TREASURY MANAGEMENT STRATEGY 2024/25 AND THIRD QUARTER REVIEW 2023/24

REPORT OF THE TREASURER

For Approval

1. PURPOSE OF REPORT

1.1 To enable the Authority to approve the Treasury Management Strategy referred from the Audit and Governance Committee.

2. RECOMMENDATIONS

2.1 The Audit and Governance Committee considered the recommended 2024/25 Treasury Strategy on 23 February 2024 and determined to refer the following recommendations to the Full Authority for approval:

i) Note the 2023/24 Treasury Management third quarter position detailed in section 5.

ii) Approve the prudential indicators outlined in Appendix A.

iii) Borrowing Strategy 2024/25
To note that in the event of a change in economic circumstances that the Treasurer may take out additional borrowing in advance of need if this secures the lowest long term interest cost.

iv) Investment Strategy 2024/25
Approve the Counterparty limits as set out in paragraph 8.7.

i) Minimum Revenue Provision (MRP) Statement
Approve the following MRP statement:

- For capital expenditure incurred before 1st April, 2008 the Authority's MRP policy is to calculate MRP in accordance with former DCLG (Department for Communities and Local Government) Regulations. This is 4% of the Capital Financing Requirement except where the Authority makes Voluntary Revenue Payments (VRP) which is in excess of the amount required by these regulations, based on asset life;
- From 1st April, 2008 the Authority calculates MRP based on asset life for all assets or where prudential borrowing is financed by a specific annuity loan, MRP will be calculated according to the actual annuity loan repayments;
- The Treasurer may determine to make Voluntary Revenue Provision payments to reduce the Authority's overall CFR if it is in the best financial interests of the Authority.

3. BACKGROUND

3.1 The Treasury Management Strategy covers:

- The strategy for the Authority's borrowing requirement arising from historic capital expenditure and the element of the approved Asset Management Plan funded from Prudential Borrowing; and
- The annual investment strategy relating to the Authority's cash flow.

3.2 The Local Government Act 2003 requires the Authority to 'have regard to' the CIPFA (Chartered Institute of Public Finance and Accountancy) Prudential Code and to set prudential indicators for the next three years to ensure the Authority's capital investment plans are affordable, prudent and sustainable.

3.3 The Act requires the Authority to set out a Treasury Management Strategy for borrowing and to prepare an Annual Investment Strategy, which sets out the policies for managing investments and for giving priority to the security and liquidity of those investments. The Secretary of State has issued Guidance on Local Government Investments which came into force on 1st April, 2004, and has subsequently been updated, most recently in 2021.

3.4 The Authority is required to nominate a body to be responsible for ensuring effective scrutiny of the Treasury Management Strategy and policies, before making recommendations to the Full Authority. This responsibility has been allocated to the Audit and Governance Committee.

3.5 This report covers the following areas:

- Economic background and outlook for interest rates
- Treasury Management Strategy 2023/24 third quarter review
- Treasury Management Strategy 2024/25
- Minimum Revenue Provision and Interest Cost and Other Regulatory Information 2024/25.

4. ECONOMIC BACKGROUND AND OUTLOOK FOR INTEREST RATES

4.1 UK – The Bank of England's Monetary Policy Committee (MPC) held the Bank Rate unchanged at 5.25% at its February meeting, for the fourth time in a row and pushing back against the prospect of near-term interest rate cut. The vote was a clear majority, with six in favour of no changes, while two members voted to increase by 0.25% and one voting for a 0.25% increase. The minutes of the meeting suggested that interest rates need remain at the current level sufficiently long to control inflation. Therefore, whilst the MPC has paused increases, it is far from certain that a cut in Bank Rate will be made in the near future, albeit there is an increasing expectation from independent economists that rate cuts will commence during 2024, given the more positive forecasts on inflation.

4.2 The latest Consumer Price Index data for December 2023 shows that the UK measure of inflation at 4% which is the lowest inflation rate since January 2022. Some of the reduction was owing to energy price reductions. Services inflation remained at 6.4%, which highlights the uncertainty regarding future potential inflation.

4.3 The Office for Budget Responsibility's revised growth forecasts up to 2027 are set out in the following table:

Year	March 2023 Growth Forecast	November 2023 Growth Forecast
2023	(0.2%)	0.6%
2024	1.8%	0.7%
2025	2.5%	1.4%
2026	2.1%	2.0%
2027	1.9%	2.0%

4.4 **European Union** (**EU) –** The European Central Bank kept interest rates unchanged at its January meeting. Inflation rates in the European Union decreased to 2.9% in December 2023 (from 3.1% in November). The Governing Council is determined to ensure that inflation returns to the 2% medium-term target in a timely manner. Future decisions will ensure that its policy rates will be set at sufficiently restrictive levels for as long as necessary.

4.5 **USA –** During the January 2024 policy meeting the Federal Reserve Committee voted unanimously for no change to the headline policy rate and do not expect any further increases in rates from current levels. The annual inflation rate went up to 3.4% in December (from 3.1% in November), still above the 2% target, but a major improvement from the four-decade high of 7.1% in June 2022. The minutes of the meeting stated that it was appropriate for policy to remain at a restrictive stance for some time until inflation was clearly moving down sustainably towards the Committee's objective.

4.6 **Other Economies –** In China, the People's Bank of China (PBoC) maintained its lending rates steady at the December fixing, as the central bank continued to attempt to revive the economy. In November CPI decreased by 0.3% year on year (the decline narrowed from 0.5% in November). A rebound in the coming months seems unlikely as household confidence also remained weak. In Japan, headline inflation dropped to 2.6% in December (from 2.8% in the November).

4.7 **Interest Rate Forecasts**

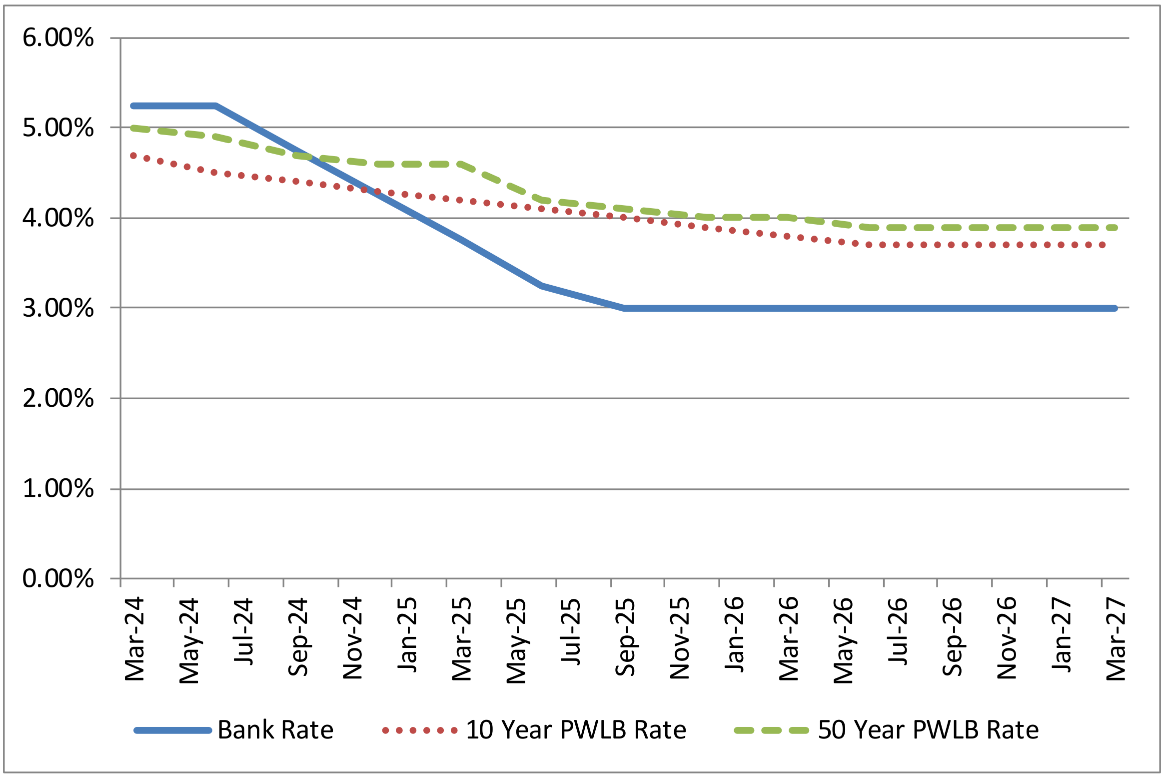
4.8 Link Asset Services (the Authority's Treasury Management advisors) continue to update their interest rate forecasts to reflect statements made by the Governor of the Bank of England and changes in the economy.

4.9 Expectations are that the Bank Rates will remain on hold at 5.25% until September 2024. Data is suggesting that further reductions in inflation will occur more slowly, and the Bank of England is forecasting an inflation rate of 2.75% by the end of 2024, with forecast inflation still slightly above the target in two years time.

4.10 Link anticipate the Bank of England will be keen to reduce interest rates when the worst of the inflationary pressures are behind us – but that timing will be one of fine judgement; cut too soon, and inflationary pressure may well build up further; cut too late and there is a risk of an economic recession.

4.11 Economic and interest rate forecasting remains difficult with so many influences impacting on the economy. UK gilt yields (i.e. Government borrowing) and Public Works Loan Board (PWLB) interest forecasts made by Link Asset Services may be liable to further amendment depending on how the political and economic developments transpire over the next year.

4.12 Interest Rate Forecast up to March 2027



5. TREASURY MANAGEMENT STRATEGY 2023/24 3RD QUARTER REVIEW

5.1 The Treasury Management Strategy for 2023/24 was approved by the Full Authority on 24th March 2023. The Authority's borrowing and investment position as at 31st December 2023 is summarised as follows:

	£m	Average Rate
LOBO Loan #	2.0	3.95%
PWLB Loans	6.8	2.92%
Gross Debt	**8.8**	**3.15%**
Investments	15.5	4.94%
Net Investment	**6.7**	

A LOBO (Lender Option, Borrower Option) loan was taken out in March 2007 at which time interest rates for comparative PWLB loans were 4.3%.

5.2 As part of the Treasury Strategy for 2023/24 the Authority set a number of prudential indicators. Compliance against these indicators is monitored on a regular basis and there are no breaches to report.

5.3 The CFR and capital expenditure financed by borrowing will vary from the original estimate approved by the Fire Authority in March 2023 owing to planned capital expenditure being re-phased between financial years.

5.4 As at 31st December, the temporary investment funds amounted to £15.6m, which reflected strategic investments, the positive cashflow impact of when capital expenditure is incurred and the receipt of the Pension Grant. All investments complied with the Annual Investment Strategy and are shown below.

Borrower	Duration	Value of Loan (£m)	Rate (%)	Start Date	Maturity Date
Call Accounts*					
Svenska Handelsbanken	On Call	3.119	2.100		Call
NatWest Bank	On Call	0.002	1.150		Call
		3.121	**2.100**		
Fixed term Deposits					
CFB Risk Management	1 year	0.084	2.740		
Lloyds	1 year	5.000	5.910	06/10/23	04/10/24
Goldman Sachs	9 months	3.000	5.700	06/10/23	05/07/24
Goldman Sachs	6 months	2.000	5.580	06/10/23	05/04/24
Debt Management Office	<1 month	0.954	5.195	19/09/23	13/10/23
Debt Management Office	1 month	1.395	5.195	20/09/23	31/10/23
		12.433	**5.650**		
Total Deposits		**15.554**	**4.937**		

5.5 In order to secure the investment income reported as part of the Medium Term Financial Strategy the Authority's strategic investments have been placed on the basis of phased maturity dates to address the change in the financial market. This revised approach has enabled the Authority to secure very favourable current interest rates on the £10m of strategy investments which matured in October - £5m invested for 12 months, £3m invested for 9 months and £2m invested for 6 months. This approach will then enable 12 month interest rates to be secured when these investments mature, which will provide the certainty for the Medium Term Financial Strategy. It is anticipated this approach should provide ongoing support until 2026/27, which protects front line services.

6. TREASURY MANAGEMENT STRATEGY 2024/25

6.1 Prudential Indicators and other regulatory information in relation to the 2024/25 Treasury Management Strategy is set out in Appendix A.

6.2 The key elements of the Treasury Management Strategy which Members need to consider are the Borrowing and Investment Strategies, detailed in section 7 and 8.

7. BORROWING STRATEGY 2024/25

7.1 Following the development and implementation of the Asset Management Plan (AMP) the Authority's CFR has risen and is forecast to continue to rise. Therefore it was recognised that a proactive borrowing strategy would need to be adopted to finance the borrowing element of the AMP and to secure historically low interest rates.

7.2 The borrowing costs associated with the AMP are minimised in the long term and can be sustained within the existing revenue budget of £1.1m (including using the recommended Capital Funding Phasing Reserve) over the period of the current Medium Term Financial Strategy and Integrated Risk Management Plan.

7.3 As indicated in Appendix A (indicator 5.1) the Authority has a borrowing requirement for the AMP in 2023/24 of £1.380m and £4.566m in 2024/25. Until long term interest rates reduce from their current level it would not be prudent to borrow for these requirements. Therefore, in the short-term (i.e. through to the end of 2024/25) these amounts will be funded from a combination of temporary borrowing and netting down investments. These borrowing decisions will also reflect the timing of actual capital expenditure as this tends to be towards the end of the financial year owing to the lead in time for capital schemes.

7.4 A decision to borrow in advance of need may be taken by the Treasurer if interest rates fall sooner than forecast if this is in the best financial interests of the Authority.

7.5 **Impact of Capital Programme on the Revenue Budget**

7.6 As previously reported detailed financial modelling has been undertaken to assess the impact of the capital programme on the revenue budget. As detailed in the Medium Term Financial Strategy report approved by the Full Authority on 9th February the capital programme and Asset Management Plan (AMP) cover operational properties, including vehicles (mainly Water Tenders). The AMP is underpinned by a funding strategy which will finance capital costs through a combination of using the earmarked Capital Investment Programme Reserve and Prudential Borrowing.

7.7 The revenue budget includes provision to meet the interest and principal repayment costs of using Prudential Borrowing. The phasing of these costs is supported from the Capital Funding Phasing Reserve.

7.8 The AMP covers fifteen-year and the detailed requirements cover the technical disciplines of Estates, Fleet, Equipment and ICT. The longer term planning period will underpin the development of the MTFS in future years.

8. INVESTMENT STRATEGY 2023/24

8.1 The Department of Levelling Up, Housing and Communities (DLUHC) issued investment guidance in 2010, updated in 2017, and this forms the structure of the Authority's policy. The key intention of the Guidance is to maintain the current requirement for authorities to invest prudently and that priority is given to security and liquidity before interest return. The Authority has adopted the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes and applies its principles to all investment activity. In accordance with the Code, the Treasurer has produced Treasury Management practices covering investment counterparty policy which requires approval each year.

8.2 The primary objectives of the Authority's investment strategy in order of importance are:

- safeguarding the re-payment of the principal and interest of its investments on time;
- ensuring adequate liquidity;
- investment return.

8.3 **Counterparty Selection Criteria**

8.4 The Authority's criteria for providing a pool of high quality investment counterparties uses the credit rating information produced by the three major ratings agencies (Fitch, Moody's and Standard & Poor's) and is supplied by our treasury consultants. All active counterparties are checked against criteria outlined below to ensure that they comply with the criteria. Any counterparty failing to meet the criteria would be omitted from the counterparty list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered on a daily basis before investments are made. For instance a negative rating watch applying to a counterparty at the minimum criteria will be suspended from use, with all others being reviewed in light of market conditions.

8.5 The **lowest common denominator** method of selecting counterparties and applying limits is used. This means that the application of the Authority's minimum criteria will apply to the lowest available rating for any institution. For instance if an institution is rated by two agencies, one meets the Authority's criteria, the other does not, the institution will fall outside the lending criteria.

8.6 The Treasurer will continue to adopt a vigilant approach resulting in what is effectively a 'named' list. This consists of a select number of counterparties that are considered to be the lowest risk.

8.7 For 2023/24 the investment time limit was increased to 2 years with the objective of securing investment income for a longer period. Following approval of this change the financial markets began to anticipate interest rates had reached the peak and therefore withdrew 2-year investments for large commercial investments. It is therefore proposed that the time limit is reduced back to 1 year. The principals and hierarchy of security / liquidity / rate of return continue to be closely adhered to.

Category	Fitch	Moody's	Standard & Poor's	Proposed Counterparty Limit	Proposed Time Limit
A	F1+/AA-	P-1/Aa3	A-1+/AA-	£7m	1 year
B	F1/A-	P-1/A3	A-1/A-	£5m	1 year
C	Debt Management Office/Treasury Bills/Gilts			£14m	1 year
D	Nationalised Banks			£5m	2 years
E	Other Local Authorities Individual Limits per Authority: - £3m County, Metropolitan or Unitary Councils - £1.5 District Councils, Police or Fire Authorities			£15m	2 years
F	Three Money Market Funds (AAA) with maximum investment of £1.5m per fund			£4.5m	Liquid (instant access)

8.8 **Specified and Non-Specified Investments**

8.9 DLUHC regulations classify investments as either Specified or Non-Specified. Non-Specified Investment is any investment not meeting the Specified definition.

8.10 The investment criteria outlined above is different to that used to define Specified and Non-Specified investments. This is because it is intended to create a pool of high quality counterparties for the Authority to use rather than defining what its investments are.

8.11 Specified Investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Authority has the right to be repaid within twelve months if it wishes. These are low risk assets where the possibility of loss of principal or investment income is small. These would include investments with:

- The UK Government (such as the Debt Management Office, UK Treasury Bills or a Gilt with less than one year to maturity).
- Other Local Authorities.
- Pooled investment vehicles (such as Money Market Funds) that have been awarded a high credit rating (AAA) by a credit rating agency.
- A body that has been awarded a high credit rating by a credit rating agency (such as a bank or building society). This covers bodies with a minimum rating of A- (or the equivalent) as rated by Standard and Poor's, Moody's or Fitch rating agencies. Within these bodies, and in accordance with the Code, the Authority has set additional criteria to set the time and amount of monies which will be invested in these bodies.

8.12 Non-specified Investments are any other type of investment (i.e. not defined as Specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Non-specified investments would include any investments with:

- Building societies not meeting the basic security requirements under the specified investments. The operation of some building societies does not require a credit rating, although in every other respect the security of the society would match similarly sized societies with ratings.
- Any bank or building society that has a minimum long term credit rating of A- for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).

9. MINIMUM REVENUE PROVISION AND INTEREST COSTS AND OTHER REGULATORY INFORMATION 2024/25

9.1 There are two elements to the Authority's annual loan repayment costs – the statutory Minimum Revenue Provision (MRP) and interest costs. The Authority is required to pay off an element of the Capital Financing Requirement (CFR) each year through a revenue charge called the Minimum Revenue Provision (MRP).

9.2 DLUHC Regulations require the Authority to approve **an MRP Statement** in advance of each year. This will determine the annual loan repayment charge to the revenue budget.

9.3 The budget strategy is based on the following MRP statement and the Authority is recommended to formally approve the existing statement:

- For capital expenditure incurred before 1st April, 2008 the Authority's MRP policy is to calculate MRP in accordance with former CLG Regulations. This is 4% of the Capital Financing Requirement except where the Authority makes Voluntary Revenue Payments which is in excess of the amount required by these regulations, based on asset life;

- From 1st April, 2008 the Authority calculates MRP based on asset life for all assets or where prudential borrowing is financed by a specific annuity loan, MRP will be calculated according to the actual annuity loan repayments.

- Continue to authorise the Treasurer to make VRP payments to reduce the Authority's overall CFR if it is in the best interests of the Authority to do so. Such VRP payments can then be potentially offset against future MRP charges if this is in the Authority's interests.

9.4 The flexible use of VRP will ensure the CFR is repaid within the original timescale, whilst providing the potential opportunity to either effectively take a MRP holiday - whilst repaying the CFR within the approved timeframe, or repay the CFR early to achieve a permanent saving. This flexibility will support managing the budget and services over a period of financial uncertainty.

9.5 Any future VRP payments will be reported as part of future Treasury Management reports.

9.6 **CIPFA Treasury Management Code of Practice**

9.7 The Authority is adopting the updated CIPFA Treasury Management Code of Practice published 20th December 2021.

9.8 The revised Treasury Management Code requires the implementation of the following:
1. Adopt a new liability benchmark treasury indicator to support the financing risk management of the capital financing requirement, with material differences between the liability benchmark and actual loans explained, this is detailed in Appendix A.
2. A **knowledge and skills register** for officers and members involved in the treasury function;
3. Reporting to members on a quarterly basis;
4. Have consideration for **Environmental, Social and Governance (ESG)** issues.

9.9 **Treasury Management Advisors**

9.10 The Authority uses Link Asset Services – Treasury Solutions as its external treasury management advisors.

9.11 The Authority recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

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

9.13 **Markets in Financial Instruments Directive (MIFID II)**

9.14 On 3rd January 2018 an updated version of the European Union's Markets in Financial Instruments Directive (known as MIFID II) came into effect. It is designed to offer greater protection for investors and inject more transparency into financial markets. Under MIFID II all local authorities are classified as "retail" counterparties and had to consider whether to opt up to "professional" status and for which type of investments. The Fire Authority opted up to professional status in order to maintain the Authority's ability to operate effectively under the new regime.

10. <u>CONCLUSION</u>

10.1 The decision by the Bank of England to retain the Base Rate at 5.25% suggests that this will be the peak level. Provided inflation continues to fall during 2024 the Bank of England should begin to reduce interest rates. The timing of these reductions will have a critical impact on the Treasury Management Strategy for two reasons.

10.2 Firstly, the strategy needs to fund the approved element of the AMP finance by borrowing at the lowest sustainable long term interest rate. Until interest rates have reduced it is not appropriate to borrow for the AMP. Therefore, as this capital expenditure is incurred it will be funded on a temporary basis from either short-term borrowing or netting down investments.

10.3 Secondly, the strategy needs to secure interest income to support the MTFS up to at least 2026/27 and hopefully beyond at £0.25m per year. The action taken in the current year and planned for 2024/25 aims to achieve this objective.

10.4 The report sets out how the Authority will comply with the regulatory framework to ensure the Council achieves the lowest borrowing costs and security for any temporary cash investments made by the Council. Within this framework and the more uncertain / volatile financial environment officers will continue to actively manage borrowing and investments to support the overall financial position of the Council.

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TREASURER