



west midlands
police and crime
commissioner



AGENDA ITEM 08

**JOINT AUDIT COMMITTEE
30 MARCH 2023**

**TREASURY MANAGEMENT STRATEGY
2023/24 REPORT**

1. PURPOSE OF REPORT

- 1.1 This report sets out the Police and Crime Commissioner's Treasury Strategy Statement for 2023/24 and updates on debt management and investment activity during the financial year 2022/23.
- 1.2 This report updates on recent Treasury Management activity, in line with recommended best practice and the revised CIPFA Code of Practice for Treasury Management 2021.
- 1.3 It is important to note that financial information contained within this report should not be used by any individual or organisation as a basis for making investment or borrowing decisions. The Commissioner and his treasury advisers will not accept any liability on behalf of any individual or organisation who seeks to act on the financial information contained within this report.

2. INTRODUCTION AND BACKGROUND

- 2.1 The Commissioner is legally required to produce an Annual Investment Strategy. Therefore, included is an Investment Strategy as part of the Treasury Strategy Statement shown in **Appendix B**.
- 2.2 In order to protect the Commissioner's position if an individual or organisation were to act upon this advice, it is deemed necessary to produce a disclaimer, which is shown as a note at the head of **Appendix B**.
- 2.3 The Commissioner is responsible for administering a Capital Programme of £190.9m between 2023-24 and 2026-27. As far as possible all surplus revenue money and other reserves are invested on a daily basis until they are required.
- 2.4 The Commissioner follows the Code of Practice for Treasury Management and The Prudential Code produced by the Chartered Institute of Public Finance and Accountancy

(CIPFA). The 2021 Treasury Management Code will require the Commissioner to implement the following: -

- **Adopt a new liability benchmark treasury indicator** to support the financing risk management of the capital financing requirement; this is to be shown in chart form for a minimum of ten years, with material differences between the liability benchmark and actual loans to be explained;
- **Long-term treasury investments**, (including pooled funds), are to be classed as commercial investments unless justified by a cash flow business case; For the Commissioners investments this would mean the CCLA investment would be categorised as a commercial investment.
- **Pooled funds** are to be included in the indicator for principal sums maturing in years beyond the initial budget year;
- Amendment to the **knowledge and skills register** for officers and members involved in the treasury management function - to be proportionate to the size and complexity of the treasury management conducted by each authority;
- **Reporting to members is to be done quarterly.** Specifically, the Chief Finance Officer (CFO) is required to establish procedures to monitor and report performance against all forward-looking prudential indicators at least quarterly. The CFO is expected to establish a measurement and reporting process that highlights significant actual or forecast deviations from the approved indicators. However, monitoring of prudential indicators, including forecast debt and investments should be reported as part of the integrated revenue, capital and balance sheet monitoring; and
- **Environmental, social and governance (ESG)** issues to be addressed within the Commissioner's treasury management policies and practices. This is a developing area, and it is not implied that the organisation's ESG policy will currently include ESG scoring or other real-time ESG criteria at individual investment level. The supporting guidance provides no further details.

The main requirements of the Prudential Code relating to service and commercial investments are: -

- The risks associated with service and commercial investments should be proportionate to their financial capacity – i.e. that plausible losses could be absorbed in budgets or reserves without unmanageable detriment to services;
- The Commissioner must not borrow to invest for the primary purpose of commercial return;
- It is not prudent for local authorities to make any investment or spending decision that will increase the CFR, and so may lead to new borrowing, unless directly and primarily related to the functions of the authority, and where any commercial returns are either related to the financial viability of the project in question or otherwise incidental to the primary purpose;
- An annual review should be conducted to evaluate whether commercial investments should be sold to release funds to finance new capital expenditure or refinance maturing debt;
- A prudential indicator is required for the net income from commercial and service investments as a proportion of the net revenue stream;

- Create new Investment Management Practices to manage risks associated with non-treasury investments, (similar to the current Treasury Management Practices).

The Capital Strategy or Annual Investment Strategy should include: -

- The approach to investments for service or commercial purposes (together referred to as non-treasury investments), including defining the Commissioner's objectives, risk appetite and risk management in respect of these investments, and processes ensuring effective due diligence;
- An assessment of affordability, prudence and proportionality in respect of the Commissioner's overall financial capacity (i.e. whether plausible losses could be absorbed in budgets or reserves without unmanageable detriment to services);
- Details of financial and other risks of undertaking investments for service or commercial purposes and how these are managed;
- Limits on total investments for service purposes and for commercial purposes respectively (consistent with any limits required by other statutory guidance on investments);
- Requirements for independent and expert advice and scrutiny arrangements;
- A statement of compliance with paragraph 51 of the Prudential Code in relation to investments for commercial purposes, in particular the requirement that the Commissioner must not borrow to invest primarily for financial return;

2.5 The Commissioner's Treasury Management activity is governed by the following documents:

- 1 Treasury Policy Statement.** This is a statement, defining treasury management and the general approach to it. It emphasises firstly the control of risk and secondly the pursuit of best value as the main factors defining the approach. A copy is attached at **Appendix A.**
- 2 Treasury Management Practices (TMPs) and Schedules to TMPs.** TMPs define the overall approach to various aspects of treasury management, including such things as risk management, performance monitoring and management, segregation of duties and dealing arrangements, cash flow management, money laundering and staff training. The Schedules to TMPs deal with the criteria for selecting third parties (banks and building societies) with whom the Commissioner is prepared to deposit funds. The TMPs and Schedules are reviewed regularly by the Commissioner's CFO and electronic copies are available on request.
- 3 Annual Treasury Strategy Statement** details the expected activities of the treasury function in the financial year 2023-24. A copy is attached at **Appendix B.**

3. DEBT MANAGEMENT ACTIVITY 2022/23

3.1 Since April 1986, the Police Authority had been incurring long term debt from the Public Works Loans Board (PWLB) to finance major capital expenditure. All the borrowing was transferred to the Commissioner in November 2012.

3.2 Borrowing at the 31 March 2023 is expected to total £105.3m, all at fixed rates and repayable over various periods up to 2072.

3.3 The Commissioner has the capacity to undertake variable rate borrowing (up to 20% of the total debt portfolio) should the need arise or to take advantage of favourable rates to fund identified need.

3.4 Two Loans matured during 2022/23 totalling £3m (£2.4m and £0.6m at 6.125% on 31/03/23) and one new loan was taken out (£7m at 3.99% for 5 years). PWLB rates for 50 years are currently 4.74%. This has been increasing throughout 2022/23 due to an increase in the Bank of England base rate.

3.5 The average rate of interest payable on debt is 3.2%. Link Asset Services, the Commissioner’s treasury advisors, continue to advise on debt restructuring to enable the Commissioner to take advantage of opportunities to reduce the overall cost of debt, set in the context of the financial constraints and markets. There were no opportunities for this during 2022/23. Rescheduling of current borrowing in the debt portfolio is unlikely to occur as there is still a very large difference between premature redemption rates and new borrowing rates.

3.6 The table below shows the level of borrowing and the average interest rate payable.

Public Works Loan Board (PWLB) Borrowing

Loan Type	Borrowing £’m		Average Interest Rates %	
	31/03/22	31/03/23	2021/22	2022/23
Fixed	101.3	105.3	3.20	3.20
Variable	0.0	0.0	0.0	0.0
Total	101.3	105.3	3.20	3.20

3.7 **Appendix E** shows the maturity profile of the Loan portfolio

4. INVESTMENT ACTIVITY 2022/23

4.1 Any surplus funds have been invested on a daily basis. The PCC uses an investment benchmark to assess the investment performance of its investment portfolio of Sterling overnight Index average (SONIA).

4.2 Interest earned on fixed term investments up to the end of March 2023 is predicted to average 1.91%. The SONIA rate to mid-Feb averages 1.97% but is calculated daily and has been increasing in line with Bank of England interest rates. Although the interest earned is lined with the benchmark it must be remembered that the primary objective of the PCC’s treasury management strategy is security and liquidity so it is these factors that will be pursued ahead of yield.

4.3 The Commissioner approved a list of counter parties with whom investments could be placed for 2022/23. At 6 March 2023, the Commissioner had £112m invested with a range of maturity dates between instant access and two years, and a further £5m with CCLA property fund with no maturity date.

4.4 All of the Commissioner's investments are with UK based entities. The split of these investments is as follows and detailed in **Appendix D**:

- 36% British Banks/Building Societies,
- 51% Money Market Funds (MMF's)
- 9% Local Authorities,
- 4% CCLA

The Commissioner has held no investments with foreign banks, all money market funds are UK based funds.

4.5 MMF's have been used to hold up to £60m throughout 2022/23 as they provide liquidity as well as yield rates which are reviewed daily. This will have generated approximately £1.2m of additional income in the 22/23 financial year.

4.6 Based on market information provided by Link Asset Services, the counter party list has been fully reviewed to reflect: current market conditions, credit ratings of sovereign nations, and the impact of Government support for the banking sector. As a consequence, the limits, both financial and duration, have been adjusted for some institutions. The group and individual limits (£65m) for the part government owned institutions (National Westminster Bank, Royal Bank of Scotland) remain the same as in 2022-23. (The NatWest group are the bankers for the PCC and any uninvested funds reside here). During 2022-23 there were a number of times where the cash held in the NatWest account exceeded £65m. This was due to peaks in grant payments received and the lack of suitable counterparties to invest in given the reluctance to enter into investments with other Local Authorities. It was deemed more prudent to keep money residing in the NatWest account.

4.7 Similarly, all Local Authorities are eligible for inclusion on the counter party list because ultimately, they have the support of the national government. However, during 2020/21 it became known that some Local Authorities issued Section 114 notices, effectively stating they cannot balance the budget for the year and placing a freeze on any non-essential spending. (It should be noted that the repayment of investments falls outside the scope of this as it is a legal obligation). As a result of this, additional due diligence is now carried out on any Local Authority investments to ensure that investments are secure and to avoid any adverse publicity.

4.8 If institutions now fall below the set criteria they have been removed from the list and added if they become eligible. A copy of the latest list, which will be kept under review by the Commissioner's CFO, in accordance with the TMP Statements, is attached at **Appendix C**. Details of the criteria are contained within the annual investment strategy in **Appendix B**.

4.9 The day to day work of Treasury Management is carried out in the Finance Department with oversight from the Director of Commercial Services. The Treasury Management Strategy is therefore managed using appropriate delegations and periodic management reporting to the Director of Commercial Services and the Commissioner's CFO. This will continue for the next financial year.

5 TREASURY STRATEGY STATEMENT 2023/24

5.1 The Treasury Strategy Statement covers the Commissioner's latest capital funding requirements, view of interest rate movements, and strategy for borrowing and investment in the light of that view. As such, it needs to be reviewed annually. The Treasury Strategy Statement for 2023/24 is attached at **Appendix B**.

5.2 Following on from recent Bank of England rate rises, future interest rate expectations can be found below. These are important for the PCC as these determine the rate at which the PCC can borrow and invest:

Short-term rates.

- The short-term Bank of England base rate is expected to peak at 4.5% mid-2023/24 before starting to come down before the end of the financial year.

Long-term rates.

- Very long-term rates (50-year PWLB rate) are 4.71%.
- PWLB is the Government organisation from whom the PCC borrows its money for capital expenditure.

5.3 The Local Government Act 2003 introduced a new system of “prudential borrowing” which allows the Commissioner to set borrowing limits subject to criteria of prudence and affordability. These criteria are set out in more detail in the CIPFA Prudential Code that specifically requires a number of prudential indicators are set. The full range of prudential indicators was considered when the 2023/24 Budget and Precept were agreed in February 2023. This is particularly relevant when set in the context of the overall limitation of planned capital resources and therefore a potential increase in prudential borrowing across the medium-term plan. The proposed indicators that relate to treasury management, including the Estates Strategy, are set out in the Treasury Strategy Statement.

5.4 The Local Government Act 2003 also requires the Commissioner to set out a treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act); this sets out the Commissioner’s policies for managing investments and for giving priority to the security and liquidity of those investments.

6. FINANCIAL IMPLICATIONS

6.1 The financial implications of the Treasury Management function are included in the Commissioner’s annual budget. The estimated total net cost of capital financing in 2023/24 (including direct charges to revenue) is £3.6m.

7. LEGAL IMPLICATIONS

7.1 These matters are governed by the Local Government Act 2003, which empowers the Commissioner to do anything which is calculated to facilitate or is conducive or incidental to the discharge of their various statutory functions.

7.2 Adoption of the CIPFA Code of Practice on Treasury Management in the Public Services as part of the Commissioner’s Standing Orders and Financial Regulations gives it the status of “a code of practice made or approved by or under any enactment” and hence proper practice under the provisions of the Local Government Act 2003.

7.3 The Commissioner’s CFO continues to delegate the responsibility for the discharge of Treasury Management on a daily basis to the Director of Commercial Services through the appropriate Finance Department staff.

8. EQUALITY IMPLICATIONS

8.1 Any issues of Equality and Diversity that may arise during the undertaking of Treasury Management activities will be noted, considered and reported upon.

9. RECOMMENDATIONS

9.1 It is recommended that the Joint Audit Committee:

- a. Note the treasury management activity in 2022-23 set out in paragraphs 3 and 4, and the interest rate observations in paragraph 5.
- b. Approve the Treasury Strategy Statement for 2023/24 set out in **Appendix B**.
- c. Approve the criteria for selecting counter parties in **Appendix B** and the current eligible counter parties and their limits as set out in **Appendix C**.
- d. Continue to include a mid-year review of Treasury Management activity in the Joint Audit Committee's work plan in accordance with the CIPFA Code of Practice for Treasury Management.

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TREASURY POLICY STATEMENT AND TREASURY MANAGEMENT PRACTICES

TREASURY POLICY STATEMENT

1. The Commissioner defines treasury management activities as:
 - the management of cash flows;
 - banking, money market and capital market transactions;
 - the effective control of the risks associated with those activities;
 - the pursuit of optimum performance consistent with those risks.

2. The Commissioner regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the Commissioner.

3. The Commissioner acknowledges that effective treasury management will provide support towards the achievement of business and service objectives. It is therefore a commitment to the principles of achieving best value in treasury management, and to employing suitable performance measurement techniques within the context of effective risk management.

4. Treasury operations are managed within the overall strategy approved by the Commissioner at the following levels:
 - Formal reviews of strategy and performance by the Commissioner's CFO, Director of Commercial Services, and Assistant Director Finance in conjunction with representatives from the external advisors (Link Asset Services).
 - Monthly monitoring is conducted by the Commissioner's CFO, Director of Commercial Services and Assistant Director Finance.
 - On a daily basis by trained staff under the direction of the Assistant Director Finance.
 - Reports to the Joint Audit Committee and treasury activity.
 - The annual review of the strategy for the Commissioner.

Note:

It is important to note that the Treasury Strategy Statement is adopted by the Commissioner based upon advice from external treasury advisors, and accordingly the Strategy is tailored to meet the specific and unique needs of the Commissioner. All financial information contained within this Report and Statement should not be used by any individual or organisation as a basis for making investment or borrowing decisions. The Commissioner and the treasury advisors will not accept any liability on behalf of any individual or organisation who seeks to act on the financial information contained within this Report and Statement.

TREASURY STRATEGY STATEMENT 2023/24**1.0 INTRODUCTION**

1.1 This Treasury Strategy Statement details the expected activities of the treasury function in the financial year 2023/24. The suggested strategy is based upon views of interest rates as advised by external advisors, supplemented with leading market forecasts. The strategy covers:

- the current portfolio position;
- prudential indicators;
- prospects for interest rates;
- the borrowing requirement & strategy;
- the investment strategy;
- debt rescheduling opportunities; and
- MRP strategy.

2.0 CURRENT PORTFOLIO POSITION

2.1 The Commissioner's estimated portfolio position as at 1st April 2023 will be as follows:

Treasury Investments	
	£m
Maturity less than 1 year	70.0
Maturity between 1 and 5 years	0.0
CCLA	5.0
	75.0
Treasury External Borrowing	
PWLB fixed rate	105.3
PWLB variable rate	0.0
	105.3
Net Treasury Borrowing	-30.3

2.2 The average rate of interest on the above debt is expected to be 3.17%.

The treasury investments less than 5 years relates to Bank, Building society, Local Authority Investments and Money Market Funds. The £5.0m investment placed with CCLA relates to the property fund and is for at least five years.

3.0 PRUDENTIAL INDICATORS for 2023/24 to 2025/26

- 3.1 The Prudential Code for Capital Finance in Local Authorities (Prudential Code) is applicable to the Police and Crime Commissioner and has been developed by the Chartered Institute of Public Finance and Accountancy (CIPFA) to provide a code of practice to underpin the system of capital finance embodied in Part 1 of the Local Government Act 2003. PCCs, like Local Authorities, are free to determine their own level of capital investment controlled by self-regulation.
- 3.2 The key objectives of the Prudential Code are to ensure that capital investment plans are affordable, prudent and sustainable.
- 3.3 The Prudential Code supports a system of self-regulation that is achieved by the setting and monitoring of a suite of Prudential Indicators that directly relate to each other. The indicators establish parameters within which the PCC should operate to ensure the objectives of the Prudential Code are met.
- 3.4 The Prudential Code introduced requirements for the manner in which capital spending plans are to be considered and approved. It requires the Commissioner to set a number of prudential indicators over a period of three years. The following prudential indicators are relevant for the purposes of setting an integrated treasury management strategy:

External debt

These indicators are intended to ensure that levels of external borrowing are affordable, prudent and sustainable. The authorised limit for external debt is a statutory limit (section 3 of the Local Government Act 2003) that should not be breached under any circumstances. The proposed limits set out below have been calculated to take account of the current Commissioner's capital expenditure and financing plans and allowing for the possibility of unusual cash movements. If this limit is likely to be breached, it would be necessary for the Commissioner to determine if it is prudent to raise the limit or to instigate procedures to ensure that such a breach does not occur.

The operational boundary for external debt is a management tool for day to day monitoring and has been calculated with regard to the Commissioner's capital expenditure and financing plans allowing for the most likely, prudent, but not worst-case scenario for cash flow. Temporary breaches of the operational boundary, due to variations in cash flow, will not be regarded as significant.

	2023/24	2024/25	2025/26
	£m	£m	£m
Authorised limit for external debt -			
Borrowing	140.0	170.0	185.0
Operational boundary -			
Borrowing	135.0	165.0	180.0

The Commissioner's actual external debt as at 31/03/23 is currently expected to be £105.3m, excluding transferred debt managed by Dudley M.B.C.

CIPFA Code of Practice for Treasury Management in the Public Services

The Commissioner continues to adopt the CIPFA Code of Practice for Treasury Management in the Public Services first adopted by the Police Authority in March 2002.

Interest rate exposures

These indicators allow the Commissioner to manage the extent to which he is exposed to changes in interest rates. The upper limit for fixed interest reflects the fact that it is possible to construct a prudent treasury strategy on the basis of using only fixed rate debt and investments, so long as the maturity dates of these debts and investments are reasonably spread. The same does not apply to variable rates where a 100% exposure could lead to significant year on year fluctuations in the cost of debt. The upper limit for variable rate exposure allows for the use of variable rate debt to offset the exposure to changes in short-term rates on the portfolio of investments. This limit reduces over time as the strategy is to gradually reduce the level of investments.

	2023/24 %	2024/25 %	2025/26 %
Upper limit for fixed interest rate exposure			
Net principal fixed rate borrowing / investments	100	100	100
Upper limit for variable rate exposure			
Net principal variable rate borrowing / investments	20	20	20

Maturity structure of borrowing and Investments longer than 364 days

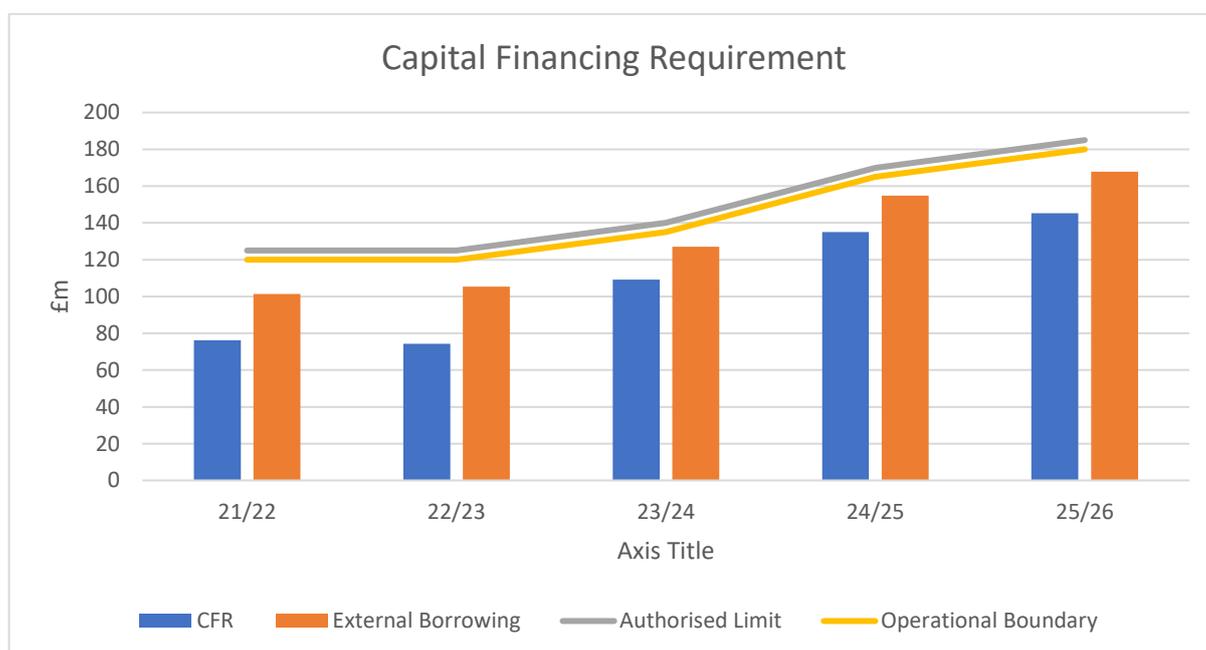
The purpose of the prudential limits for principal sums invested for periods longer than 364 days is for the Commissioner to contain his exposure to the possibility of loss that might arise as a result of having to seek early repayment of principal sums invested. The maturity structure of fixed rate borrowing is designed to protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years.

Upper limit of principal invested for periods over 364 days	£40m	
Maturity structure of fixed rate borrowing	Upper limit	Lower limit
	%	%
Under 12 months	25	0
12 months and within 24 months	25	0
24 months and within 5 years	50	0
5 years and within 10 years	75	0
10 years and above	100	25

3.5 In considering the capital programme for 2023/24, the anticipated future borrowing requirements were considered in the context of overall capital resources and the impact on the revenue budget.

	31 March 2022 £'m	31 March 2023 £'m	31 March 2024 £'m	31 March 2025 £'m	31 March 2026 £'m
Capital Financing Requirements	76.2	74.2	109.2	135.1	145.2
Existing borrowing	93.8	101.3	105.3	127.0	154.8
Repayments	0.0	-3.0	-0.8	-2.2	-2.0
New Borrowing	7.5	7.0	22.5	30.0	15.0
Net External borrowing	101.3	105.3	127.0	154.8	167.8

3.6 The CFR is the historic underlying need to borrow for capital expenditure net of all capital receipts, grant, revenue contributions etc. The CFR increases when unfinanced expenditure is incurred and reduces when provision is made to repay that debt (through MRP).



3.7 External borrowing is used to finance capital expenditure in land and buildings. Therefore, although there is an increased liability on the balance sheet this is offset by an increase in the value of assets to be utilised by the commissioner.

3.8 The PCC is currently in a 'overborrowed position'. There are a number of reasons why the PCC is in an 'overborrowed' position but among them is the meaningful levels of Minimum Revenue Provision (MRP) that have been applied on recent years. In

essence this is a natural position to be in if new external debt is not required (or it not cost effective to repay debt early- see 3.9), as an annual provision is made to set aside cash in advance of loans maturing. If loans are not due for maturity for some time then all other things being equal the CFR will reduce as historic borrowing is depreciated through the MRP charge.

3.9 The table above shoes how the CFR is expected to change over the period of the MTFP. Although the level of actual debt exceeds the Capital Financing Requirement it is currently prohibitively expensive to prematurely repay existing debt. If there are cost-effective opportunities to avoid, or reduce, an overborrowed position they will be considered as long as they are in the best long-term financial interests of the PCC.

4.0 PROSPECTS FOR INTEREST RATES

4.1 The prospect for interest rates is important for the PCC to understand as it can affect the interest rate earned on investments and the rate at which it can borrow money for capital purposes.

4.2 The Commissioner continues to use Link Asset Services (Link) as a treasury advisor and has made use of their services in formulating a view on interest rates. Link has in turn drawn upon the work of a number of City economic forecasters.

4.3 LINK group have provided the following interest rate forecasts on 7 February 2023:

Link Group Interest Rate View 07.02.23													
	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26
BANK RATE	4.25	4.50	4.50	4.25	4.00	3.75	3.25	3.00	2.75	2.75	2.50	2.50	2.50
3 month ave earnings	4.30	4.50	4.50	4.30	4.00	3.80	3.30	3.00	2.80	2.80	2.50	2.50	2.50
6 month ave earnings	4.40	4.50	4.40	4.20	3.90	3.70	3.20	2.90	2.80	2.80	2.60	2.60	2.60
12 month ave earnings	4.50	4.50	4.40	4.20	3.80	3.60	3.10	2.70	2.70	2.70	2.70	2.70	2.70
5 yr PWLB	4.00	4.00	3.90	3.80	3.70	3.60	3.50	3.40	3.30	3.20	3.10	3.10	3.10
10 yr PWLB	4.20	4.20	4.10	4.00	3.90	3.80	3.60	3.50	3.50	3.40	3.30	3.30	3.20
25 yr PWLB	4.60	4.60	4.40	4.30	4.20	4.10	3.90	3.80	3.70	3.60	3.50	3.40	3.40
50 yr PWLB	4.30	4.30	4.20	4.10	3.90	3.80	3.60	3.60	3.40	3.30	3.20	3.20	3.10

4.4 Additional Notes from Link to accompany current forecasts:

Our central forecast for interest rates was previously updated on 19 December and reflected a view that the Monetary Policy Committee (MPC) would be keen to further demonstrate its anti-inflation credentials by delivering a succession of rate increases. This has happened but the Government’s continued policy of emphasising fiscal rectitude will probably mean Bank Rate will not need to increase to further than 4.5%.

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. Our best judgment is that there will be scope for an early Christmas present for households with a December rate cut priced in, ahead of further reductions in 2024 and 2025.

The CPI measure of inflation looks to have peaked at 11.1% in Q4 2022 (currently 10.1%). 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.

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 significant 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.

4.5 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 coming 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 remain elevated 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 later in the year or in 2024.
- 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 if inflation remains more stubborn than the market currently anticipates, pulling gilt yields up higher consequently.
- Projected gilt issuance, inclusive of natural maturities and QT, could be too much for the markets to comfortably digest without higher yields compensating.

- 4.6 The overall Treasury Management Strategy will be based on the projections above. However, the Commissioner will maintain flexibility to take account of unexpected variations from the forecast.
- 4.7 As a result of the above interest rate forecast, investment returns are expected to remain significant in 2023/24. However, the cost of borrowing is also likely to stay high and given the requirement to borrow for the Capital Programme the interest repayable cost for the PCC is likely to increase.

5.0 ANNUAL INVESTMENT STRATEGY

- 5.1 The Commissioner's investment activities have regard to guidance issued by the Government and CIPFA. The Department of Levelling Up, Housing and Communities (DLUHC) and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with treasury (financial) investments. Non-financial investments, essentially the purchase of income yielding assets and service investments, are covered in the Capital Strategy.
- 5.2 In making investment decisions, the Commissioner's investment priorities will be security first (capital preservation), liquidity second and then yield (return). Pursuit of the best possible return on investments will only be allowed to the extent that this is consistent with very low levels of risk in terms of security and liquidity.
- 5.3 In the current economic climate, it is considered appropriate to keep investments short term to cover cash flow needs. However, where appropriate (from an internal as well as external perspective), the Commissioner will also consider the value available in periods up to 12 months with high credit rated financial institutions, whilst investment rates remain elevated, as well as a wider range of options.
- 5.4 The Commissioner will make use of both specified investments and non-specified investments. Specified investments are those that satisfy the following conditions:
- a) The investment is denominated in sterling and any payments or repayments in respect of the investment are payable only in sterling.
 - b) The Commissioner requires that the investment be repaid or redeemed within 12 months of the date on which the investment was made.
 - c) The investment does not involve the acquisition of share capital or loan capital in any corporate body.
 - d) The investment satisfies any of the following conditions:

The investment is made with the UK government (Debt Management Agency Deposit Facility), a local authority, a parish council or a community council.

The investment is made with a body which has been awarded a "high credit rating" by a credit rating agency.

- If the body is not a UK bank, the sovereign country must be awarded a "high credit rating" by a credit rating agency.

For the purposes of this strategy, use is made of the creditworthiness service provided by Link Asset Services to define a “high credit rating” :

- UK banks and building societies – short-term rating F1 or higher and viability rating of “a-” or higher.
- Foreign banks – short-term rating F1+, and a viability rating of a minimum of “a” with a sovereign rating of AAA.
- Money market Funds (MMF’s) – Any AAA rated fund

These will be supported by other accredited rating systems (Standard & Poor’s and Moody’s), credit watches and outlooks, Credit Default Swap data, and information from the financial press. A list of suggested counterparties and their current credit ratings can be found in **Appendix C**.

- 5.5 Since the credit crisis, there are some semi-nationalised banks in the UK with credit ratings which do not conform to the credit criteria usually used to identify banks which are of high credit worthiness. In particular, as they no longer are separate institutions in their own right, it is impossible for the rating agencies to assign them an individual rating for their standalone financial strength. However, these institutions are now recipients of at least an F2 short term rating (effectively taking on the creditworthiness of the Government). That implies deposits made with them are effectively being made to the Government. This relates to National Westminster Bank and Royal Bank of Scotland.
- 5.6 The Commissioner’s CFO will monitor credit ratings through the receipt of credit rating bulletins from the treasury management consultants at Link Asset Services. Institutions that cease to meet the criteria above will immediately cease to be treated as specified investments.
- 5.7 Non-specified investments are those that do not meet the criteria in 5.4 to 5.6 above. In determining which categories of non-specified investments may prudently be used, account will be taken of advice from the advisors, Link Asset Services, and, if investments are for 12 months or more, long-term credit ratings will be utilised as determined by Fitch IBCA.
- 5.8 So far, the following categories of investment have been identified as prudent for use for non-specified investments. The table also shows the maximum value of investments that may be held:

Category of investment	Maximum value for this category of investments
Sterling deposits in excess of 364 days with Local Authorities and UK banks (where these are not “specified investments” as defined above).	£40m
Property Funds based in the UK	£5m

- 5.10 Property funds provide investors with long term income and potential long-term capital appreciation. These types of funds are actively managed in a diversified portfolio of commercial property

- 5.11 In determining the maximum period for which investments may be held, regard to the most recent cash flow forecast will be taken. No investment will be entered into where the cash-flow forecast indicates that, as a result of that investment, the Commissioner would be forced to borrow money in a future year that would not otherwise have had to be borrowed.
- 5.12 Also at the time of making a new investment, long-term investments (investments of one year's duration or more) should not constitute more than 30% of the total pool of investments.

6.0 CAPITAL BORROWING REQUIREMENT & STRATEGY

- 6.1 The Commissioner's CFO has undertaken a review of capital investment requirements and likely resource levels. Although there is some uncertainty around specific requirements and future funding levels, it is certain that there will be a need to borrow further to fund the Estates Strategy over the life of the Capital Programme.
- 6.2 The next financial year is expected to see a peak in the bank rate which may push decisions to borrow back in anticipation of rates dropping in the future. If investments exceed the borrowing requirement over the next year, and cash can be accessed from maturing investments, consideration needs to be given to the potential of internal borrowing.
- 6.3 The Commissioner's CFO will continue to cautiously monitor the interest rate market and adopt a pragmatic approach to any changing circumstances such as the evolving Estates Strategy or deployment of new technology.
- 6.4 The Commissioner may choose to forward borrow and lock in lower interest rates if the opportunity presents itself. This will involve committing to borrow an amount of money at a date in the future at a designated rate. The Commissioner will then be committed to take on the borrowing even if the requirement to borrow is no longer present or the prevailing interest rate drops.

7.0 DEBT RESCHEDULING AND PREMATURE REPAYMENT OPPORTUNITIES

- 7.1 The introduction of different PWLB rates on 1 November 2007 for new borrowing as opposed to early repayment of debt, and the setting of a spread between the two rates (of about 40 – 50 basis points for the longest period loans narrowing down to 25 – 30 basis points for the shortest loans), has meant that PWLB to PWLB debt restructuring is now much less attractive.
- 7.2 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.

8.0 MINIMUM REVENUE PROVISION STRATEGY

- 8.1 Capital expenditure is expenditure on assets which have a life expectancy of more than one year e.g. buildings, vehicles, and equipment. Occasionally the Commissioner has to borrow to fund this expenditure. The loans taken out for this purpose are fully repayable at a future point in time (they are paid off at maturity and not in instalments). The concept of Minimum Revenue Provision was introduced to prescribe a minimum

amount which must be charged to the revenue account each year in order to make provision to meet the cost of that borrowing.

- 8.2 Under Regulation 27 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, where the Authority has financed capital expenditure by borrowing it is required to make a provision each year through a revenue charge (MRP). The Commissioner is required to calculate a prudent provision of MRP which ensures that the outstanding debt liability is repaid over a period that is reasonably commensurate with that over which the capital expenditure provides benefits. The MRP Guidance (2018) gives four ready-made options for calculating MRP, but the Commissioner can use any other reasonable basis that can be justified as prudent.
- 8.3 Options 1 and 2 should only be used in relation to Capital expenditure incurred before 1 April 2008 and which the Commissioner is satisfied forms part of Supported Capital Expenditure. For all unsupported borrowing covered by the Prudential Code on or after 1 April 2008, Options 3 or 4 must be used.
- 8.4 The MRP options are:
- **Option 1 – Regulatory Method.** MRP is equal to the amount determined in accordance with the former sections 28 and 29 of the 2003 Regulations as if they had not been revoked.
 - **Option 2 – Capital Financing Requirement Method.** MRP is equal to 4% of the Capital Financing Requirement at the end of the previous year.
 - **Option 3 – Asset Life Method.** Revenue provision is spread over the determined useful life of the Asset either in equal instalments or using an annuity method. The first charge can be delayed until the asset is operational.
 - **Option 4 – Depreciation Method.** MRP is equal to the provision required in accordance with depreciation accounting in respect of the asset.
- 8.5 For expenditure incurred before 1 April 2008 which forms part of supported capital expenditure, the MRP policy will be based on Option 2, but using an average of 40 years, giving a calculation of 2.5% of the CFR, being more reflective of the useful life of our assets.
- 8.6 From 1 April 2008 for all unsupported borrowing the MRP policy will be Option 3, Asset life method, looking at the lives of the assets to which the borrowing has been applied.

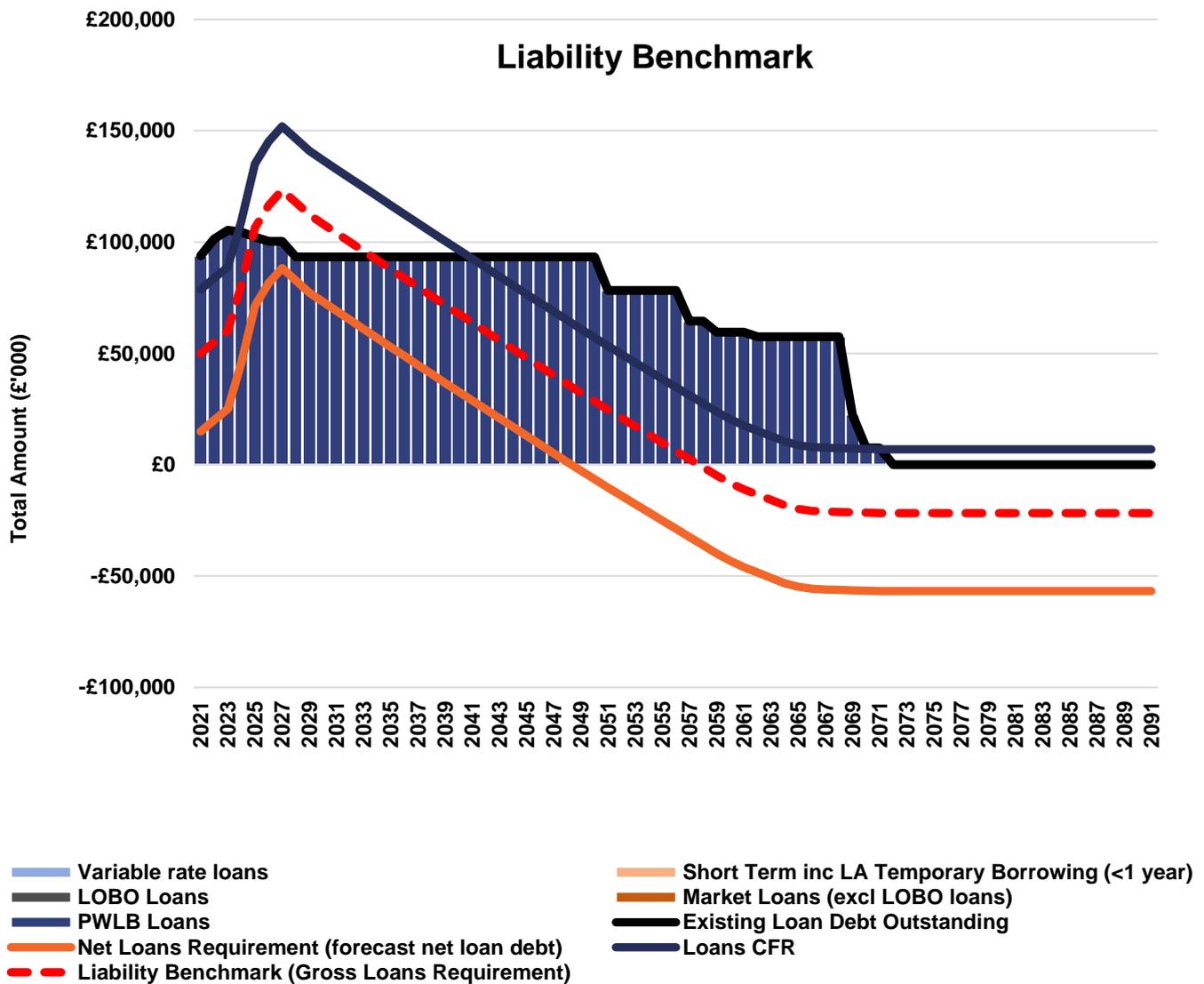
9.0 Liability Benchmark

- 9.1 A 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.
- 9.2 There are four components to the LB: -
- **Existing loan debt outstanding:** the Commissioner's existing loans that are still outstanding in future years.
 - **Loans CFR:** this is 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:** this will show the Authority’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.

9.3 The liability benchmark is a projection of the amount of loan debt outstanding that the authority needs each year into the future to fund its existing debt liabilities, planned prudential borrowing and other cash flows. This is shown by the gap between the authority’s existing loans that are still outstanding at a given future date and the authority’s future need for borrowing (as shown by the liability benchmark). In particular, the liability benchmark identifies the maturities needed for new borrowing in order to match future liabilities. It therefore avoids borrowing for too long or too short.

9.4 The Liability Benchmark chart is shown below:



EXTERNAL INVESTMENTS - APPROVED COUNTERPARTY LIST 2023/24

BRITISH BANKS & SUBSIDIARIES	FITCH RATING		LIMIT £m	GROUP	
	L/T	S/T		LIMIT	PERIOD
Lloyds Banking Group				30	6mth
Lloyds Bank	A+	F1	30		6mth
RBS Group				65	6mth
National Westminster	A+	F1	65		6 mth
Royal Bank of Scotland	A+	F1	65		6 mth
HSBC	AA-	F1+	30		1 year
Santander UK plc	A+	F1	30		6mth
Standard Chartered Bank	A+	F1	30		6mth
Barclays	A+	F1	30		6mth
Goldman Sachs	A+	F1	30		6mth
Handelsbanken Plc	AA	F1+	30		1 year
National Bank of Kuwait	A+	F1	30		6mth
Bank of England (DMADF)			100		1 year +

BUILDING SOCIETIES	FITCH RATING		LIMIT £m	PERIOD
	L/T	S/T		
Nationwide	A	F1	30	6mth
Leeds	A-	F1	30	100 days
Skipton	A-	F1	30	6mth
Yorkshire	A-	F1	30	100 days
Coventry	A-	F1	30	6mth

FOREIGN COUNTRIES	NATIONAL RATING	LIMIT	
		£m	PERIOD
Australia	AAA	20	3mth
Denmark	AAA	20	3mth
Germany	AAA	20	3mth
Netherlands	AAA	20	3mth
Singapore	AAA	20	3mth
Sweden	AAA	20	3mth
Switzerland	AAA	20	3mth
USA	AAA	20	3mth

Investments with foreign banks will only be made if they are in Sterling and it is economically attractive to do so. The minimal national credit rating for the country and bank must then be AAA.

LOCAL AUTHORITIES	LIMIT for each LA	PERIOD
	£000	
All Local Authorities**	30	1 year+

** Local authorities may be subject to lower limits throughout the year if they are deemed to be under severe financial stress.

Money Market funds		LIMIT £000	PERIOD
All	AAA	30	<1 year

Long Term Ratings AAA to DDD the best quality to junk bonds

Short Term Ratings F1+ to F3 the safest to the riskier

Local Authorities are assumed to have the same ratings as UK Government.

APPENDIX D

INVESTMENTS AS AT 06/03/23				
Maturity	Borrower	Principal	Rate	Type
		£	%	
17-Mar-23	Goldman Sachs	10,000,000	3.28	Bank
24-Mar-23	National Bank of Kuwait	10,000,000	3.81	Bank
24-Mar-23	National Bank of Kuwait	10,000,000	3.87	Bank
07-Jul-23	Dudley MBC	10,000,000	1.70	Local Authority
Instant	Money Market Fund CCLA	30,000,000	variable	
Instant	Money Market Fund Federated	30,000,000	variable	
5 to 10 years	CCLA	5,000,000	variable	Property Fund

Appendix E

Loan maturity profile

Maturity Date	Loan amount	Interest rate	Annual int. payable
15/10/2023	800,000	6.625%	53,000.00
15/10/2024	2,200,000	6.625%	145,750.00
15/10/2025	2,000,000	6.625%	132,500.00
30/11/2027	7,000,000	3.990%	279,300.00
23/01/2051	15,000,000	3.700%	555,000.00
15/06/2056	5,587,000	4.450%	248,621.50
01/03/2057	8,200,000	4.350%	356,700.00
15/08/2058	5,000,000	4.390%	219,500.00
01/09/2061	2,000,000	4.875%	97,500.00
07/12/2068	10,000,000	2.640%	264,000.00
10/12/2068	10,000,000	2.540%	254,000.00
12/02/2069	5,000,000	2.370%	118,500.00
28/03/2069	10,000,000	2.160%	216,000.00
08/10/2069	15,000,000	1.630%	244,500.00
14/03/2072	7,500,000	2.070%	170,250.00
TOTAL	105,287,000		3,340,121.50