North Somerset Council

REPORT TO THE AUDIT COMMITTEE

DATE OF MEETING: 27 JANUARY 2022

SUBJECT OF REPORT: TREASURY MANAGEMENT STRATEGY 2022/23

TOWN OR PARISH: ALL

OFFICER/MEMBER PRESENTING: AMY WEBB, DIRECTOR OF CORPORATE SERVICES

KEY DECISION: N/A

REASON: Not an Executive decision

RECOMMENDATIONS

The Audit Committee is requested to note the contents of the report which summarise the Treasury Management Strategy for 2022/23 and its associated impacts.

1. SUMMARY OF REPORT

The purpose of the report is to present the council's draft annual ***treasury management strategy*** (TMS) for the 2022/23 financial year and builds on the previous report on this matter, which was considered by the Audit Committee at its meeting in November 2021.

To provide further training and support in this area, an informal workshop session held on 11 January 2022, which was jointly facilitated by Finance Officers and Arlingclose, who are the council's treasury management advisors. This approach is consistent with previous years when specialist information sessions have also been arranged.

The report contains details of;

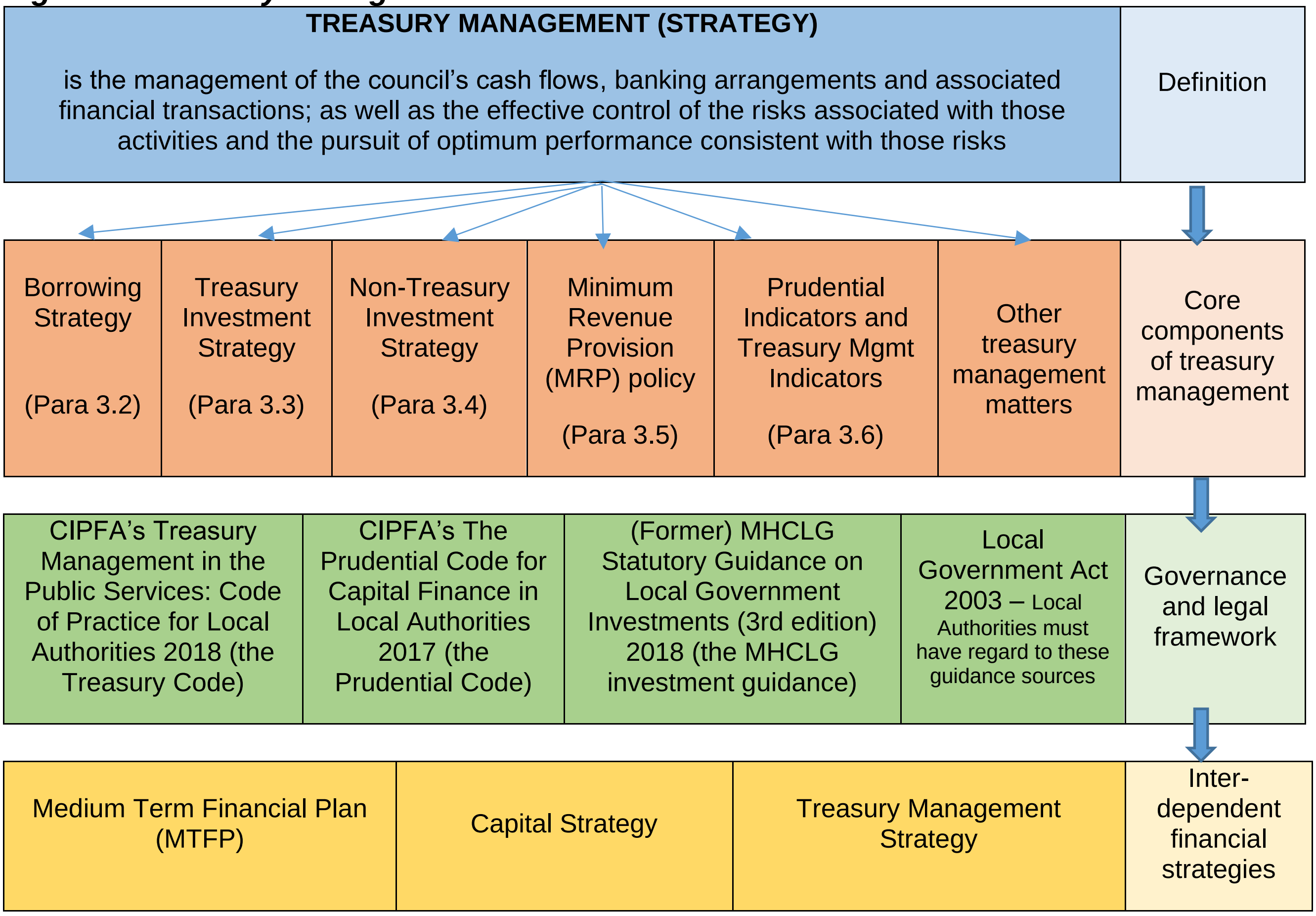
- how the council plans to manage its cash-flows and resources to ensure effective treasury management,
- the proposed Prudential Indicators for 2022/23, and
- the proposed policy for making Minimum Revenue Provision in respect of the repayment of the council's external debt, within the revenue budget.

2. POLICY

The council's budget process should ensure that all resources are planned, aligned and managed effectively to achieve the corporate aims and objectives of the council. The council's treasury related strategies link directly into the revenue and capital budget planning processes and all aim to support effective service delivery across the council, in this year, as well as across the medium term.

Treasury management, its definition, constituent parts and its relationships with other policies and regulation is depicted in Figure 1 below.

Figure 1: Treasury Management



Each of the core components of treasury management, as noted above, are summarised in **Section 3** with further technical detail provided within the Treasury Management Strategy in **Appendix 1**.

3. DETAILS

3.1 Introduction and 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 therefore to ensure that this cash flow is adequately planned, with cash being available when it is needed. Much of the day-to-day **treasury** activity is linked to investing surplus monies in low-risk counterparties or instruments commensurate with the councils' low 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, subject to it being appropriate and affordable having taken into account premature redemption costs.

The contribution the **treasury management** function makes to the council is therefore 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. Since cash balances generally result from reserves and balances, 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.

As expected given the nature of the transactions undertaken in this area, together with the significant amount and types of risk involved, treasury management is heavily regulated both in terms of legal statute, technical investment guidance provided by government departments as well as Codes of Practice issued by the Chartered Institute of Public Finance and Accountancy (CIPFA). The council is required to adhere to and give due regard, to all of these relevant frameworks.

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.”

This definition not only describes the various elements of treasury management activity, it also demonstrates how interlinked they are with other, which can make it difficult to explain the council’s technical and strategic plans for the year ahead, in a way that can be easily understood.

The report has therefore been drafted to summarise the council’s proposed approach for the 2022/23 financial within each of the following sections, with further detail contained within the appendices at the end of the paper;

- Borrowing strategy – paragraph 3.2
- Treasury investment strategy – paragraph 3.3
- Non-treasury investment strategy – paragraph 3.4
- Minimum revenue provision policy – paragraph 3.5
- Prudential indicators and treasury management indicators 3.6

3.2 Borrowing Strategy

3.2.1. Background and local context:

In some instances the council may find itself in a position whereby it may need to borrow short-term loans to cover unplanned cash flow shortages arising from operations. However, most of the council's borrowing activity is linked to its capital spending plans.

CIPFA's Prudential Code for Capital Finance in Local Government, requires the council to determine that all its capital expenditure and investment decisions are affordable, prudent and sustainable, and it must ensure that it sets limits on the amount that it can afford to borrow in the context of wider capital planning.

To understand whether new borrowing plans can be deemed affordable, the council must first understand its current borrowing position and then overlay planned changes.

On 31st December 2021, the council held £180m of borrowing which it has drawn down over a number of years to fund capital previous expenditure.

- £143m of this debt is held with the Public Works Loan Board (PWLB) at an average rate of 3.86%
- £ 12m of this debt relates to debt managed by Bristol City Council, in respect of the former Avon
- £ 25m of this debt relates to long-term leasing arrangements, the largest of which relates to the Sovereign Centre

The summary below details the estimated level of borrowing that are likely to be required over the next few years to fund the schemes that are included within the current capital programme, as well as those being requested for approval in the Capital Strategy report for 2022/23.

EXPENDITURE BUDGET	**2021/22 £'000**	**2022/23 £'000**	**2023/24 £'000**	**2024/25 £'000**	**2025/26 £'000**	**TOTAL £'000**
Approved Programme	**94,624**	**94,799**	**99,181**	**17,977**	**0**	**306,581**
- Planned additions to the programme	0	38,722	58,331	37,689	20,569	**155,311**
DRAFT CAPITAL PROGRAMME	**94,624**	**133,521**	**157,512**	**55,666**	**20,569**	**461,892**

FUNDING RESOURCES	**2021/22 £'000**	**2022/23 £'000**	**2023/24 £'000**	**2024/25 £'000**	**2025/26 £'000**	**TOTAL £'000**
Earmarked Grants and contributions	74,328	80,472	108,910	28,665	16,302	**308,677**
Unsupported Borrowing	14,216	48,969	43,263	27,274	4,267	**137,989**
Capital Receipts	1,510	1,621	1,500	1,562	0	**6,193**
Revenue Contributions	1,774	145	0	0	0	**1,919**
Non Earmarked Receipts	2,796	2,314	3,839	-1,835	0	**7,114**
	94,624	**133,521**	**157,512**	**55,666**	**20,569**	**461,892**

As can be seen from the table above, the overall level of new borrowing required over the period to 2026 is currently estimated to be £137.989m, with approximately £63.185m of this new borrowing being required to finance capital expenditure before the end of March 2023.

The summary above and all the borrowing calculations in this report only reflect proposals which are to be included within the council's approved capital programme. Should any further increases in borrowing or forward funding decisions subsequently be made beyond these levels, then further council approval would be required to re-state prudential indicators, and additional revenue resources identified to fund debt repayment costs.

The council may also borrow additional sums to pre-fund future years' requirements, providing that this does not exceed the authorised limit for borrowing, which is currently set at £244m.

3.2.2. Summary:

The council currently holds £180m of long-term debt and this would increase by a further £64m should the council spend the amount of capital expenditure that it plans to approve. Given the level of surplus cash-balances currently being held then the financial plan shows that the council does not anticipate a need to externalise this borrowing during 2022/23.

3.2.3. Objectives:

The council's main objectives when borrowing is to achieve a low but certain cost of finance, while retaining flexibility should plans change in future.

3.2.4. Proposed Strategy for 2022/23:

External borrowing decisions will be deferred in respect of the 2022/23 financial year and the focus would instead be to draw-down and access the council's internal borrowing through reducing cash balances.

3.2.5. Borrowing strategy beyond 2022/23:

Given the levels of planned investment the council recognises that it will be required to borrow externally over the period 2023-2026 however, before any future borrowing is considered, officers would seek advice from the council's treasury management advisors in relation to the potential costs of different options and to ensure an option proposal aligned to the objectives.

Whilst the council has previously raised the majority of its long-term borrowing from the PWLB it will consider long-term loans from other sources in the future, including banks, pensions and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. An important change for local authorities is that they are no longer able to draw down loans from the PWLB if their plans relate to buying investment assets primarily for yield. Given that the council does not intend to borrow for yield, then it is likely that we will retain access to PWLB loans if needed.

3.3 Treasury investment strategy

3.3.1. Background and local context

Given that the primary purpose of treasury management is linked to the management of cash-flows, then it must be accepted that the council will make investment decisions on an almost daily basis in order to smooth cash-flows and ensure that cash is planned and available when needed. These decisions and transactions are known as **treasury investments** and sums are often placed in short-term, low risk, highly liquid products which is commensurate with the council's low-risk appetite.

In addition to the daily cash-flows that are related to the annual budget, at any one time the council's balance sheet will show that it is also holding surplus cash-flows in respect of prior year activities, examples include the receipt of capital grants in advance of spending plans and also the retention of monies within reserves, which are may be held to fund future spending or be held to manage risk. It will be necessary for these funds to also be placed in treasury investments during the year however, it is possible that some of these investments could be placed in a more strategic way that is more aligned to the nature and timescale of the relevant cash-flow, i.e. investments could be made across a longer-period of time if it is understood that the monies may not be required for a specific period of time.

Irrespective of whether the treasury related investment is placed for a short or a longer period, it is essential that **all** such investments are placed in accordance with the both the legal framework as well as the council's approach to risk and defined objectives.

Before considering its Strategy for treasury investments for the year ahead it is therefore important to firstly understand;

- the current level of investment balances held and performance,
- market conditions, interest rates and future expectations,
- current regulatory framework and also future changes,
- annual cash-flow forecasts for the year ahead,
- planned profile of spending linked to capital receipts, grants and reserves,
- new investment plans, and
- any other strategic decisions that may have been taken elsewhere within the council's treasury management strategy (i.e. its borrowing strategy)

3.3.2. Summary:

In the past 12 months, the council's treasury investment balance has ranged between £112m and £190m which is significantly above levels in previous years. A review has been undertaken which show that this is, to a large extent, linked to the ongoing impacts of Covid-19, notably surrounding the cash flows related to the many support packages and intervention measures that the government has put in place over the past 2 years. Forecasts do indicate that these levels are expected to reduce by 31 March 2022 as sums are paid to businesses, providers and potentially returned to the government, and even further during 2022/23.

Arlingclose facilitate regular benchmarking programs to assess how the council's treasury management investment decisions and outcomes compare with other local authorities. Recent results show that the council's investment portfolio is not considered high risk, and, whilst investment returns have significantly reduced due to the current economic environment, the portfolio is providing returns in line with the risks being taken.

Market conditions currently show that interest rates are beginning to rise, initially driven by the recent bank of England base rate rise, it will therefore be important to consider interest rates before placing any long-term fixed rate investments as the council may inadvertently lock in funds and miss a potential opportunity. Arlingclose, as the council's appointed treasury advisors, provide on-going economic commentary and interest rate forecasts to assist the Council in formulating its treasury strategies. Key issues from the latest economic commentary are detailed in Appendix 1, Section 7.

The borrowing strategy described in para 3.2.4 above recommends that external borrowing is not taken, but spending will instead be offset against current surplus cash balances, i.e. it will be funded internally.

3.3.3. Objectives:

Both the CIPFA Code and the MHCLG Guidance require councils to have two underlying objectives, these being;

- Security – protecting the capital sum invested from loss; and
- Liquidity – ensuring the funds invested are available for expenditure when needed

The generation of yield is distinct from these two prudential objectives although guidance says that this does not mean that local authorities are recommended to ignore potential revenues but, recognises that it would be reasonable to consider what yield could be obtained, consistent with these priorities once proper levels of security and liquidity are determined, as well as the council's appetite to risk.

3.3.4. Treasury Investment Strategy for 2022/23:

A) The council continues to place short-term treasury investments in fixed and variable-term cash deposits with a range of counter-parties; this Strategy would reduce the risk of capital losses, ensure liquidity is maintained and also limits the council's exposure to interest rate risk losses as well as minimising exposure to credit risk through diversification. This will be achieved through the application of limits on the amount and period of its investments with individual counterparties, and in individual countries.

B) The council continues to place some medium to longer-term investments in alternative investment products; this Strategy would align some longer-term cash balances to longer term investment periods, provide further diversification of the portfolio in terms of product, counter-party / credit risk and inflationary risk. These types of investment will provide higher rates of return however, it must be accepted that they may potentially provide a capital loss should prices fall beyond the initial investment levels, which would need to be reflected within the annual revenue budget from April 2023.

C) The council will not use any of its surplus cash-flows to make non treasury related investments, as these would fall outside of the permissions of the treasury investment policies and guidance and they would also expose the council to the potential for further capital losses.

3.3.5. Approved counterparties and limits:

The council may undertake treasury related investments of surplus funds with any of the counterparty types below, subject to the limits shown.

Sector	Overall Limit[1]	In-house Limit	Tradition Limit	Time Limit
UK Central Government	**no limit**	unlimited	unlimited	50 years
UK Local Authorities[3]	**£15m**	£10m	£5m	25 years
Banks* and other organisations* (unsecured) whose lowest published long-term credit rating from Fitch, Moody's and Standard and Poor's is:				
AAA	**£30m**	£30m	£0m	5 years
AA+	**£25m**	£25m	£0m	5 years
AA	**£22m**	£22m	£0m	4 years
AA-	**£20m**	£16m	£4m	3 years
A+	**£18m**	£14m	£4m	2 years
A	**£16m**	£12m	£4m	13 months
A-	**£13m**	£9m	£4m	13 months
UK building societies* whose lowest long-term rating is A- and societies without credit ratings, that have an asset size of more than **£0.4bn**	**£10m**	£6m	£4m	6 months
UK building societies* whose lowest long-term rating is A- and societies without credit ratings, that have an asset size of more than **£1bn**	**£10m**	£6m	£4m	13 months
Money market funds[2] and similar pooled vehicles whose lowest published credit rating is AAA*	**£15m**	£15m	£0m	N/A
Pooled Investment funds	**£5m per Fund Type**	*£5m per Fund type*	£0m	N/A
The Council's Bank accounts	**Net £9m**	Net £9m	£0m	No limit

[1] *limits shown are per organisation*
[2] *as defined in the Local Authorities (Capital Finance and Accounting) Regulations 2003*
[3] *as defined in the Local Government Act 2003*
This table must be read in conjunction with the notes in **Appendix 1**

3.3.6. Investment limits:

The maximum that could be lent to any one organisation (other than the UK Government) will therefore **be £30m**. This will limit the potential loss in the case of a single bank. A group of banks under the same ownership will be treated as a single organisation for limit purposes.

There is no intention to restrict investments to banks and building society deposits, and investments may be made with any public or private sector organisation that meets the credit rating criteria above.

3.3.7. Minimum credit rating:

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

3.4 Non-treasury investment strategy

Non-treasury investments often include purchases which are deemed to be capital expenditure in nature, whether that be the purchase of financial assets, such as share capital in any body corporate or non-financial assets, such as the purchase of land or buildings.

To date, the council has not purchased share capital as this would provide potential exposure and further risk in terms of capital losses, which goes against the legal and regulatory framework in place for treasury related investments.

The council does however have non-treasury investments in the form of property through the commercial investment portfolio. The commercial strategy was approved by Council in January 2019, following professional advice provided by Montagu Evans. The strategy established a framework under which the council could acquire a portfolio of investments in commercial property which generate an income stream which can be used to contribute to the revenue budget pressures, whilst potentially providing capital appreciation over the longer-term.

Under this arrangement two assets have been acquired and the arrangements for the governance and management of associated risks of the council's service investments and commercial property investments is detailed in Section 5 of the Treasury Management Strategy shown at **Appendix 1**. No further commercial investments are being sought as this would be prohibited under the new borrowing permissions, which do not allow councils to borrow to generate a yield. There are no proposed changes to this area of the strategy for 2022/23.

3.5 Minimum Revenue Provision Statement

When the council funds capital expenditure by long-term borrowing, the costs are charged to the council tax-payer in future years, reflecting the long-term use of the assets procured. There are two elements to this cost – the interest on borrowing is charged in the year it is payable, and the principal (or capital) element is charged as a "minimum revenue provision" (MRP).

The Local Government Act 2003 requires the council to have regard to the former Ministry for Housing, Communities and Local Government's guidance on Minimum Revenue Provision (the MHCLG Guidance), most recently issued in 2018.

The broad aim of the MHCLG Guidance is to ensure that capital expenditure is financed over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

The MHCLG Guidance requires the council to approve an Annual MRP Statement each year, and recommends several options for calculating a prudent amount of MRP. The council's policy adopts options recommended in the Guidance, as well as locally determined prudent judgements in applying the recommended methodologies.

It is recommended that the council continues to apply the following policy to determine its MRP for 2022/23:

a. For capital expenditure incurred before 1st April 2008, the MRP for 'Supported borrowing' will be determined by writing down the Council's Capital Financing Requirement using a 'straight line' basis over the estimated average life of the relevant assets of 33 years. This approach results in the council charging the same value each year for this element of the MRP.

b. For capital expenditure incurred after 31st March 2008, the MRP for 'Prudential borrowing' will be determined by charging the expenditure over the expected useful life of the relevant asset, starting in the year after the asset becomes operational.

c. For assets acquired by finance leases, and for the transferred debt from Avon County Council, MRP will be determined as being equal to the element of the rent or charge that goes to write down the balance sheet liability.

d. Where former operating leases have been brought onto the balance sheet on 1st April 2022 due to the adoption of the IFRS 16 Leases accounting standard, and the asset values have been adjusted for accruals, prepayments, premiums and/or discounts, then the annual MRP charges will be adjusted so that the total charge to revenue remains unaffected by the new standard.

e. Capital expenditure incurred during 2022/23 will not be subject to an MRP charge until 2023/24.

It should be noted that the MRP charge associated with current capital spending approvals has been included within the budget for 2022/23 and the planned spending for 2022/23 has been factored into the council's medium term financial plan for 2023/24.

3.6 Prudential Indicators

Under the Local Government Act 2003, and the associated CIPFA Prudential Code for Capital Finance in Local Authorities, 'Prudential Indicators' relating to the revenue implications of capital programme decisions need to be approved by members and considered when setting the revenue and capital budgets.

The CIPFA Treasury Management Code of Practice also requires locally decided indicators relating to treasury activities to be approved.

These indicators provide information to Members on the affordability of the council's borrowing plans, and whether the impact of treasury management actions on the council's revenue budget are sustainable.

The Indicators are detailed in **Appendix 2**.

4. CONSULTATION

The Audit Committee has a key role to play in reviewing the council's treasury management arrangements and practices, and they routinely receive performance monitoring reports on the subject covering both prior and current years, as well as reports which provide an opportunity for discussion to take place to consider the proposed strategy for the year ahead. The latest reports were considered by the Committee in November 2021 and a further report will be considered at the meeting in January 2022.

Over recent years Member training and workshops have been provided to support understanding of technical matters, with the latest session held being in January 2022. The timing of the session enabled further opportunities to consider the proposed Strategy for 2022/23.

The meeting was facilitated by Arlingclose, the council's external advisors and featured information relating to the legal framework, the definitions and differences between capital and treasury investments and impacts, the types of investments available to the council and how these might fit in with the council's borrowing plans, as well as further information to understand the more strategic factors which are likely to influence treasury strategy decisions of a council.

5. FINANCIAL IMPLICATIONS

Financial implications are contained throughout the report. Treasury management decisions impact on both the revenue budget and the balance sheet in current and future years.

6. LEGAL POWERS AND IMPLICATIONS

Under the Local Government Act 2003 s1, and s12, local authorities may:

- invest money or borrow money:
- for any purpose relevant to their functions
- for prudent financial management

Under Local Government Act 2003 s2, and s13, local authorities must not:

- exceed their affordable borrowing limit
- borrow in foreign currency
- mortgage their property as security for loans borrowed

Under Local Government Act 2003 s3, s14, and s15, local authorities must:

- set and review affordable borrowing limits / authorised limits
- have regard to guidance published by CLG and CIPFA
    - CLG Investment Guidance
    - CIPFA Code of Practice on Treasury Management

- CIPFA Prudential Code

The council has adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2018 Edition (the CIPFA Code) which requires it to approve a treasury management strategy before the start of each financial year.

Under this guidance, the role of the (Full) Council is to:

- Set the budget and capital programme, including debt and investment interest, and the Minimum Revenue Provision
- Approve the Capital Strategy
- Approve the Treasury Management Strategy (which includes the (Non-Treasury) Investment Strategy)
- Approve the Prudential Indicators
- Approve Treasury Management Indicators
- Approve the MRP policy statement

Under the Local Authorities (Functions and Responsibilities) (England) Regulations 2000, local authorities must not delegate the approval of an annual strategy to any committee or person.

The role of the Executive is to consider these strategies, and, if appropriate, recommend them for approval by Council.

Treasury risk management at the council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2018 Edition (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year. This report fulfils the council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

7. CLIMATE CHANGE & ENVIRONMENTAL IMPLICATIONS

The council will continue to avoid any direct treasury management investments in fossil fuel related companies and will engage with its advisors to explore and assess the potential for any future investment opportunities in funds with a Renewable Energy & Sustainability focus as these products continue to be developed by the market in response to the Climate & Nature Emergency agenda.

The council has maintained its funds placed in a "Green Deposit Account", which is an investment facility that ensures deposits are linked to a wide range of projects in the pursuit of transition to a lower carbon economy. These projects cover a variety of themes including energy efficiency renewable energy, green transport, sustainable food, agriculture and forestry and greenhouse gas emission reductions.

It is also the intention to better understand the extent to which other investments held may contribute towards climate change, understand exposure to risks driven by climate change, and to keep abreast of potential investment opportunities that have regard to climate change. However, the primary considerations will remain security and liquidity, then yield.

8. RISK MANAGEMENT

Members will be aware that there is a direct link between the levels of risk and the levels of return achieved on investment, although there are many other factors which also affect the capital financing budgets.

The council's treasury management activities expose it to a variety of financial risks, notably:

a. credit risk – the risk that other parties might fail to pay amounts due to the council. Includes bail-in risk – the risk that shareholders and depositors in banks and building societies bear losses in the event of counter-party's failure or reduction in net asset value,
b. liquidity and re-financing risk – the risk that the council might not have funds available to meet its commitments to make payments as they fall due,
c. market risk (interest rate and price risks) – the risk that financial loss might arise for the council as a result of changes in such measures as interest rates, investment valuations, and stock market movements.

The council's Treasury Management Strategy sets out the council's approach to managing these risks.

A summary of the risks relating to treasury management that the council is exposed to, and the mitigation arrangements in place through the Treasury Management Strategy, is detailed at **Appendix 3.**

The priority of the Treasury Management Strategy will continue to be the reduction of risk to safeguard public resources.

The risk appetite of the council is low in order to give priority to the security of its investments. The council will also aim to achieve the optimum return on its investments commensurate with desired levels of security and liquidity.

It should be noted that the council's Treasury Management Strategy sets out how the council manages and mitigates these risks but cannot eliminate risks completely.

9. EQUALITY IMPLICATIONS

Have you undertaken an Equality Impact Assessment? N/A

10. CORPORATE IMPLICATIONS

The safeguarding of public money is critical to the council's reputation, and the measures contained within the report are intended to address member and public concerns and ensure an appropriate balance of return on investment whilst ensuring managing associated risks.

11. OPTIONS CONSIDERED

This report considers the strategy to be followed during 2022/23, for investment and borrowing, which have been aligned with the capital programme. It also sets out the council's expectation for interest rates and highlights the uncertainties and risks in the forecast due to market conditions.

Furthermore, the report considers those aspects of treasury policy that change annually or more frequently, highlighting the council's views or interpretation of factors that may influence treasury management decisions and proposes how these matters will be dealt with during 2022/23.

The CIPFA Code and MHCLG statutory guidance require the authority to set out its approach to non-treasury investments. A summary of the impact and the council's approach is included in **paragraph 3.2** of this report.

The council's Treasury Management Strategy is broadly consistent with the previous strategy and is developed from and complies with the council's Treasury Management Policy and takes account of the CIPFA code and MHCLG guidance referred to above.

The Prudential Code and Treasury Management Codes of Practice have been updated effective from December 2021. Due to the late publication, and that not all guidance has been published at the time of writing, full adoption of the reporting requirements has been deferred until 2023/24 as permitted by the Code.

APPENDICES
1. Treasury Management Strategy for 2022/23
2. Prudential Indicators for 2022/23
3. Treasury Risk Register
4. Glossary of Terms

AUTHORS

Amy Webb, Director of Corporate Services
Amy.webb@n-somerset.gov.uk

Mark Anderson, Principal Accountant (Resources & Financial Planning)T: 01934 634616
Mark.Anderson@n-somerset.gov.uk

Melanie Watts, Head of Finance T: 01934 634618
Melanie.Watts@n-somerset.gov.uk

BACKGROUND PAPERS

Other relevant guidance includes:
- CIPFA – The Prudential Code for Capital Finance in Local Authorities 2017
- MHCLG – Statutory Guidance on Local Government Investments (3rd edition) 2018
- CIPFA - Treasury Management in Public Services – Guidance notes for local authorities 2018

1 INTRODUCTION

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

The council maintains and operates a treasury management policy comprising the principles and practices to which the activity will comply. Alongside this policy, the council must have regard to the (former) Ministry for Communities and Local Government (MCLG) guidance (the MHCLG guidance), under section 15(1)(a) of the Local Government Act 2003. This guidance provides for each authority to determine its own controls within a given framework.

Any external investment managers employed by the council are required, contractually, to comply with this Strategy.

2 STRATEGY OVERVIEW

Under the Local Government Act 2003, the council may invest money or borrow money:
- for any purpose relevant to its functions, and
- for prudent financial management.

The council invests its money for three broad purposes:
- Treasury management investments – ie management of operational cashflows. Investment of surplus cash balances generated as a result of its day-to-day activities, for example when income is received in advance of expenditure,
- Service investments - to support local public services by lending to, or buying shares in other organisations, and
- Commercial investments - to earn investment income, usually rental income, and to provide capital appreciation, from a portfolio of property investments.

The strategy for 2022/23 in respect of the following aspects of the treasury management function is based upon the treasury officers' views on risks and interest rates, supplemented with advice provided by the council's treasury advisors, currently Arlingclose Ltd.

The strategy covers:
- Section 3 - current treasury portfolio
- Section 4 - the treasury investment strategy
- Section 5 - the non-treasury investment strategy
- Section 6 - the borrowing strategy
- Section 7 - interest rates and economic outlook
- Section 8 - other treasury management matters

3 CURRENT TREASURY PORTFOLIO

The Council's current treasury portfolio, as at 31st December 2021 is as follows:

Table 5: Current portfolio of borrowing and investment balances

LONG-TERM DEBT	**Principal £m**		**Average rate**	**Average term**
Fixed rate – PWLB	£142.9	£142.9	3.86%	1-36 years
Other long-term liabilities; - Ex-Avon loan debt - Other (incl leasing)*	 £12.0 £24.7	 £36.7	 4.82% 4.60%	 1-30 years 1-40 years
TOTAL DEBT		**£179.6m**		
SHORT-TERM TREASURY INVESTMENTS	**Principal £m**		**Average rate**	**Average term**
Managed in-house; - UK banks - UK building societies - Local authority/ DMO	 £13.0 £22.0 £116.0	 £151.0	 0.15% 0.17% 0.10%	 12 months 6 months 8 months
Cash managed by Tradition; - Local authority/ DMO	 £10.0	 £10.0	 0.10%	 10 months
LONG-TERM TREASURY INVESTMENTS	**Principal £m**		**Average rate**	**Average term**
Managed in-house; - CCLA - UBS Multi Asset Income Fund - Ninety-One Diversified Income Fund	 £5.0 £1.0 £4.0	 £10.0	 4.63% 4.69% 3.59%	 3-5 years 3-5 years 3-5 years
TOTAL TREASURY INVESTMENTS		**£171.0m**		
TOTAL NET DEBT		**£8.6m**		

**The lease principal, rate and term as at the previous year end (31st March 2021) - updated figures will be calculated at the end of the financial year.*

The maturity profile of the Council's PWLB borrowing and investments is as follows (excluding Avon loan debt and lease liabilities):

Table 6: maturity profile of the Council's PWLB borrowing and investments

MATURITY PROFILE	**PWLB LONG TERM DEBT £m**	**SHORT TERM INVESTMENTS £m**	**NET DEBT / (INVESTMENT) £m**
Maturing Jan to March 2022	£2.5	£36.0	(£33.5)
Maturing 2022/23 & 2023/24	£6.0	£125.0	(£119.0)
Maturing 2024/25 to 2026/27	£28.3	£0	£28.3
Maturing 2027/28 to 2031/32	£31.1	£0	£31.1
Maturing 2032/33 to 2036/37	£33.0	£0	£33.0
Maturing 2037/38 to 2041/42	£22.0	£0	£22.0
Maturing after 2041/42	£20.0	£0	£20.0
TOTALS	**£142.9**	**£161.0**	**(£18.1)**

4 TREASURY INVESTMENT STRATEGY

4.1 The council typically receives its income in cash (e.g. from taxes and grants) before it pays for its expenditure in cash (e.g. through payroll and invoices). It also holds reserves for future expenditure and collects local taxes on behalf of other local bodies and central government. These activities, plus the timing of borrowing decisions, lead to a cash surplus which is invested in accordance with guidance from CIPFA.

4.2 **Contribution:** The contribution that these investments make to the objectives of the council is to support effective treasury management activities.

4.3 **Objectives:** Both the CIPFA Code and the MHCLG Guidance require councils to invest their treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield.

4.4 **Negative interest rates:** The COVID-19 pandemic has increased the risk that the Bank of England will set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. Since investments cannot pay negative income, negative rates will be applied by reducing the value of investments. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

4.5 **Strategy:** The council minimises its exposure to credit risk through diversification, through the application of limits on the amount and period of its investments with individual counterparties, and in individual countries.

4.6 The council's current investment strategy allows surplus cash balances to be managed by two treasury teams, each having distinct and separate controls and flexibilities. This allows the council to spread risk by investing in different financial products, and utilising experienced external cash managers, who do not have responsibilities for managing the council's daily cash-flows. The treasury teams are;

a. Tradition UK Ltd
b. In-house Treasury Team

4.7 **Approved counterparties:** The approved counterparties and notes are included in **Table 3** in the main body of the report. Further details on each of the permitted counterparties are included below.

4.8 The maximum duration of the investment will depend upon its lowest published long-term credit rating, time limits are included within the table.

4.9 Long-term investments will be limited to 50% of the counter-party limit (except the UK Government). The combined value of short-term and long-term investments with any organisation will not exceed the limits for investments in the table above.

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

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

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

4.13 **Strategic pooled funds:** Bond, equity and property funds that offer enhanced returns over the longer term but are more volatile in the short term. These allow the council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the council's investment objectives will be monitored regularly.

4.14 **Operational bank accounts:** The council may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £9m per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the council maintaining operational continuity.

4.15 **Risk assessment and credit ratings**: One of the key ways that the council manages credit risk is by using credit ratings.

4.16 The council uses long-term credit ratings from the three main rating agencies, Fitch Ratings Ltd, Moody's Investors Service Inc and Standard & Poor's Financial Services LLC, to assess the risk of investment default. The lowest available credit rating will be used to determine credit quality.

4.17 Long-term ratings are expressed on a scale from AAA (the highest quality) through to D (indicating default). Ratings of BBB- and above are described as 'investment grade', while ratings of BB+ and below are described as 'speculative grade'. The council's credit rating criteria are set to ensure that it is unlikely that the council will hold speculative grade investments, despite the possibility of repeated downgrades.

4.18 Credit ratings are obtained and monitored by the council's treasury advisers on at least a monthly basis, who will notify changes in ratings as they occur.

4.19 **Other Information on the security of investments:** Full regard will be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the council's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

4.20 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the council's cash balances, then the surplus will be deposited with the UK Government, or with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

4.21 Foreign countries

4.22 Investments in foreign countries will be limited to those that hold a AAA, AA+ or AA sovereign credit rating from all three major credit rating agencies, and to a maximum of **£12 million per country**, this limit to be divided between the in-house team (£8m) and cash manager Tradition (£4m). There is no limit on investments in the UK whatever the sovereign credit rating.

4.23 Banks that are domiciled in one country but are owned in another country will need to meet the rating criteria and will count against the limit for both countries. Overseas subsidiaries of foreign banking groups will normally be assessed according to the country of domicile of the parent organisation. However, Santander UK plc (a subsidiary of Spain's Banco Santander) will be classed as a UK bank due to its substantial UK franchises and the arms-length nature of the parent-subsidiary relationship.

4.24 Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

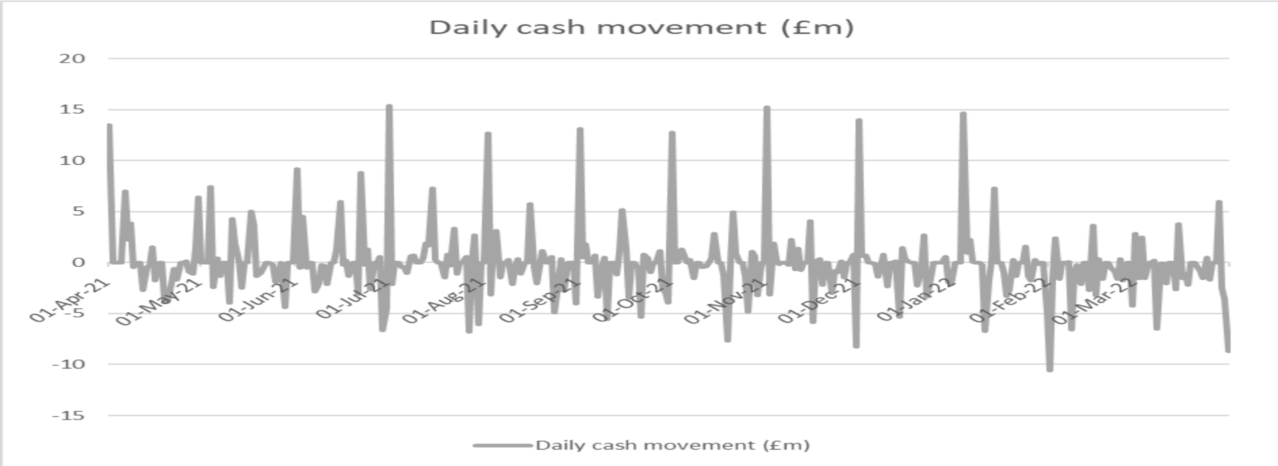
4.25 Liquidity management

4.26 The council uses a series of control spreadsheets to monitor and forecast the council's cash flows, to determine the maximum period for which funds may prudently be committed, and to manage the council's exposure to liquidity and re-financing risks. The forecast is compiled on a prudent basis, with receipts under-estimated and payments over-estimated to minimise the risk of the council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the council's medium term financial plan and cash flow forecast.

4.27 The council has an agreed overdraft facility, and access to sources of cash such as borrowing from the PWLB, and other counterparties, such as banks and other local authorities. In addition, the council's investment holdings can be readily realised, if required.

4.28 Management of cash-flows

Annual cash-flow forecasts can be seen in the table below.



4.29 Although the cash-flow movements could be described as fluctuating or potentially even volatile, trends do begin to emerge when the nature of the movements are understood, for example;

- Significant inflows include council tax and business rates income, government grants and subsidy used to support and fund parts of the annual revenue budget including schools, contributions from stake-holders in respect of funding agreements (e.g. health partners), grants and contributions used to fund capital projects. Some of these inflows follow a regular pattern, which may be weekly, bi-weekly, monthly or quarterly and others do not, they simply arrive into the councils bank accounts.

- Significant outflows include monthly payments to staff, pension providers and government agencies, payments to suppliers 3 times each week covering both revenue and capital spending, payment of housing benefits, payments to major preceptors such as Fire, Police, Environment Agency, Town and Parish councils.

4.30 Over the past two years the councils cash-flows have been significantly impacted by Covid as it has received significant amounts of additional funding and support packages, both in relation to the council's own budget, as well as when it has been acting as an agent for the government by passporting monies onto individuals, suppliers and businesses.

4.31 Whilst the new capital investment spending totals are anticipated for next year, the spending profiles associated with them have yet to be developed in any detail although it is estimated that less spending will be incurred during the first quarter of the year.

4.32 The intended borrowing strategy for 2022/23 recommends that external borrowing is not taken, but spending will instead be offset against current surplus cash balances, i.e. it will be funded internally, which means that cash-flow forecasts for next year will decrease from current levels.

5 NON-TREASURY INVESTMENT STRATEGY

5.1 This non-treasury management investment strategy focuses on the council's service investments and commercial property investments.

5.2 Service investments: Loans

5.3 Loans to social enterprises and local businesses may potentially be considered where they contribute to the council's overall objectives, through inclusion in the MTFP, treasury management and capital strategies. Where investment in regeneration and infrastructure in North Somerset clearly support local public services, and stimulate local economic growth, financing may also potentially be considered on projects that offer adequate security and returns, subject to the council having sufficient resources available to it at that time.

5.4 The only loan approved to date is an amount of £0.9m lent to a care home provider in 2008. The care provider has subsequently made repayments (including interest) in line with its agreed schedule. The outstanding balance at the time of writing is £0.8m.

5.5 Commercial investments: Property

5.6 The council's Commercial Investment Strategy was approved by Council in January 2019. In line with this strategy, the council has made two investments in commercial property to earn investment income, through a combination of rental and car parking income, whilst potentially providing capital appreciation over the long-term.

5.7 The investments made under the strategy to date consist of one outright purchase funded from long term borrowing, the North Worle District Centre, and one property acquired under a finance lease, the Sovereign Centre in Weston-super-Mare. Other sums have been set aside for improvements to the Sovereign Centre. There were no purchases or sale of assets during the year.

5.8 In February 2021 the Executive approved a revised Sovereign Centre Business Plan, setting out the challenges, opportunities and a new vision for the property. As part of this Business Plan, some of the vacant retail space within the centre is to be converted into office space to diversify away from pure retail use. Funding for this investment will come from the Getting Building Fund, which is a government grant with the regional allocation administered by the West of England Combined Authority (Weca).

5.9 After servicing costs, fees and borrowing costs, these assets are budgeted to generate an annual net return to the revenue budget of £0.3m (2021/22 £0.1m).

5.10 Commercial property investments are likely to be less liquid than financial investments, as property may take time to sell in certain market conditions. The council's commercial property investments are considered sufficiently proportionate to its overall investment and borrowing balances to not be likely to significantly impact on the council's overall liquidity position.

5.11 The council has no plans to dispose of its commercial investment properties at this time.

6 BORROWING STRATEGY

6.1 <u>Local context</u>

6.2 Forecast changes to the capital financing requirement and borrowing forecasts are shown in the balance sheet analysis in the table below.

Capital Financing Requirement vs forecast borrowing

	Actual 31/3/21 £m	Forecast 31/3/22 £m	Estimate 31/3/23 £m	Estimate 31/3/24 £m	Estimate 31/3/25 £m
Overall CFR	184.9	193.1	236.7	270.8	286.8
Less: CFR re finance leases and Ex Avon loan debt*	-34.7	-33.9	-33.0	-32.1	-31.3
CFR re loan debt	150.2	159.2	203.7	238.7	255.5
Less: External borrowing **	-150.6	-143.4	-200.9	-170.6	-142.6
Implies: Internal borrowing	-0.4	15.8	2.8	68.1	112.9

*

finance leases and Ex-Avon loan debt that form part of the Council's total debt
*** includes capital expenditure included in the Capital Strategy, but not yet approved*

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

6.4 The council's Capital Strategy forecasts indicate that it is likely to need to borrow to finance its planned capital expenditure. The decision of whether, and when, to take external borrowing will be made considering current and forecast interest rates. The council may choose to finance this borrowing requirement from its operational cash resources, known as 'internal borrowing'. This reduces interest costs and exposure to other risks.

6.5 CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. The table in para 6.2 above shows that the Authority expects to comply with this recommendation during 2022/23.

6.6 **Sources of borrowing:** the approved sources of long-term and short-term borrowing are:

a) HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
b) Other Local Authorities and Pension Funds (except the Avon Pension Fund)
c) UK Municipal Bond Agency plc and other special purpose companies created to enable local authority bond issues
d) Funds administered by the West of England Combined Authority including

i) Revolving Infrastructure Fund
ii) Local Growth Fund
iii) Economic Development Fund

e) any institution approved for investments (see above)
f) any other bank or building society on the Financial Services Authority list

6.7 **Other sources of debt finance:** In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

a) leases
b) private finance initiative schemes
c) sale and leaseback
d) revolving infrastructure grants

6.8 The council's debt portfolio is managed to ensure that the maturity profile will not leave any one future year with a high level of repayments that could present difficulties in refinancing. Fixed rate loans are usually taken to lock into known interest rates, thus protecting against fluctuations and providing certainty when managing and setting the budget.

6.9 Whilst the above deals with past or present borrowing requirements, it is also possible to borrow in advance of need where there is a clear business case for doing so and only for the approved capital programme or to finance future debt maturities, as permitted by the guidance. Borrowing in advance of need introduces additional credit and interest risk. Whilst there is no present intention to borrow in advance, all risks will be considered as part of any borrowing decision, should conditions favour such action.

6.10 Furthermore, the PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. The council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

7 INTEREST RATES AND ECONOMIC OUTLOOK

7.1 **Economic background:** The ongoing impact on the UK from coronavirus, together with higher inflation, higher interest rates, and the country's trade position post-Brexit, will be major influences on the council's treasury management strategy for 2022/23.

7.2 The Bank of England (BoE) increased Bank Rate to 0.25% in December 2021 while maintaining its Quantitative Easing programme at £895 billion. The Monetary Policy Committee (MPC) voted 8-1 in favour of raising rates, and unanimously to maintain the asset purchase programme.

7.3 Within the announcement the MPC noted that the pace of the global recovery was broadly in line with its November Monetary Policy Report. Prior to the emergence of the Omicron coronavirus variant, the Bank also considered the UK economy to be evolving in line with expectations, however the increased uncertainty and risk to activity the new variant presents, the Bank revised down its estimates for Q4 GDP growth to 0.6% from 1.0%. Inflation was projected to be higher than previously forecast, with CPI likely to remain above 5% throughout the winter and peak at 6% in April 2022. The labour market was generally performing better than previously forecast and the BoE now expects the unemployment rate to fall to 4% compared to 4.5% forecast previously, but notes that Omicron could weaken the demand for labour.

7.4 UK CPI for November 2021 registered 5.1% year on year, up from 4.2% in the previous month. Core inflation, which excludes the more volatile components, rose to 4.0% y/y from 3.4%. The most recent labour market data for the three months to October 2021 showed the unemployment rate fell to 4.2% while the employment rate rose to 75.5%.

7.5 **Credit outlook:** Since the start of 2021, relatively benign credit conditions have led to credit default swap (CDS) prices for the larger UK banks to remain low and had steadily edged down throughout the year up until mid-November when the emergence of Omicron has caused them to rise modestly. However, the generally improved economic outlook during 2021 helped bank profitability and reduced the level of impairments many had made as provisions for bad loans. However, the relatively recent removal of coronavirus-related business support measures by the government means the full impact on bank balance sheets may not be known for some time.

7.6 The improved economic picture during 2021 led the credit rating agencies to reflect this in their assessment of the outlook for the UK sovereign as well as several financial institutions, revising them from negative to stable and even making a handful of rating upgrades.

7.7 Looking ahead, while there is still the chance of bank losses from bad loans as government and central bank support is removed, the institutions on the council’s counterparty list are well-capitalised and general credit conditions across the sector are expected to remain benign. Duration limits for counterparties on the council’s lending list are under regular review and will continue to reflect economic conditions and the credit outlook.

7.8 **Interest rate forecast:** The council’s treasury management adviser Arlingclose is forecasting that Bank Rate will continue to rise in calendar Q1 2022 to subdue inflationary pressures and the perceived desire by the BoE to move away from emergency levels of interest rates.

7.9 Investors continue to price in multiple rises in Bank Rate over the next forecast horizon, and Arlingclose believes that although interest rates will rise again, the increases will not be to the extent predicted by financial markets. In the near-term, the risks around Arlingclose’s central case are to the upside while over the medium-term the risks become more balanced.

8 OTHER TREASURY MANAGEMENT MATTERS

8.1 The CIPFA Code requires the council to include the following in its treasury management strategy:

8.2 **Financial Derivatives**: Councils may make use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals), and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

8.3 In line with the CIPFA Code, the council will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications. The council has no plans to make use of financial derivatives in 2022/23.

8.4 **Markets in Financial Instruments Directive:** The council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the council's treasury management activities, the Section 151 Officer believes this to be the most appropriate status.

1.1 INTRODUCTION

Having adopted both the CIPFA Treasury Management in the Public Services Code of Practice, and also the Prudential Code for Capital Finance in Local Authorities, the council is required follow the elements within the Guidance and set 'indicators' which demonstrate that it follows good practice and has implemented and operates within appropriate systems of control before making capital financing and treasury management decisions.

1.2 PRUDENTIAL INDICATORS: '<u>PRUDENTIAL' CODE</u>

The Prudential Code aims to improve the transparency of investment decisions. The Code include the requirement to produce a Capital Strategy, and the inclusion of prudential indicators within the report to allow the reader to understand the forecast the council's overall debt levels, in conjunction with the capital programme and investment decisions, and how this external borrowing will be repaid.

1.2.1 <u>Authorised borrowing limit and Operational limit</u>

The council is required to set an 'affordable borrowing limit' (also termed the 'authorised limit for external debt') each year. In line with statutory guidance, a, lower, "operational boundary" is also set, as a warning level should debt approach the affordable borrowing limit.

The **authorised limit** is the 'affordable borrowing limit' which the council is required to set in section 3 of the Local Government Act 2003 and <u>cannot be exceeded</u> without acting ultra vires. The authorised limit is set at a higher level than the operational boundary to provide headroom for unexpected borrowing requirements.

The **operational boundary/ limit** should be the council's best estimate of the most likely, prudent, maximum levels of debt to be held during the years in question. The boundary <u>can</u> be exceeded in the short-term should the council need to undertake temporary borrowing, or debt rescheduling, but should not be exceeded for new long-term borrowing proposals.

Table 1.2.1: *PI: Authorised limit and operational boundary for external debt*

Authorised limit and operational boundary for external debt	2021/22 limit £m	2022/23 limit £m	2023/24 limit £m	2024/25 limit £m
Authorised limit – total external debt	234	243	283	254
Operational boundary – total external debt	224	238	260	229

It is currently estimated that long-term borrowing at the end of 2022/23 will be **£169.7m** (PWLB debt £134.4m, Salix £2.3m, Ex Avon loan debt £11.3m, and finance leases £21.7m).

The council's Treasury Management Strategy aims to keep sufficient, but not excessive, cash available to meet the council's spending needs, while managing the associated risks. Surplus cash is invested until required to produce a return, while shortages of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account.

The council is typically cash rich in the short-term as revenue income is received before it is spent, but cash poor in the long-term as capital expenditure is incurred before being financed. Due to decisions taken in the past, the council currently has £179.6m external borrowing, charging an average interest rate of 4.0%, and £171m treasury investments, earning an average rate of 0.35%.

1.2.2 Capital Expenditure

This indicator details the Capital Expenditure to be incurred by the council. The actual spend for 2020/21, the revised programme for 2021/22 and totals for the proposed programmes for 2022/23 to 2024/25, as set out in the Capital Strategy, are shown below.

***Table 1.2.2**: PI: Capital expenditure*

Capital Expenditure	Actual 2020/21 £m	Forecast 2021/22 £m	Estimate 2022/23 £m	Estimate 2023/24 £m	Estimate 2024/25 £m
Total Capital Expenditure	41.9	94.6	133.5	157.7	55.7

1.2.3 Actual external debt and the Capital Financing Requirement

In this indicator, projected levels of the council's total outstanding external debt (which comprises borrowing and leases) are compared with the Capital Financing Requirement. The Capital Financing Requirement measures the council's underlying need to borrow for a capital purpose for the current and future year. The actual Capital Financing Requirement as at the year-end is included in each year's statutory accounts.

***Table 1.2.3:** PI: Gross external debt and the Capital Financing Requirement*

Gross external debt and the Capital Financing Requirement	Actual as at 31/3/21 £m	Forecast as at 31/3/22 £m	Estimate as at 31/3/23 £m	Estimate as at 31/3/24 £m	Estimate as at 31/3/25 £m
Capital Financing Requirement	184.9	193.1	235.7	270.6	286.5
Total Debt (incl leases ex-Avon)	185.3	177.2	232.9	203.9	175.5

Statutory guidance is that total debt should remain below the Capital Financing Requirement, except in the short-term. As can be seen from the table above, the council expects to comply with this requirement in the medium-term.

In accordance with best professional practice, North Somerset Council does not associate its borrowing with particular items or types of expenditure. The council manages its treasury position, borrowings and investments in accordance with its approved Treasury Management Strategy and practices. In day-to-day cash management, no distinction is made between revenue cash and capital cash. External borrowing arises because of all the financial transactions of the council, and not simply those arising from capital spending. The council may choose to finance capital expenditure from its existing operational cash resources, rather than undertaking external borrowing, in order to minimise interest costs.

In contrast, the Capital Financing Requirement reflects the council's underlying need to borrow for a capital purpose. The capital financing requirement indicators shown above reflect the totality of the capital expenditure contained within the proposed capital programme.

1.2.4 Affordability - Ratio of Financing Costs to Net Revenue Stream

Although capital expenditure is not charged directly to the revenue budget, interest payable on loans, the MRP, and loans fund repayments are charged to revenue, offset by any investment income receivable. The net annual charge is known as the council's financing costs. In this indicator, financing costs are compared to the net revenue stream i.e. the amount funded from Council Tax, business rates and general government grants, to provide a measure of the affordability of the council's forecast borrowing.

Table 1.2.4*: PI: Proportion of financing costs to net revenue stream*

	Actual 2020/21	**Forecast 2021/22**	**Estimate 2022/23**	**Estimate 202324**	**Estimate 2024/25**
Net Financing costs (£m)	£10.3m	£10.7m	£11.5m	£12.6m	£13.6m
Proportion of net revenue (%)	6.4%	6.0%	6.1%	6.6%	7.0%

1.2.5 Maturity structure of borrowing

Refinancing risk is the risk that a borrower cannot refinance by borrowing to repay existing debt. In order to address this risk, limits are set of the proportions of the council's borrowing which are due to fall due in specified periods.

Table 1.2.5*: PI: upper & lower limits on borrowing maturities, as a % of total borrowing:*

Maturity Structure of Borrowing	**Upper**	**Lower**
Under 12 months	50%	0%
12 months and within 24 months	30%	0%
24 months and within five years	40%	0%
5 years and within 10 years	50%	0%
10 years and above	100%	0%

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

1.2.6 Principal sums invested for periods longer than a year

The purpose of this indicator is to control the council's exposure to the risk of incurring losses by seeking early repayment of its investments.

Table 1.2.6: PI: The limits on the total principal sum invested with final maturities longer than 365 days beyond the period end:

Investments longer than 365 Days	**2022/23**	**2023/24**	**2024/25**
Limit on principal invested with maturities longer than 365 days beyond year end	£60m	£50m	£50m

1.3 TREASURY MANAGEMENT INDICATORS: ‘TREASURY CODE’

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

1.3.1 Interest rate exposures

The treasury management team has an active strategy for assessing interest rate exposure that feeds into the setting of the annual budget, and which is used to update the budget quarterly during the year. This allows any adverse changes to be identified and accommodated. The analysis also informs whether new borrowing is taken out at fixed or variable interest rates.

1.3.2 Total value exposure to risk

The first indicator below shows the council’s total exposure to potential investment losses.

***Table 1.3.2**: Total investment exposure in £millions*

Total investment exposure	**Actual Held as at 31/03/21 £m**	**Forecast Held as at 31/03/22 £m**	**Forecast Held as at 31/03/23 £m**
Treasury management investments	143.0	127.0	107.0
Service investments: Loans	0.8	0.8	0.8
Commercial investments: Property*	32.6	32.6*	32.6*
TOTAL EXPOSURE	**176.4**	**160.4**	**140.4**

** Commercial investment properties are re-valued annually by the council’s valuers - valuations as at 31/3/22 are not yet available and cannot be forecast with reasonable certainty.*

As noted above, there are significant uncertainties over the timing and amounts of cash balances available for investment during the Covid pandemic. Significant uncertainty also applies to the valuation of commercial property investments during the current economic environment.

1.3.3 Rate of return received on investments

This indicator shows the investment income received less the associated costs, including the cost of borrowing where appropriate, as a proportion of the sum initially invested. Note that due to the complex local government accounting framework, not all recorded gains and losses affect the revenue account in the year they are incurred.

***Table 1.3.3**: Investment rate of return (net of all costs)*

Investments net rate of return	**Actual 2020/21 %**	**Forecast 2021/22 %**	**Forecast 2022/23 %**
Treasury management investments	0.56	0.37	0.53
Service investments: Loans	2.38	2.36	2.36
Commercial investments: Property	0.10	0.27	-0.10
ALL INVESTMENTS	**0.42**	**0.35**	**0.35**

Treasury management risk register

Risk	Impact	Probability	Unmitigated risk	Mitigating arrangements:	Revised probability	Residual risk
Credit risk						
- Loss of principal and/or interest due to counter-parties not being able to meet principal / interest payments as they fall due. Includes losses due to 'bail in' requirements. - Potential delays in being able to access funds. - Emerging markets carry a higher risk of financial loss than more developed markets, as they may have less developed legal, political, economic or other systems.	5	4	20	- Measurement of risk (use of credit ratings, CDS spreads, balance sheet analysis). - Monitoring of TM advisor advice, news, discussions with brokers, and reacting to events (eg both trading and regulatory). - Setting appropriate lending limits per counter-party re amounts, period and country of investment. - Diversification between lenders, lender types, countries. - Exposure to equity and tradable debt instruments only through diversified funds.	3	15
Liquidity risk						
- Running out of accessible cash, leading to inability to make payments as they are due. - Needing to borrow at higher cost than otherwise available. - Needing to sell assets / investments at short notice / at lower prices. - Not having available counter-parties to invest in.	4	2	8	- Daily cash flow forecasting. - Overdraft facility agreed. - Ready access to sources of cash from eg PWLB, other local authorities and banks and building societies. - Holding investments that can be readily realised.	1	4
Interest rate risk						
- Increasing interest rates lead to increase in cost of fixed rate and variable rate borrowing. - Decreasing market value of tradable fixed income investments (e.g. bonds) when interest rates rise. - Falling interest rates lead to lower return - Re-financing risk - Falling borrowing interest rates mean opportunity to re-finance borrowing at lower cost missed. - The use of derivatives may increase overall risk, by magnifying the effect of both gains and losses, leading to large changes in value and potentially large financial loss.	4	5	20	- Monitoring of TM advisor advice, news, discussions with brokers re economic outlook, and expected interest rate movements. - Taking into account uncertainty in future outcomes. - Monitoring of available / emerging sources of borrowing. - Maintaining suitable mix of fixed and variable interest rates for borrowing and investments. - Maintaining mix of maturity dates. - Monitoring of cost of re-financing borrowing compared to potential savings - Diversification of investment types. - Exposure to tradable debt instruments only through diversified funds. - Restriction of use of derivatives to stand-alone instruments that can be clearly demonstrated to reduce overall risk.	4	16
Inflation risk						
- The value of cash balances is eroded over time due to inflation (notably when interest rates on investments are lower than inflation)	4	4	16	- Monitoring of TM advisor advice, news, discussions with brokers re economic outlook, and expected inflation and related interest rate movements. - Identify balances not likely to be needed in the short term for operational cash flows, and invest these balances in longer term to generate sufficient income to at least match inflation.	3	12
Currency risk						
- The risk of loss from fluctuating foreign exchange rates when an investor has exposure to foreign currency or in foreign-currency-traded investments	1	0	0	- Local authorities are not allowed to borrow or invest in foreign currencies. All transactions must be in sterling.	0	0
Regulatory and political risk						
Risk that changes in regulations or leglislation may have an adverse impact on the Council's finances, including: - Brexit - leads to uncertainty in the economic outlook, and hence uncertainty over future interest rates and economic growth, and hence inflation, and government expenditure. - Changes in PWLB / other borrowing rates impact on the Council's borrowing costs - Changes in PWLB regulations limit availability/criteria of borrowing. - Changes in MiFID 2 regulatory requirements may increase costs and decrease access to markets.	3	4	12	- Monitoring of TM advisor advice, news, discussions with brokers, and reacting to events (eg both trading and regulatory). - On-going professional training and development of treasury management officers. - On-going training and updates to members on Treasury Management. - Regular review and update of overall Treasury Management Strategy. - Regular review and update of mix of borrowing and investments held to ensure the portfolio continues to meet the objectives of the Treasury Management Strategy.	3	9

Key: Scores: 1 (Lowest)-5 (Highest)

Authorised Limit – the maximum amount of external debt at any one time in the financial year.

Bank Rate – the Bank of England base rate.

Capital Financing Requirement – financing needs of the council – i.e., the requirement to borrow.

CIPFA - the Chartered Institute of Public Finance and Accountancy. The institute is one of the leading professional accountancy bodies in the UK and the only one which specialises in the public sector. It is responsible for the education and training of professional accountants and for their regulation through the setting and monitoring of professional standards. Uniquely among the professional accountancy bodies in the UK, CIPFA has responsibility for setting accounting standards for a significant part of the economy, namely local government. CIPFA's members work, in public service bodies, in the national audit agencies and major accountancy firms.

CLG – Communities and Local Government – see MHCLG.

Counterparty – the organisation the council is investing with.

Credit Rating – an assessment of the credit worthiness of an institution.

Creditworthiness – a measure of the ability to meet debt obligations.

Finance Lease - a finance lease is a lease that is primarily a method of raising finance to pay for assets, rather than a genuine rental. The latter is an operating lease. The key difference between a finance lease and an operating lease is whether the lessor (the legal owner who rents out the assets) or lessee (who uses the asset) takes on the risks of ownership of the leased assets. The classification of a lease (as an operating or finance lease) also affects how it is reported in the accounts.

Gilts – long term fixed income debt security (bond) issued by the UK Government and traded on the London Stock Exchange.

LIBID – London Interbank BID Rate – the interest rate at which London banks are willing to borrow from one another.

MHCLG – Ministry of Housing, Communities and Local Government. The Government department that sets policy on supporting local government, communities and neighbourhoods, regeneration, housing, planning building and the environment and fire. The name for this Government department has recently changed and is now known as **DLUCH**, which is the **Department for Levelling Up, Communities and Housing**.

Minimum Revenue Provision - the minimum amount which must be charged to an authority's revenue account each year and set aside towards repaying borrowing.

Money Market - the market in which institutions borrow and lend.

Money Market Rates – interest rates on money market investments.

Ninety-One – one of the council's cash managers who invest in multi-asset funds. They were previously known as Investec.

Operational Boundary – the most likely, prudent but not worst-case scenario of external debt at any one time.

Pooled Funds – investments are made with an organisation who pool together investments from other organisations and apply the same investment strategy to the portfolio. Pooled fund investments benefit from economies of scale, which allows for lower trading costs per pound, diversification, and professional money management.

Prudential Code – a governance procedure for the setting and revising of prudential indicators. Its aim is to ensure, within a clear framework, that the capital investment plans of the council are affordable, prudent, and sustainable and that treasury management decisions are taken in accordance with good practice.

Prudential Indicators – indicators set out in the Prudential Code that calculates the financial impact and sets limits for treasury management activities and capital investment.

PWLB (Public Works Loans Board) - a central government agency which provides long and medium-term loans to local authorities at interest rates only slightly higher than those at which the Government itself can borrow. Local authorities can borrow to finance capital spending from this source.

Sovereign – the countries the council can invest in.

Tradition UK Ltd – is one of the council's cash managers who manage £10m of investments on our behalf. Tradition place funds in fixed term cash deposits with a range of financial institutions.

Treasury Management – the management of the council's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risk associated with those activities and the pursuit of optimum performance with those risks.

Treasury Management Practices – schedule of treasury management functions and how those functions will be carried out.

Variable Net Asset Value money market funds – the principal invested may fluctuate below that invested.