at a later date.

5. IMPACT ASSESSMENT – ADDITIONAL INFORMATION

5.1 None identified

6. PREVIOUS MINUTES

6.1 Not Applicable

7. BACKGROUND PAPERS

Appendix A - Treasury Management Strategy and Capital Prudential Indicators 23/24 – 27/28
Appendix B - Credit and Counterparty Risk Management
Appendix C - Approved Countries for Investment
Appendix D - Treasury Management Scheme of Delegation
Appendix E – Prospect for Interest Rates & Economic Background

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Treasury Management Strategy and Capital Prudential Indicators 2023/24 to 2027/28

1 INTRODUCTION

1.1 Background

The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's risk appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.

The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. It is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

CIPFA defines treasury management as:

> *"The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."*

Following reporting requirements introduced in 2019/20 (re the MHCLG Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code) this Strategy now links to the Council's Capital Strategy which provides a longer-term framework for our capital plans.

1.2 Reporting Requirements

1.2.1 Capital Strategy

The CIPFA Prudential Code for Capital Finance in Local Authorities (the code) requires all local authorities to prepare a 'Capital Strategy'.

The Council's Capital Strategy (approved by Council in June 2022) builds upon the Council's Commercial Asset Strategy and Treasury Management Strategy in order to:

- Set the long term context in which capital expenditure and investment decisions are made in a sustainability way:
- Set the basis upon which risk and reward and priority outcomes are considered as an integral part of capital decisions;

- Set the context within which capital decision making is consistent with the concepts of value for money, public stewardship and prudence;
- Report explicitly on the deliverability, affordability and risk associated with Capital Strategy.

The Capital Strategy should be viewed as a working document for ongoing decisions including the prioritisation of capital expenditure decisions, the setting of capital budgets, spend and borrowing decisions and how risk is managed.

The term of this Capital Strategy is 2022/23 to 2026/27 although all the elements included should be seen as integral to an overarching twenty-five-year strategic Capital vision.

1.2.2 Treasury Management reporting

Members receive for approval, as a minimum, three main reports each year, which incorporate a variety of polices, estimates and actuals.

1. **Prudential and treasury indicators and treasury strategy** (this report) - The first, and most important report covers:
   - the capital plans (including prudential indicators);
   - a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
   - the Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury indicators; and
   - an Investment Strategy (the parameters on how investments are to be managed).

2. **A periodic treasury management report** – This will update members with the progress of the capital position, amending prudential indicators if necessary, and whether the treasury strategy and/or policies require revision.

3. **An annual treasury report** – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Scrutiny - The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Audit & Risk Committee.

1.3 Treasury Management Strategy for 2023/24

The strategy for 2023/24 covers two main areas:

Capital issues
- the capital expenditure plans and the associated prudential indicators;
- the minimum revenue provision (MRP) policy.

Treasury management issues
- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

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

1.4 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny of the policy and operations. Training events are run for all members (including the Cabinet member for Corporate, who has responsibility for treasury management) by Link Group our treasury management advisors.

The training needs of treasury management officers are periodically reviewed.

1.5 Treasury Management Consultants

The Council uses Link Group as its external treasury management advisors.

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

2 THE CAPITAL PRUDENTIAL INDICATORS 2023/24 – 2027/28

The Council's capital expenditure plans are a key driver of treasury management activity. The output of the capital expenditure plans is reflected in prudential indicators, which are designed to assist member's overview and confirm capital expenditure plans.

2.1 Capital Expenditure

This prudential indicator is a summary of the Council's capital expenditure plans. The capital expenditure forecasts to 2027/28 (which form part of the Capital Programme and was approved by Council on 21 February 2023) are as follows:

Capital expenditure £000s	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate	2027/28 Estimate
Corporate	9,356	0	0	0	0
Business Transformation	360	45	335	55	45
Welfare Services	1,127	1,127	1,127	1,127	1,127
Community Services	891	3,836	0	0	0
Planning & Business Enterprise	0	0	0	0	0
Total	**11,733**	**5,008**	**1,462**	**1,182**	**1,172**

The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a borrowing need (to be met either through internal funds or external borrowing).

Capital expenditure £000s	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate	2027/28 Estimate
Total	**11,733**	**5,008**	**1,462**	**1,182**	**1,172**
Financed by:					
Capital Receipts	1,172	45	335	55	45
Capital Grants & Other Contributions	1,127	1,127	1,127	1,127	1,127
Revenue	3,100	0	0	0	0
Revenue Grant	0	0	0	0	0
Total Internal Financing	**5,399**	**1,172**	**1,462**	**1,182**	**1,172**
Net External Financing Requirement	**6,335**	**3,836**	**0**	**0**	**0**

2.2 The Council's Borrowing Need (the Capital Financing Requirement)

The second prudential indicator is the Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the indebtedness in line with each asset's life, and so charges the economic consumption of capital assets as they are used.

The CFR includes any other long-term liabilities (e.g. finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of schemes include a borrowing facility and so the Council is not required to separately borrow for these schemes.

Audit & Risk Committee is asked to recommend to Full Council that the following CFR projections are approved:

Capital Financing Requirement (CFR) £000s	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate	2027/28 Estimate
Capital Financing Requirement (CFR)	**37,926**	**41,030**	**40,177**	**39,379**	**38,575**
Movement in CFR	5,784	3,104	-853	-798	-804
Movement in CFR is represented by					
Net financing need for the year	6,335	3,836	0	0	0
Less MRP & other financing movements	-551	-732	-853	-798	-804
Movement in CFR	**5,784**	**3,104**	**-853**	**-798**	**-804**

The above table shows that as a result of the Council's capital plans (as set out in 2.1) the CFR (which essentially is a measure of the Council's underlying borrowing need) will increase to £41.030m in 2024/25 before starting to reduce from 2025/26 as the planned capital spend slows down and MRP contributions are made.

2.3 Liability Benchmark

A third and new prudential indicator for 2023/24 is the Liability Benchmark (LB). The Authority is required to estimate and measure the LB for the forthcoming financial year and the following two financial years, as a minimum.

Liability Benchmark £000s	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate	2027/28 Estimate
PWLB Loans	15,000	17,500	20,000	20,000	20,000
Existing Loan Debt Outstanding	**15,000**	**17,500**	**20,000**	**20,000**	**20,000**
Opening Loan Debt	15,000				
Less: opening treasury investments	-18,150				
Plus: planned prudential borrowing	2,500	2,500	0	0	0
Less: MRP & Capital Receipts set aside	-551	-732	-853	-798	-804
+/- other forecast cashflows	3,944	2,365	3,334	4,176	4,722
Net Loans Requirement (forecast net loan debt)	**2,743**	**6,876**	**9,357**	**12,735**	**16,653**
Opening Loans CFR	15,000				
Plus: planned Prudential Borrowing	2,500	2,500	0	0	0
Less: MRP & Capital Receipts set aside	-551	-732	-853	-798	-804
Loans CFR	**16,949**	**18,717**	**17,864**	**17,066**	**16,262**
Liquidity allowance above net debt (liquidity buffer)	15,000	15,000	15,000	15,000	15,000
Liability Benchmark (Gross Loans Requirement)	**17,743**	**21,876**	**24,357**	**27,735**	**31,653**
Forecast Investments	15,000	15,000	15,000	15,000	15,000
(Over)/Under Liability Benchmark	**2,743**	**4,376**	**4,357**	**7,735**	**11,653**

2.4 Minimum Revenue Provision (MRP) Policy Statement

The Council 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), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP). DLUHC regulations have been issued which require the full Council to approve **an MRP Statement** in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement:

For capital expenditure which in the future will be Supported Capital Expenditure, the MRP policy will be based on the CFR.

From 1 April 2008 for all unsupported borrowing (including finance leases) the MRP policy will be based on the Asset life methodology:

- 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) (option 3).

This option provides for a reduction in the borrowing need over approximately the asset's life. Finance leases are applied to revenue as MRP.

MRP Overpayments - A change introduced by the revised MHCLG MRP Guidance was the allowance that any charges made over the statutory minimum revenue provision (MRP), voluntary revenue provision or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year. At the date of this report the council has not made, nor has any plans to make, any VRP overpayments.

2.5 Core Funds (available to invest or cover the borrowing position)

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are prudent estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Year End Resources £000s	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate	2027/28 Estimate
General Fund Balance	6,589	5,269	3,297	-824	-5,501
Capital Receipts Reserve	1,226	1,181	846	791	746
Earmarked Reserves	5,503	4,503	3,476	3,476	3,476
Total Core Funds	**13,318**	**10,953**	**7,619**	**3,443**	**-1,279**
Working Capital*	1,000	1,000	1,000	1,000	1,000
Total Core Funds Available to Invest	**12,318**	**9,953**	**6,619**	**2,443**	**-2,279**

3 TREASURY MANAGEMENT

The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the the relevant professional codes, so that sufficient cash is available to meet this service activity and the Council's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 Current Portfolio Position

The current treasury position as at 31.12.22 and the estimated portfolio as at 31.03.23 are shown below for both investments and borrowing

Treasury Position £000s	Current 31.12.22	Estimated 31.03.23
Investments		
CCLA	11,000	8,800
Federated MMF	7,700	5,350
Internal Investments	8,000	4,000
Total Investments	**26,700**	**18,150**
External Borrowing		
PWLB	15,000	15,000
Total External Borrowing	**15,000**	**15,000**

The Council's forward projections for borrowing are summarised below. The table shows the actual external debt, against the underlying capital borrowing need, (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

External Debt £000s	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate	2027/28 Estimate
Debt at 1 April	**15,000**	**17,500**	**20,000**	**20,000**	**20,000**
Expected change in Debt	2,500	2,500	0	0	0
Actual gross debt at 31 March	**17,500**	**20,000**	**20,000**	**20,000**	**20,000**
The Capital Financing Requirement	37,926	41,030	40,177	39,379	38,575
Under / (over) borrowing	**20,426**	**21,030**	**20,177**	**19,379**	**18,575**

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2023/24 and the following two financial years. This allows some flexibility for limited early borrowing for future years but ensures that borrowing is not undertaken for revenue or speculative purposes.

The Corporate Director Finance & Resource reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future – as set out in the above table. This view takes into account current commitments, existing plans, and the proposals in this budget report.

3.2 Treasury Indicators: Limits to borrowing activity

The operational boundary. This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and internally available funds.

Operational boundary £000s	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate	2027/28 Estimate
Debt	38,000	41,000	40,000	39,000	39,000
Other long-term liabilities	1,000	1,000	1,000	1,000	1,000
Total	**39,000**	**42,000**	**41,000**	**40,000**	**40,000**

The authorised limit for external debt. A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.

Audit and Risk Committee is asked to recommend to Full Council that the following authorised limit is approved:

Authorised Limit £000s	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate	2027/28 Estimate
Debt	41,000	44,000	43,000	39,000	39,000
Other long-term liabilities	1,000	1,000	1,000	1,000	1,000
Total	**42,000**	**45,000**	**44,000**	**40,000**	**40,000**

In order to ensure that the Council has the overall scope to borrow, the Authorised Limit has been adjusted upwards to reflect the approved Capital Programme. This provides the flexibility to borrow, but not the obligation.

The authorised limit has been set at a level higher than the (net) external borrowing need in 3.1. This provides some headroom for changes in available funds/working balances.

It should be noted that these limits have been set based on the current planned capital programme. Should proposals come forward for additional capital items these limits would be reviewed and risks and rewards reconsidered.

3.3 Borrowing Strategy

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

The table below summarises the council forecast under-borrowing position.

Year End Resources £000s	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate	2027/28 Estimate
Under borrowing	20,426	21,030	20,177	19,379	18,575

The Corporate Director Finance & Resource will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *if it was felt that there was a significant risk of a sharp FALL in borrowing rates, then borrowing will be delayed or taken short term*.

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

Any decisions will be reported to the Audit and Risk Committee at the next available opportunity.

Treasury Management Limits on Activity
There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs/improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments;
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

Audit and Risk Committee is asked to recommend to Full Council that the following treasury indicators and limits are approved:

Interest Rate Exposures £000s	2023/24 Upper	2024/25 Upper	2025/26 Upper	2026/27 Upper	2027/28 Upper
Limits on fixed interest rates	41,000	44,000	43,000	39,000	39,000
Limits on variable interest rates	14,000	15,000	14,000	13,000	13,000

Maturity Structure of borrowing
These gross limits are set to reduce the Council's exposure to large, fixed rate sums falling due for refinancing and are required for upper and lower limits.

Audit and Risk Committee is asked to recommend to Full Council that the following treasury indicators and limits are approved:

Maturity structure of variable interest rate borrowing 2022/23		
	Lower	**Upper**
Under 12 months	0%	50%
12 months to 2 years	0%	50%
2 years to 5 years	0%	50%
5 years to 10 years	0%	50%
10 years and above	0%	50%

**Please note that this excludes other long term liabilities (leases)*

There are no limits to fixed rate borrowing which can be upto 100% of our debt portfolio.

3.4 Policy on Borrowing in Advance of Need

The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

3.5 Debt Rescheduling

Rescheduling of current borrowing in our debt portfolio is unlikely to occur as there is still a large difference between premature redemption rates and new borrowing rates.

If rescheduling is to be undertaken, it will be reported to the Audit & Risk Committee, at the earliest meeting following its action.

The reasons for any rescheduling to take place will include:
- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

All rescheduling will be reported to the Audit & Risk Committee, at the earliest meeting following its action.

3.6 New financial institutions as a source of borrowing and / or types of borrowing

The Public Works Loans Board (PWLB) forms part of HM treasury, part of its function is to provided loans to local authorities in the UK, primarily to fund capital projects. The council has the ability to borrow from PWLB at the Certainty Rate, which is a rate set at 0.20% below its standard interest rate.

Currently the PWLB Certainty Rate is set at gilts + 80 basis points for both HRA and non-HRA borrowing. However, consideration may still need to be given to sourcing funding from the following sources for the following reasons:

- Local authorities (primarily shorter dated maturities out to 3 years or so – still cheaper than the Certainty Rate).
- Financial institutions (primarily insurance companies and pension funds but also some banks, out of forward dates where the objective is to avoid a "cost of carry" or to achieve refinancing certainty over the next few years).

Our advisors will keep us informed as to the relative merits of each of these alternative funding sources.

3.7 Approved sources of long- and short-term borrowing

On Balance Sheet	**Fixed**	**Variable**
PWLB	●	●
Municipal bond agency	●	●
Local authorities	●	●
Banks	●	●
Pension funds	●	●
Insurance companies	●	●
UK Infrastructure Bank	●	●
Market (long-term)	●	●
Market (temporary)	●	●
Market (LOBOs)	●	●
Stock issues	●	●
Local temporary	●	●
Local Bonds	●	
Local authority bills	●	●
Overdraft		●
Negotiable Bonds	●	●
Internal (capital receipts & revenue balances)	●	●
Commercial Paper	●	
Medium Term Notes	●	
Finance leases	●	●

4 ANNUAL INVESTMENT STRATEGY

4.1 Investment policy – Management of risk

The DLUHC and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with financial investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of assets regeneration, are covered in the Capital Strategy, (a separate report).

The Council's investment policy has regard to the following: -

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

The Council's investment priorities will be security first, portfolio liquidity second and then yield, (return).

The above guidance from the DLUHC and CIPFA place a high priority on the management of risk. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -

1. Minimum acceptable **credit criteria** are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.

2. **Other information:** ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as **"credit default swaps"** and overlay that information on top of the credit ratings.

3. **Other information sources** used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

4. This authority has defined the list of **types of investment instruments** that the treasury management team are authorised to use. There are two lists in appendix B under the categories of 'specified' and 'non-specified' investments.

    - **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year.
    - **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.

5. **Non-specified investments limit.** The Council has determined that it will limit the maximum total exposure to non-specified investments as being 40% of the total investment portfolio, (see Appendix B).

6. **Lending limits**, (amounts and maturity), for each counterparty will be set through applying the matrix table in paragraph 4.2.

7. **Transaction limits** are set for each type of investment in paragraph 4.2.

8. This authority will set a limit for the amount of its investments which are invested for **longer than 365 days**, (see paragraph 4.4).

9. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating**, (see paragraph 4.3).

10. This authority has engaged **external consultants**, (see paragraph 1.5), to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.

11. All investments will be denominated in **sterling**.

12. As a result of the change in accounting standards for 2022/23 under IFRS 9, this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. In November 2018, the Ministry of Housing, Communities and Local Government (MHCLG), concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years ending 31.3.23.

This authority will also pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see paragraph 4.5). Regular monitoring of investment performance will be carried out during the year.

It is also recognised that Security, Liquidity and Yield should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector in relation to the economic and political environments in which institutions operate. In addition, there are other risks of material importance to the treasury portfolio from an ethical, environmental, social and governance perspective. It is important, therefore, to assess these categories as well and to understand if these create potential longer-term financial and reputational risks for the Council, and if there are any commonalities with the Council's key objectives in this regard. To this end, the Council will use information sources and its advisors as appropriate to assist it in scrutinising and understanding if these might affect the suitability of potential counterparties.

Other information sources used will include the financial press, share price and other such information pertaining to the banking sector to establish the most robust scrutiny process on the suitability of potential investment counterparties.

4.2 Creditworthiness policy

The Council has utilised and applied the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- Credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;
- Sovereign ratings to select counterparties from only the most creditworthy countries.

This modelling approach combines credit ratings, credit Watches and credit Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:

•	Yellow	5 years*
•	Dark Pink	5 years for Enhanced money market funds (EMMFs) with a credit score of 1.25
•	Light pink	5 years for Enhanced money market funds (EMMFs) with a credit score of 1.5
•	Purple	2 year
•	Blue	1 year (only applies to nationalised or semi nationalised UK Banks)
•	Orange	1 year
•	Red	6 months
•	Green	100 days
•	No colour	Not to be used

The Link creditworthiness service uses a wider array of information other than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings.

Typically, the minimum credit ratings criteria the Council use will be a short-term rating (Fitch or equivalents) of F1 and a long-term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances, consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

All credit ratings are regularly monitored. The Council is alerted to changes to ratings of all three agencies through its use of the Link creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Council will be advised of information in movements in Credit Default Swap spreads against the iTraxx European Financials benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

Sole reliance will not be placed on the use of this external service. In addition, this Council will also use market data and market information, as well as information on any external support for banks to help support its decision-making process.

Y	Pi1	Pi2	P	B	O	R	G	N/C
1	1.25	1.5	2	3	4	5	6	7
Up to 5yrs	Up to 5yrs	Up to 5yrs	Up to 2yrs	Up to 1yr	Up to 1yr	Up to 6mths	Up to 100days	No Colour

	Colour (and long-term rating where applicable)	Money and / or % Limit	Time Limit
Banks	**Yellow**	**£4m / 25%**	**5 years**
Banks	**Purple**	**£3m / 25%**	**2 years**
Banks	**Orange**	**£3m / 25%**	**1 year**
Banks – part nationalised	**Blue**	**£3m / 25%**	**1 year**
Banks	**Red**	**£1m / 10%**	**6 months**
Banks	**Green**	**£1m / 10%**	**100 days**
Banks	**No colour**	**Not to be used**	
Limit 3 category – Council's banker (not meeting Banks 1)	**n/a**	**£10m**	**14 days**
Other institutions limit*	**-**	**£100,000**	**3 years**
DMADF	**AAA**	**100%**	**6 months**
Local authorities	**n/a**	**£4m / 25%**	**3 years**
	Fund rating	**Money and / or % Limit**	**Time Limit**
Money market funds	**AAA**	**£15m per MMF**	**liquid**
Ultra-Short Dated Bond funds with a credit score of 1.25	**Dark pink / AAA**	**£4m / 25%**	**liquid**
Ultra-Short Dated Bond funds with a credit score of 1.5	**Light pink / AAA**	**£3m / 25%**	**liquid**

*The Council, from time to time, may also issue small short term loans to local parishes, charities and similar organisations. These organisations do not have a credit rating and so fall outside of the normal credit rating assessments; however these are covered under other institutions within the criteria set above

4.3 Other limits

Due care will be taken to consider the exposure of the Council's total investment portfolio to non-specified investments, countries, groups and sectors.

a) **Non-specified treasury management investment limit.** The Council has determined that it will limit the maximum total exposure of treasury management investments to non-specified treasury management investments as being 40% of the total treasury management investment portfolio.

b) **Country limit.** The Council has determined that it will only use approved counterparties from the UK and from countries with a **minimum sovereign credit rating of *AA1*** from Fitch *or equivalent*. The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix C. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

c) **Other limits.** In addition:

- no more than 50% will be placed with any non-UK country at any time;
- limits in place above will apply to a group of companies;
- sector limits will be monitored regularly for appropriateness.

4.4 Investment strategy

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

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

Investment returns expectations.

Interest rate forecast are included in Appendix E. Interest rates have continued to increase since the autumn of 2022 with current BoE base rate sitting at 4% at the time of writing this report, these increases are expected to continue to rise over the short term before reducing slightly over the medium term.

The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year.

Average earnings in each year	
2022/23 (remainder)	4.00%
2023/24	4.40%
2024/25	3.30%
2025/26	2.60%
2026/27	2.50%

Investment treasury indicator and limit - total principal funds invested for greater than 365 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

The Council is asked to approve the treasury indicator and limit: -

Maximum principal sums invested longer than 365 days					
£m	2023/24	2024/25	2025/26	2026/27	2027/28
Principal sums invested longer than 365 days*	£4m	£4m	£4m	£4m	£4m

For its cash flow generated balances, the Council will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated deposits in order to benefit from the compounding of interest.

*Please note that currently the council does not have any investments invested for more than 365 days.

4.5 Property Funds

The Council current uses CCLA as one of its main Money Market Funds, CCLA also offer investments in property funds. The use of these instruments can be deemed capital expenditure, and as such will be an application (spending) of capital resources. This Authority will seek guidance on the status of any additional funds it may consider using. Appropriate due diligence will also be undertaken before investment of this type is undertaken.

The council does not currently have any investments in property funds.

4.6 End of year investment report

At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

TREASURY MANAGEMENT PRACTICE (TMP1) – CREDIT AND COUNTERPARTY RISK MANAGEMENT

SPECIFIED INVESTMENTS: All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum 'high' quality criteria where applicable.

NON-SPECIFIED INVESTMENTS: These are any investments which do not meet the specified investment criteria. A maximum of 40% will be held in aggregate in non-specified investment

A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the above categories.

The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

	Minimum credit criteria / colour band	**£ limit per institution / Max % of total investment**	**Max. maturity period**
Specified			
DMADF – UK Government	N/A	100%	6 months
UK Government gilts	UK sovereign rating	£4 million / 50%	1 Year
UK Government Treasury bills	UK sovereign rating	£4 million / 50%	1 Year
Bonds issued by multilateral development banks	AAA (or state your criteria if different)		
Local authorities	N/A	£4m / 25%	3 Years
Council's banker (Barclays)		£10 million	14 days
Money Market Funds CNAV	AAA	£15 million Per fund	Liquid
Money Market Funds VNAV	AAA	£15 million per fund	Liquid
Money Market Funds LVNAV	AAA	£15 million per fund	Liquid

Ultra-Short Dated Bond Funds with a credit score of 1.25 *		£4 million / 25%	Liquid
Ultra-Short Dated Bond Funds with a credit score of 1.5*		£3 million / 25%	Liquid
Term Deposits with part nationalised banks	Blue Orange Red Green	£3 million / 25%	1 Year 1 Year 6 Months 100 days
Term deposits with banks and building societies	Blue Orange Red Green	£3million/ 25%	1 Year 1 Year 6 Months 100 days
CDs or corporate bonds with banks and building societies	Blue Orange Red Green	£3million/ 25%	1 Year 1 Year 6 Months 100 days
Non-Specified			
Term Deposits with part nationalised banks	Red Green	£1 million / 10%	6 months 100 days
Term deposits with banks and building societies	Red Green	£1 million / 10%	6 months 100 days
CDs or corporate bonds with banks and building societies	Red Green	£1 million / 10%	6 months 100 days
Ultra-Short Dated Bond Funds with a credit score of 1.25*		£4 million / 25%	Liquid
Ultra-Short Dated Bond Funds with a credit score of 1.5*		£3 million / 25%	Liquid
Property funds - The use of these instruments will normally be deemed to be capital expenditure, and as such will be an application (spending) of capital resources. The key exception to this is an investment in the CCLA Local Authorities Property Fund. This Authority will seek guidance on the status of any fund it may consider using.	AAA	£4 million / 25%	10 years

*Any investments in ultra-short dated bond funds will be considered on an individual basis due to the complex nature of this type of investment. These types of funds do not always have an official rating, in the event that the Council wishes to invest in the type of fund the council will seek guidance from its treasury advisors and undertake additional due diligence prior to any decision.

Accounting treatment of investments. The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

APPROVED COUNTRIES FOR INVESTMENTS

This list is based on those countries which have sovereign ratings of AA- or higher, (we show the lowest rating from Fitch, Moody's and S&P) and also, (except - at the time of writing - for Hong Kong, Norway and Luxembourg), have banks operating in sterling markets which have credit ratings of green or above in the Link credit worthiness service.

Based on lowest available rating

AAA

- Australia
- Denmark
- Germany
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Canada
- Finland
- U.S.A.

AA

- Abu Dhabi (UAE)
- France

AA-

- Belgium
- Qatar
- **U.K.**

THIS LIST IS CORRECT AS AT 25.01.23

Treasury management scheme of delegation

(i) Full Council

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.

(ii) Audit & Risk Committee (responsibility for scrutiny)

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- reviewing the treasury management policy and procedures and making recommendations to the responsible body.
- receiving and reviewing regular monitoring reports and acting on recommendations;

The treasury management role of the section 151 officer

The S151 (responsible) officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.

<u>Prospects for Interest Rates</u>

The Council has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Link provided the following forecasts on 19 December 2022. These are forecasts for certainty rates, gilt yields plus 80 bps.

Link Group Interest Rate View	19.12.22												
	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
BANK RATE	3.50	4.25	4.50	4.50	4.50	4.00	3.75	3.50	3.25	3.00	2.75	2.50	2.50
3 month ave earnings	3.60	4.30	4.50	4.50	4.50	4.00	3.80	3.30	3.00	3.00	2.80	2.50	2.50
6 month ave earnings	4.20	4.50	4.60	4.50	4.20	4.10	3.90	3.40	3.10	3.00	2.90	2.60	2.60
12 month ave earnings	4.70	4.70	4.70	4.50	4.30	4.20	4.00	3.50	3.20	3.10	3.00	2.70	2.70
5 yr PWLB	4.20	4.20	4.20	4.10	4.00	3.90	3.80	3.60	3.50	3.40	3.30	3.20	3.10
10 yr PWLB	4.30	4.40	4.40	4.30	4.10	4.00	3.90	3.80	3.60	3.50	3.40	3.30	3.30
25 yr PWLB	4.60	4.60	4.60	4.50	4.40	4.20	4.10	4.00	3.90	3.70	3.60	3.50	3.50
50 yr PWLB	4.30	4.30	4.30	4.20	4.10	3.90	3.80	3.70	3.60	3.50	3.30	3.20	3.20

Additional notes by Link on this forecast table: -

Our central forecast for interest rates was updated on 19 December and reflected a view that the MPC would be keen to further demonstrate its anti-inflation credentials by delivering a succession of rate increases. Bank Rate stands at 3.5% currently but is expected to reach a peak of 4.5% in H1 2023.

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

The CPI measure of inflation looks to have peaked at 11.1% in Q4 2022 (currently 10.7%). Despite the cost-of-living squeeze that is still taking shape, the Bank will want to see evidence that wages are not spiralling upwards in what is evidently a very tight labour market.

Regarding the plan to sell £10bn of gilts back into the market each quarter (Quantitative Tightening), this has started and will focus on the short, medium and longer end of the curve in equal measure, now that the short-lived effects of the Truss/Kwarteng unfunded dash for growth policy are firmly in the rear-view mirror.

In the upcoming months, our forecasts will be guided not only by economic data releases and clarifications from the MPC over its monetary policies and the Government over its fiscal policies, but the on-going conflict between Russia and Ukraine. (More recently, the heightened tensions between China/Taiwan/US also have the potential to have a wider and negative economic impact.)

On the positive side, consumers are still estimated to be sitting on over £160bn of excess savings left over from the pandemic so that will cushion some of the impact of the above challenges. However, most of those are held by more affluent people whereas lower income families already spend nearly all their income on essentials such as food, energy and rent/mortgage payments.

PWLB RATES

- The yield curve movements have become less volatile of late and PWLB 5 to 50 years Certainty Rates are, generally, in the range of 4.10% to 4.80%.
- We view the markets as having built in, already, nearly all the effects on gilt yields of the likely increases in Bank Rate and the elevated inflation outlook.

The balance of risks to the UK economy: -

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

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

- **Labour and supply shortages** prove more enduring and disruptive and depress economic activity (accepting that in the near-term this is also an upside risk to inflation and, thus, rising gilt yields).

- **The Bank of England** acts too quickly, or too far, over the next year to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.

- **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.

- **Geopolitical risks,** for example in Ukraine/Russia, China/Taiwan/US, Iran, North Korea and Middle Eastern countries, which could lead to increasing safe-haven flows.

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

- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly and for a longer period within the UK economy, which then necessitates Bank Rate staying higher for longer than we currently project or even necessitates a further series of increases in Bank Rate.

- **The Government** acts too quickly to cut taxes and/or increases expenditure in light of the cost-of-living squeeze.

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

- Longer term **US treasury yields** rise strongly and pull gilt yields up higher than currently forecast.

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

Borrowing advice: Our long-term (beyond 10 years) forecast for Bank Rate stands at 2.5%. As all PWLB certainty rates are currently above this level, borrowing strategies will need to be reviewed in that context. Better value can generally be obtained at the shorter end of the curve and short-dated fixed LA to LA monies should be considered. Temporary borrowing rates are likely, however, to remain near Bank Rate and may also prove attractive whilst the market waits for inflation, and therein gilt yields, to drop back later in 2023.

Our suggested budgeted earnings rates for investments up to about three months' duration in each financial year are rounded to the nearest 10bps as follows: -

Average earnings in each year	
2022/23 (remainder)	4.00%
2023/24	4.40%
2024/25	3.30%
2025/26	2.60%
2026/27	2.50%
Years 6 to 10	2.80%
Years 10+	2.80%

As there are so many variables at this time, caution must be exercised in respect of all interest rate forecasts.

Our interest rate forecast for Bank Rate is in steps of 25 bps, whereas PWLB forecasts have been rounded to the nearest 10 bps and are central forecasts within bands of + / - 25 bps. Naturally, we continue to monitor events and will update our forecasts as and when appropriate.

Economic Update

Against a backdrop of stubborn inflationary pressures, the easing of Covid restrictions in most developed economies, the Russian invasion of Ukraine, and a range of different UK Government policies, it is no surprise that UK interest rates have been volatile right across the curve, from Bank Rate through to 50-year gilt yields, for all of 2022.

Market commentators' misplaced optimism around inflation has been the root cause of the rout in the bond markets with, for example, UK, EZ and US 10-year yields all rising by over 200bps since the turn of the year. The table below provides a snapshot of the conundrum facing central banks: inflation is elevated but labour markets are extra-ordinarily tight, making it an issue of fine judgment as to how far monetary policy needs to tighten.

	UK	Eurozone	US
Bank Rate	3.5%	2.0%	4.25%-4.50%
GDP	-0.2%q/q Q3 (2.4%y/y)	+0.2%q/q Q3 (2.1%y/y)	2.6% Q3 Annualised
Inflation	10.7%y/y (Nov)	10.1%y/y (Nov)	7.1%y/y (Nov)

Unemployment Rate	3.7% (Oct)	6.5% (Oct)	3.7% (Nov)

Q2 of 2022 saw UK GDP revised upwards to +0.2% q/q, but this was quickly reversed in the third quarter, albeit some of the fall in GDP can be placed at the foot of the extra Bank Holiday in the wake of the Queen's passing. Nevertheless, CPI inflation has picked up to what should be a peak reading of 11.1% in October, although with further increases in the gas and electricity price caps pencilled in for April 2023, and the cap potentially rising from an average of £2,500 to £3,000 per household, there is still a possibility that inflation will spike higher again before dropping back slowly through 2023.

The UK unemployment rate fell to a 48-year low of 3.6%, and this despite a net migration increase of c500k. The fact is that with many economic participants registered as long-term sick, the UK labour force actually shrunk by c500k in the year to June. Without an increase in the labour force participation rate, it is hard to see how the UK economy will be able to grow its way to prosperity, and with average wage increases running at over 6% the MPC will be concerned that wage inflation will prove just as sticky as major supply-side shocks to food and energy that have endured since Russia's invasion of Ukraine on 22nd February 2022.

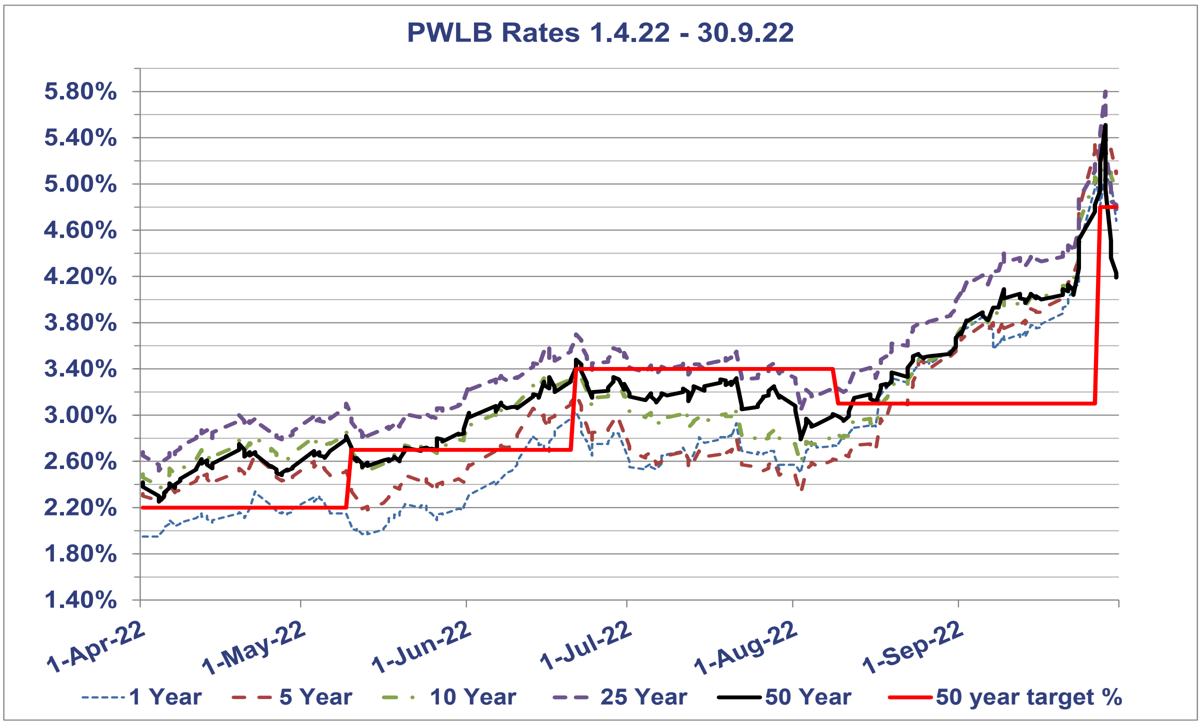
Throughout Q3 Bank Rate increased, finishing the quarter at 2.25% (an increase of 1%). Q4 has seen rates rise to 3.5% in December and the market expects Bank Rate to hit 4.5% by May 2023.

Following a Conservative Party leadership contest, Liz Truss became Prime Minister for a tumultuous seven weeks that ran through September and October. Put simply, the markets did not like the unfunded tax-cutting and heavy spending policies put forward by her Chancellor, Kwasi Kwarteng, and their reign lasted barely seven weeks before being replaced by Prime Minister Rishi Sunak and Chancellor Jeremy Hunt. Their Autumn Statement of 17th November gave rise to a net £55bn fiscal tightening, although much of the "heavy lifting" has been left for the next Parliament to deliver. However, the markets liked what they heard, and UK gilt yields have almost completely reversed the increases seen under the previous tenants of No10/11 Downing Street.

Globally, though, all the major economies are expected to struggle in the near term. The fall below 50 in the composite Purchasing Manager Indices for the UK, US, EZ and China all point to at least one, if not more, quarters of GDP contraction. In November, the MPC projected eight quarters of negative growth for the UK lasting throughout 2023 and 2024, but with Bank Rate set to peak at lower levels than previously priced in by the markets and the fiscal tightening deferred to some extent, it is not clear that things will be as bad as first anticipated by the Bank.

The £ has strengthened of late, recovering from a record low of $1.035, on the Monday following the Truss government's "fiscal event", to $1.22. Notwithstanding the £'s better run of late, 2023 is likely to see a housing correction of some magnitude as fixed-rate mortgages have moved above 5% and affordability has been squeezed despite proposed Stamp Duty cuts remaining in place.

In the table below, the rise in gilt yields, and therein PWLB rates, through the first half of 2022/23 is clear to see.



However, the peak in rates on 28th September as illustrated in the table covering April to September 2022 below, has been followed by the whole curve shifting lower. PWLB rates at the front end of the curve are generally over 1% lower now whilst the 50 years is over 1.75% lower.

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.95%	2.18%	2.36%	2.52%	2.25%
Date	01/04/2022	13/05/2022	04/04/2022	04/04/2022	04/04/2022
High	5.11%	5.44%	5.35%	5.80%	5.51%
Date	28/09/2022	28/09/2022	28/09/2022	28/09/2022	28/09/2022
Average	2.81%	2.92%	3.13%	3.44%	3.17%
Spread	3.16%	3.26%	2.99%	3.28%	3.26%

After a shaky start to the year, the S&P 500 and FTSE 100 have climbed in recent weeks, albeit the former is still 17% down and the FTSE 2% up. The German DAX is 9% down for the year.

CENTRAL BANK CONCERNS – DECEMBER 2022

In December, the Fed decided to push up US rates by 0.5% to a range of 4.25% to 4.5%, whilst the MPC followed by raising Bank Rate from 3% to 3.5%, in line with market expectations. EZ rates have also increased to 2% with further tightening in the pipeline.

Having said that, the sentiment expressed in the press conferences in the US and the UK were very different. In the US, Fed Chair, Jerome Powell, stated that rates will be elevated and stay higher for longer than markets had expected. Governor Bailey, here in the UK, said the opposite and explained that the two economies are positioned very differently so you should not, therefore, expect the same policy or messaging.

Regarding UK market expectations, although they now expect Bank Rate to peak within a lower range of 4.5% - 4.75%, caution is advised as the Bank of England Quarterly Monetary Policy Reports have carried a dovish message over the course of the last year, only for the Bank to have to play catch-up as the inflationary data has proven stronger than expected.

In addition, the Bank's central message that GDP will fall for eight quarters starting with Q3 2022 may prove to be a little pessimistic. Will the £160bn excess savings accumulated by households through the Covid lockdowns provide a spending buffer for the economy – at least to a degree? Ultimately, however, it will not only be inflation data but also employment data that will mostly impact the decision-making process, although any softening in the interest rate outlook in the US may also have an effect (just as, conversely, greater tightening may also).