Attachment 5

Report to the Audit & Governance Committee

Date of meeting: 13th February 2023

Epping Forest District Council

Portfolio:	**Finance, Qualis Client & Economic Development**	
Subject:	**Treasury Management Strategy (including Investment Strategy) 2023/24**	
Responsible Officer:	**Andrew Small**	**(01992 564278)**
Democratic Services:	**Laura Kirman**	**(01992 564243)**

Recommendations/Decisions Required:

(1) To consider and recommend for approval by full Council, the draft Treasury Management Strategy 2023/24 (attached at ***Appendix A***); and

(2) To consider and recommend for approval by full Council, the draft Investment Strategy 2023/24 (attached at ***Appendix B***).

Executive Summary:

The preparation of an annual Treasury Management Strategy is a requirement of CIPFA's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) and generally accepted good practice. It covers planned treasury activity for the financial year 2023/24 and is attached at ***Appendix A***.

In addition, following the issue of (MHCLG) statutory guidance on Local Government Investments in 2018, the Council is also recommended to produce an annual Investment Strategy, covering the Council's wider investment activities. The 2023/24 Strategy is attached at ***Appendix B.***

The overriding position that this report presents in the year ahead is a further rise in Borrowing activity as the Council continues to roll out its capital investment plans. Conversely Investment activity is expected to be very limited.

Both borrowing and investing is taking place against a backdrop of rising interest rates; although interest rate expectations reduced during October and November 2022, multiple interest rate rises are still expected in the medium-term.

The purpose of this report is to allow the Audit and Governance Committee to consider and comment on both strategies, before making appropriate recommendations to full Council on 28th February 2023.

Reasons for Proposed Decision:

To provide assurance to full Council that the risks associated with treasury management and investments are being appropriately managed.

Legal and Governance Implications:

The Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2021 Edition* (the CIPFA Code) requires the Council to prepare for approval by full Council, an annual Treasury Management Strategy. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

The Government (MHCLG) issued Investment Guidance in 2018, recommending the preparation (at least annually) of an Investment Strategy for approval by full Council.

The role of the Audit and Governance Committee is to consider this report – covering both the Treasury Management and Investment strategies – and make recommendations to full Council.

Safer, Cleaner and Greener (SCG) Implications:

None.

Background Papers:

Treasury Management in the Public Services: Code of Practice (2021 Edition) published by CIPFA December 2021.

(MHCLG) Statutory Guidance on Local Government Investments (3rd Edition). Issued under section 15(1)(a) of the Local Government Act 2003 and effective for financial years commencing on or after 1st April 2018.

Arlingclose Technical Update (revised Prudential and Treasury Management Codes) issued 22nd December 2021.

Risk Management:

There are a range of inherent financial risks associated with Treasury Management activity; not least the potential for loss of interest and/or deposits. The Council therefore engages the services of external Treasury Management advisors, Arlingclose Ltd.

Borrowing and Investment decisions are made in accordance with the Council's formally adopted Treasury Management Strategy. The Strategy includes several Risk Management features, including – for example – the overriding priority that security of deposit takes precedence over return on investment.

Attachment 5

Appendix A

Treasury Management Strategy 2023/24 (DRAFT)

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.

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 2021 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.

Investments held for service purposes or for commercial profit are considered in a different report, the Investment Strategy ***(Appendix B).***

External Context

The ongoing impact on the UK from the war in Ukraine, together with higher inflation, higher interest rates, uncertain Government policy, and a deteriorating economic outlook, will be major influences on the Council's Treasury Management Strategy for 2023/24.

The Bank of England (BoE) increased the Bank Rate by 0.5% to 3.5% in December 2022. This followed a 0.75% rise in November which was the largest single rate hike since 1989 and the ninth successive rise since December 2021. The December decision was voted for by a 6-3 majority of the Monetary Policy Committee (MPC), with two dissenters voting for a no-change at 3% and one for a larger rise of 0.75%.

The November 2022 quarterly Monetary Policy Report (MPR) forecast a prolonged but shallow recession in the UK with CPI inflation remaining elevated at over 10% in the near-term. While the projected peak of inflation is lower than in the August 2022 report, due in part to the Government's support package for household energy costs, inflation is expected remain higher for longer over the forecast horizon and the economic outlook remains weak, with unemployment projected to start rising.

The UK economy contracted by 0.3% between July and September 2022 according to the Office for National Statistics, and the BoE forecasts Gross Domestic Product (GDP) will decline 0.75% in the second half of the calendar year due to the squeeze on household income from higher energy costs and goods prices. Growth is then expected to continue to fall throughout 2023 and the first half of 2024.

CPI inflation is expected to have peaked at around 11% in the last calendar quarter of 2022 and then fall sharply to 1.4%, below the 2% target, in two years' time and to 0% in three years' time if Bank Rate follows the path implied by financial markets at the time of the November MPR (a peak of 5.25%). However, the BoE stated it considered this path to be too high, suggesting that the peak in interest rates will be lower, reducing the risk of inflation falling too far below target. Market rates have fallen since the time of the November 2022 MPR.

The labour market remains tight for now, with the most recent statistics showing the unemployment rate was 3.7%. Earnings were up strongly in nominal terms by 6.1% for both total pay and for regular pay but factoring in inflation means real pay for both measures was -2.7%. Looking forward, the November MPR shows the labour market weakening in response to the deteriorating outlook for growth, leading to the unemployment rate rising to around 6.5% in 2025.

The Arlingclose forecast for November 2022 anticipates the Bank Rate will continue to rise in 2022 and 2023 as the BoE attempts to subdue inflation which is significantly above its 2.0% target.

While interest rate expectations reduced during October and November 2022, multiple interest rate rises are still expected over the forecast horizon despite looming recession. Arlingclose expects Bank Rate to rise to 4.25% by June 2023.

Local Context

At close of business on 31st December 2022, the Council held £267.173 million Borrowing and £16.048 million in Treasury Investments (excluding Qualis Working Capital Loan). This is set out in further detail in Table 5 below. Forecast changes in these sums are shown in the Balance Sheet analysis in Table 1 below.

Table 1: Balance Sheet Summary and Forecast

	31/03/22 Actual £m's	31/03/23 Estimate £m's	31/03/24 Forecast £m's	31/03/25 Forecast £m's	31/03/26 Forecast £m's
General Fund CFR	151.9	161.9	208.7	243.6	240.7
HRA CFR	157.6	158.5	180.2	202.1	214.4
Total CFR	**309.5**	**320.4**	**388.9**	**445.7**	**455.1**
Less: Other debt liabilities*	0	0	0	0	0
Less: External borrowing	(269.0)	(246.6)	(221.3)	(219.0)	(216.7)
Internal borrowing	**40.5**	**73.8**	**167.6**	**226.7**	**238.4**
Less: Balance Sheet Resources	(59.2)	(59.2)	(59.2)	(59.2)	(59.2)
Investments/ (New Borrowing)	**18.7**	**(14.6)**	**(108.4)**	**(167.5)**	**(179.2)**

** Leases and PFI liabilities that form part of the Council's total debt*

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

The Council has an increasing CFR due to the Capital Programme (including Qualis Investments) and will therefore be required to take out further (new) borrowing up to £179.2 million over the forecast period (2023/24 to 2025/26).

CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Council expects to comply with this recommendation during 2023/24.

Liability Benchmark

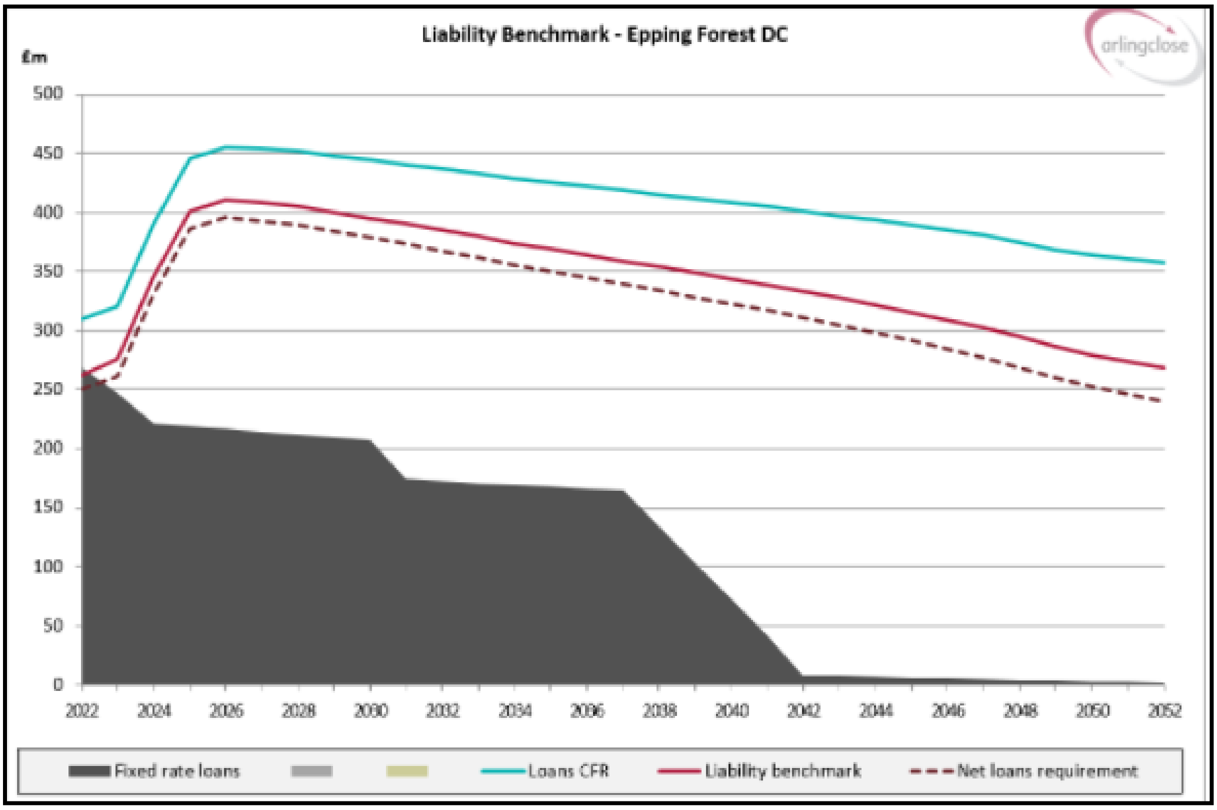
To compare the Council's actual borrowing against an alternative strategy, a Liability Benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as Table 1 above, but that cash and investment balances are kept to a minimum level of £15.0 million at each year-end to maintain adequate liquidity but minimise credit risk.

The Liability Benchmark is an important tool to help establish whether the Council is likely to be a Long-Term Borrower or Long-Term Investor in the future, and so shape its strategic focus and decision making. The Liability Benchmark itself represents an estimate of the cumulative amount of External Borrowing the Council must hold to fund its current Capital and Revenue plans while keeping Treasury Investments at the minimum level required to manage day-to-day cash flow.

Table 2: Prudential Indicator: Liability Benchmark

	31/03/22 Actual £m's	31/03/23 Estimate £m's	31/03/24 Forecast £m's	31/03/25 Forecast £m's	31/03/26 Forecast £m's
Loans CFR	309.5	320.4	388.9	445.7	455.1
Less: Balance Sheet Resources	(59.2)	(59.2)	(59.2)	(59.2)	(59.2)
Net Loans Requirement	**250.3**	**261.2**	**329.7**	**386.5**	**396.0**
Liquidity Allowance	12.0	15.0	15.0	15.0	15.0
Liability benchmark	**262.3**	**276.2**	**344.7**	**401.5**	**411.0**

Following on from the medium-term forecasts in table 2 above, the long-term Liability Benchmark assumes capital expenditure funded by borrowing of up to £411.0 million by 31st March 2026. Tailored Minimum Revenue Provision (MRP) contributions based on asset lives – ranging from 10 years on Equipment up to 50 years on Buildings – on new capital expenditure have been applied with an underlying inflation rate of 2.5% per annum assumed on income, expenditure, and reserves. This is shown in the Chart below, together with the Council's existing borrowing.



The Chart presented above spans 30-years and illustrates how the Council's borrowing is significantly below the Liability Benchmark. The year ahead (2023/24) is planned to include a number of 30-Year Loans (primarily for on-lending to Qualis), which will have the effect of smoothing the borrowing profile in the later years.

Borrowing Strategy

The Council currently (@ 31st December 2022) holds £267.173 million in loans, a decrease of £1.783 million compared to 31st March 2022, as part of its strategy for funding previous years' Capital Programmes. The Council's current lenders are the PWLB and other local authorities. There are total loans of £232.173 million outstanding with the PWLB as summarised in Table 3 below.

Table 3: PWLB Borrowing

PWLB Loans (@ 31st December 2022)			
Description	**Amount (£m's)**	**Interest Rate**	**Maturity Date**
Long-Term Maturities			
Fixed-Rate Maturity	30.000	2.06%	21/09/30
Fixed-Rate EIP	9.667	2.99%	28/01/37
Fixed-Rate Maturity	30.000	3.46%	28/03/38
Fixed-Rate Maturity	30.000	3.47%	28/03/39
Fixed-Rate Maturity	30.000	3.48%	28/03/40
Fixed-Rate Maturity	30.000	3.49%	28/03/41
Fixed-Rate Maturity	33.656	3.50%	28/03/42
Fixed-Rate EIP	5.700	1.98%	25/03/51
Fixed-Rate EIP	5.900	1.98%	28/01/52
Fixed-Rate EIP	10.000	3.96%	15/12/52
Fixed-Rate EIP	9.250	2.99%	03/12/59
Short-Term Maturities			
Fixed-Rate EIP	8.00	4.14%	25/10/23
Total PWLB	**232.173**		

Local authorities are able to access preferential interest rates on PWLB loans (known as the "Certainty Rate"; currently a 0.2% discount on published rates) provided they submit a high-level description of their capital spending and financing plans (whether it is financed through PWLB borrowing or another source) for the following three years (meaning any capital spending and financing for the whole current financial year and subsequent two financial years), including their expected use of the PWLB.

The PWLB lending terms are contained in *Circular 163* (issued 21st October 2021). The updated terms now explicitly forbid borrowing for the purposes of purchasing investment assets primarily for yield. Thus Paragraph 41 requires that – before a loan can be granted – the Council's Section 151 Officer must confirm that the Council does not plan to:

- Use the PWLB to refinance any prior investment asset primarily for yield transactions which concluded after 25th November 2020; and/or
- Buy investment assets primarily for yield in the next three years.

The Council also has further outstanding loans of £35.0 million with other local authorities as summarised in Table 4 below.

Table 4: Local Authority Borrowing

Local Authority Short-Term Loans (@ 31st December 2022)*			
Lender	**Amount (£m's)**	**Interest Rate**	**Maturity Date**
East Suffolk Council	2.0	3.55%	14/04/23
East Suffolk Council	4.0	4.10%	18/07/23
Horsham District Council	4.0	1.42%	06/03/23
Northern Ireland Housing Executive	6.0	1.42%	24/03/23
Northern Ireland Housing Executive	5.0	3.60%	31/03/23
Northern Ireland Housing Executive	5.0	3.80%	28/04/23
Northern Ireland Housing Executive	4.0	2.91%	31/05/23
West Midlands Combined Authority	5.0	2.00%	31/03/23
Total Local Authority	**35.0**		

**Exclusively fixed rate Maturity Loans*

The Council *expects* to borrow up to £344.7 million in 2023/24 (if the minimum Investment balance of £15.0 million illustrated in Table 2 is achieved). The Council may also borrow additional sums to pre-fund future years' requirements, providing the Authorised Limit for Borrowing of £409.973 million is not exceeded.

Objectives

The Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

Strategy

Given the significant cuts to local government funding in recent years, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

By doing so, the Council reduces its net borrowing costs (despite foregone investment income) and reduces overall treasury risk. The benefits of internal and short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Council with this ‘cost of carry’ and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2023/24 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

The Council has previously raised all of its long-term borrowing from the PWLB but will consider long-term loans from other sources including banks, pension funds 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. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Council intends to avoid this activity in order to retain its access to PWLB loans.

Alternatively, the Council may arrange forward starting loans, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

In addition, the Council may take out further short-term loans to cover unplanned cash flow shortages.

Sources of Borrowing

The approved sources of long-term and short-term borrowing are:

- HM Treasury’s PWLB lending facility (formerly the Public Works Loan Board)
- Any institution approved for investments (see below)
- Any other bank or building society authorised to operate in the UK
- Any other UK public sector body
- UK public and private sector pension funds (except Essex County Pension Fund)
- Capital market bond investors; and
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues.

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:

- Leasing
- Hire purchase; and
- Sale and leaseback.

Municipal Bonds Agency

UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It issues bonds on the capital markets and lends the proceeds to local authorities. This is a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency would therefore be the subject of a separate report to full Council.

Short-Term and Variable Rate Loans

These loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the Treasury Management indicators below.

Debt Rescheduling

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. Other lenders may also be prepared to negotiate premature redemption terms. 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. The recent rise in interest rates means that more favourable debt rescheduling opportunities should arise than in previous years.

Treasury Investment Strategy

The Council holds significant invested funds, representing income received in advance of expenditure, plus balances and reserves held. During 2022/23, the Council's 'Cash and Cash Equivalent' balance has so far remained over £9.0 million at all times (with the lowest available balance being £9.347 million on 19th July 2022), although substantial Government support for a range of support schemes to local businesses and residents – initially Covid-19 related, but increasingly 'cost of living' related – has so far made achieving the 2022/23 target liquidity level of £12.0 million difficult again (the highest available balance peaked at £35.828 million on 15th December 2022, immediately ahead of scheduled repayment of £10.0 million in local government short-term loans). This Strategy therefore includes a "Liquidity Allowance" of £15.0 million.

The Council currently (@ 31st December 2022) holds £16.048 million in Cash and Cash Equivalents, a decrease of £2.7 million compared to 31st March 2022. In addition, an outstanding balance of £4.750 million is owed by Qualis to the Council in respect of the original Cash Flow Loan of £6.0 million. The overall position is summarised in Table 5 below.

Table 5: Treasury Management Investments

Treasury Management Investments (@ 31st December 2022)		
Counterparty	**Amount (£m's)**	**Interest Rate**
Long-Term Investments (maturity > 12 months)		
Qualis Working Capital Loan	4.750	3.80%
Short-Term Investments (maturity < 12 months)		
None	N/A	N/A
Cash and Cash Equivalents (instant access)		
NatWest Bank (bank deposits)	4.048	0.80%
DMADF (Government)	7.000	3.20%
Deutsche Managed (MMF)	5.000	3.32%
Total Investments	**20.798**	

Objectives

The CIPFA Code requires the Council to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested. The Council also aims to be a responsible investor and will consider environmental, social and governance (ESG) issues when investing.

Strategy

As demonstrated by the Liability Benchmark above, the Council expects to be a long-term borrower and new treasury investments will therefore be made primarily to manage day-to-day cash flows using short-term low risk instruments.

ESG Policy

Environmental, Social and Governance (ESG) considerations are increasingly a factor in global investors' decision making, but the framework for evaluating investment opportunities is still developing and therefore the Council's ESG policy does not currently include ESG scoring or other real-time ESG criteria at an individual investment level.

Nevertheless, the Council is mindful of its ESG responsibilities and only invests in banks and funds that have Arlingclose approval. This ensures (through an annual check) – for example – that approved banks remain signatories to the UN Principles for Responsible Banking and approved Money Market Fund managers remain signatories to the UN Principles for Responsible Investment.

Approved Counterparties

The Council may invest its surplus funds with any of the counterparty types in Table 6 below, subject to the limits shown.

Table 6: Treasury Investment Counterparties and Limits

Sector	Time limit	Counterparty limit	Sector limit
The UK Government	50 years	Unlimited	N/A
Local authorities & other Government entities	25 years	£10 million	Unlimited
Banks (unsecured)*	13 months	£4.0 million	£20.0 million
Building Societies* (unsecured)	13 months	£2.0 million	£2.0 million
Registered Providers* (unsecured)	5 years	£3.0 million	£3.0 million
Money Market Funds*	N/A	£10.0 million	Maximum of 3 Funds (see below)

Note - this table must be read in conjunction with the notes below.

** 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 account of.

For entities without published credit ratings, investments may be made either (a) where external advice indicates the entity to be of similar credit quality; or (b) to a maximum of £10 million per counterparty as part of a diversified pool (e.g., via a peer-to-peer platform).

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.

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.

Registered providers (unsecured)

Loans to, and bonds issued or guaranteed by, registered providers of social housing or registered social landlords, formerly known as housing associations. These bodies are regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government, and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving Government support if needed.

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.

If operational need requires the use of more than three funds, the S151 officer can authorise this in consultation with the Portfolio Holder for Finance, Qualis Client and Economic Development, provided this is reported to the Chair of the Audit and Governance Committee, and a report is submitted to the next available meeting of the Audit and Governance Committee.

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 £4.0 million per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25.0 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.

Risk Assessment and Credit Ratings

Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- No new investments will be made
- Any existing investments that can be recalled or sold at no cost, will be; and
- Full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "negative watch") so that it may fall below the approved rating criteria, then only investments that can be withdrawn [on the next working day] will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

Other Information on the Security of Investments

The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore 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.

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.

Investment Limits

The Council had £15.603 million in (General Fund + HRA) revenue reserves on its (draft) Balance Sheet as at 31st March 2022 to cover unexpected credit losses in an emergency. A reasonable level of risk to carry in a single institution would be (say) 25%. An Investment Limit for a single institution (excluding Government and Money Market Funds) of £4.0 million has therefore been applied.

Liquidity Management

The Council uses cash flow forecasting to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis 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.

The Council will usually spread its liquid cash over at least three providers (e.g., Bank, DMADF and Money Market Funds) to ensure that access to cash is maintained in the event of operational difficulties at any one provider.

Treasury Management Prudential Indicators

The Council measures and manages its exposures to Treasury Management risks using the following indicators.

Security

The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

Credit Risk Indicator	Target
Portfolio average credit rating	A-

Liquidity

The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling [three] month period, without additional borrowing.

Liquidity Risk Indicator	Target
Total cash available within 3 months	£12.0 million

Interest Rate Exposure

This indicator is set to control the Council's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates will be:

Interest Rate Risk Indicator	Limit £'s
Upper limit on one-year revenue impact of a 1% rise in interest rates	96,000
Upper limit on one-year revenue impact of a 1% fall in interest rates	(96,000)

The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at new market rates.

The indicator shows that, as a net borrower, the Council benefits from a reduction in interest rates, rather than an increase.

Maturity Structure of Borrowing

This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the Maturity Structure of Borrowing will be:

Refinancing Rate Risk Indicator	Upper Limit	Lower Limit
Under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	50%	0%
10 years and within 15 years	50%	0%
15 years and within 20 years	50%	0%
25 years and above	50%	0%

It should be noted that – based on Arlinclose advice – the proposed limits presented above are deliberately wide in range. This is because the indicator is only designed to cover the risk of replacement loans being unavailable, rather than interest rate risk.

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.

Long-Term Treasury Management Investments

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. The prudential limits on long-term treasury management investments will be:

Price Risk Indicator	2023/24	2024/25	2025/26
Limit on principal invested beyond year end	£15.0 million	£10.0 million	£5.0 million

Related Matters

Housing Revenue Account

On 1st April 2012, the Council notionally split each of its existing long-term loans into General Fund and HRA pools. In future, new long-term loans borrowed will be assigned in their entirety to one pool or the other. Interest payable and other costs/income arising from long-term loans (e.g., premiums and discounts on early redemption) will be charged/ credited to the respective revenue account. Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. This balance will be measured, with interest transferred between the General Fund and HRA at the Council's average interest rate on investments, adjusted for credit risk.

Markets in Financial Instruments Directive (MIFID)

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.

Financial Implications

In 2023/24, overall investment income (General Fund and HRA) is budgeted at £478,500.

The budgets for General Fund and HRA debt interest payable in 2023/24 are £4,587,200 (including £1,780,072 on Qualis loans for on-lending) and £5,616,000 respectively.

If investment levels and borrowing, or interest rates, differ from expectations, performance against budget will be correspondingly different.

Other Options Considered

The CIPFA Code does not prescribe any specific Treasury Management Strategy for local authorities to adopt. The Section 151 Officer, having consulted the Portfolio Holder for Finance and Economic Development, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on Income and Expenditure	Impact on Risk Management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

Attachment 5

Annex 1 (Appendix A)

Existing Investment & Debt Portfolio

	31/12/22 Actual Portfolio £m	31/12/22 Average Rate %
External Borrowing		
Public Works Loan Board	232.173	3.23%
Local authorities	35.0	2.75%
Other loans	-	-
Total External Borrowing	**267.173**	
Other Long-Term Liabilities:		
Leases	-	-
Total Other Long-Term Liabilities	**-**	
Total Gross External Debt	**267.173**	
Treasury Investments		
The UK Government	7.0	3.20%
Local authorities	-	-
Banks (unsecured)	4.048	0.80%
Money market funds	5.000	3.32%
Other investments (Qualis WC loan)	4.750	3.80%
Total Treasury Investments	**20.798**	
Net Debt	**246.375**	

Appendix B

Investment Strategy 2023/24 (DRAFT)

Introduction

The Council invests its money for three broad purposes:

- Because it has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure (known as **Treasury Management Investments**)
- To support local public services by lending to or buying shares in other organisations (**Service Investments**); and
- To earn investment income (known as **Commercial Investments** where this is the main purpose).

This Investment Strategy meets the requirements of statutory guidance issued by the Government in January 2018 and focuses on the second and third of these categories.

Treasury Management Investments

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 authorities and the Government. These activities, plus the timing of borrowing decisions, lead to a cash surplus which is invested in accordance with guidance from the Chartered Institute of Public Finance and Accountancy (CIPFA). The balance of Treasury Management investments is expected to fluctuate in 2023/24, although the aim is to maintain a minimum liquidity level of £4.0million as part of a £15.0 million balance available for investments.

Contribution

The contribution that these investments make to the objectives of the Council is to support effective Treasury Management activities.

Full details of the Council's policies and its plan for 2023/24 for Treasury Management investments are covered in a separate document, the Treasury Management Strategy (***Appendix A*** of this report).

Service Investments: Loans

Contribution

The Council will sometimes make investments to support service delivery objectives where there is a strategic case for doing so. This is an approach that has been adopted by the Council for many years for the delivery of a package of services, including Refuse Collection and Leisure. For example, the Council has previously invested in contractor loans for the procurement of Refuse Vehicles, which has realised a return for the Council in the form of lower contract payments, whilst protecting the local Waste Collection service.

More recently, the Council has invested (and continues to invest) in Service Loans to Qualis in order to help enable the deliver on the creation more jobs, growth in the local economy, and the improvement of housing and public amenities in the district.

The Council also provides "Home Assistance Loans" to eligible homeowners in certain circumstances (e.g., to help achieve the 'Decent Homes' standard in private sector housing). The loans are funded from the General Fund Capital Programme; they are secured against the property and are repayable on disposal.

In addition, the Council is committed to providing loans to leaseholders in Council owned blocks of flats for the cost of major works, for which they are liable under Section 20 of the Landlord and Tenant Act 1985 (as amended by the Commonhold and Leasehold Reform Act 2002). The loans are funded through the Housing Revenue Account and take the form extended payment periods (subject to interest charges). It is a new scheme, recently approved by the Cabinet, and the first loans are expected to be issued in 2023/24.

Security

The Qualis Business Plan requires the approval of the Council, and forms part of a wider Governance Framework purposely set-up to protect the interests of the Council (when lending to Qualis).

The main risk when making service loans generally is that the borrower will be unable to repay the principal lent and/or the interest due. In order to limit the risk, and ensure that overall exposure to service loans remains proportionate to the size of the Council, upper limits on the outstanding loans to each category of borrower have been set as follows:

Table 1: Service Investments

Category of Borrower	31/03/22 Actual			Total Approved Limit
	Balance Owing	Loss Allowance	Net Figure in Accounts	
	£000's	£000's	£000's	£000's
Subsidiaries (Qualis):				
Working Capital Loan	4,050	(69)	3,981	**6,000**
Asset Purchase Loan	14,630	(257)	14,373	**16,782**
Development Loans	10,800	(265)	10,535	**68,218**
Regeneration Loans	0	0	0	**35,000**
Home Assistance Loans (General Fund)	426	(186)	240	**150***
Leaseholder Loans (HRA)	0	0	0	**250****
TOTAL	**29,906**	**(777)**	**29,129**	**126,400**

** Draft Capital Programme allocation 2023/24 to 2027/28 (£30,000 over five-years)*
***Based on estimates supplied by Housing officers*

Accounting standards require the Council to set aside a loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Council's Statement of Accounts are shown net of this loss allowance. However, the Council makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments.

Risk Assessment

The Council assesses the risk of loss before committing to, and whilst holding, service loans. The approach taken is tailored to individual circumstances and will often include the engagement of professional advisors, the undertaking of credit checks etc. In addition, the Council will – wherever possible – look to securitise loans against physical assets (Property, Plant and Equipment).

Service Investments: Shares

Contribution

The Council will sometimes invest in shares to support local public services and stimulate local economic growth. Most notably the Council has 1 Ordinary Share in, and is the sole shareholder of, the Qualis Group, which has been set up to help create more jobs, grow the local economy, and improve housing and public amenities in the district.

Security

One of the risks of investing in shares is that they fall in value meaning that the initial outlay may not be recovered. However, in the case of the Qualis Group, (other than for service purposes) the Council has invested with a view to realising a significant financial return through the receipt of dividends and, despite limited liability status, the Council carries significant risk in the event of the financial failure of Qualis (e.g., through a guarantee to the Pension Fund as part of the transfer of staff from the former in-house Housing Repairs service).

The Qualis Business Plan therefore requires the approval of the Council, and forms part of a wider Governance Framework purposely set-up to protect the interests of the Council.

Risk Assessment

The Council assesses the risk of loss before committing to, and whilst holding, shares. The approach taken is tailored to individual circumstances, although in the case of Qualis, extensive use of professional advisors was made.

Non-Specified Investments

Shares are the only investment type that the Council has identified that meets the definition of a non-specified investment in Government guidance.

Commercial Investments: Property

Contribution

The Council invests in the acquisition of commercial property in a range of locations across the district. The value of the overall portfolio rose from £147.305 million to £162.006 million in 2021/22, with net income of £7.490 million achieved. Shops and Industrial Units have been two areas of emphasis and the returns achieved have been a key enabler in maintaining a low Council Tax charge in the district (currently the lowest district Council Tax in Essex) as well as helping to shape the district through the protection and promotion of local business and employment opportunities.

Table 2: Commercial Property Investments

Portfolio Category	Actuals				Expected		
	Balance Sheet Value 01/04/14	Net Additions/ (Disposals)	Gains/ (Losses)	Balance Sheet Value 31/03/22	Net Additions/ (Disposals)	Gains/ (Losses)	Balance Sheet Value 31/03/23
	£000's	£000's	£000's	£000's	£000's	£000's	£000's
Shops	**17,201**	58,220	23,721	**99,142**	(140)	205	**99,207**
Industrial Units	**12,997**	10,193	20,513	**43,703**	1,254	0	**44,957**
Other	**9,556**	320	9,285	**19,161**	0	0	**19,161**
Total Portfolio	**39,754**	**68,733**	**53,518**	**162,006**	**1,114**	**205**	**163,325***

**31/03/23 valuation estimates not available*

Security

In accordance with Government guidance, the Council considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs, a fair value assessment of the Council's investment property portfolio has been made within the past twelve months, and the underlying assets provide security for capital investment.

The Council's Commercial Property Portfolio has been acquired over many years and, within reporting deadlines, it has not been possible to identify the purchase cost of some of the older assets. Instead, the Balance Sheet value as at 1st April 2014 has been used as a proxy for purchase cost. The table above quite clearly shows a substantial gain in the value of the Portfolio over the last decade.

Risk Assessment

The Council assesses the risk of loss before committing to commercial property acquisitions; the 'strength of covenant' is of primary interest. Thus, checks on tenants, purchasers or sellers are done through Dunn & Bradstreet, with reports reviewed by property and finance teams within Qualis. Where financial strength is low/higher risk, rent deposits or guarantors may be required. For major transactions, Qualis may advise the Council not to engage with the other party if they are deemed to be high risk. Depending on the opportunity, in some instances, Qualis may look at insurance options in order to mitigate risk.

Liquidity

Compared with other investment types, commercial property is relatively difficult to sell and convert to cash at short notice and can take a considerable period of time to sell in certain market conditions.

However, the Council's liquidity risk is very low, which reflects the financing structure of the portfolio; underlying borrowing is minimal, having been purchased historically during a period when the Council's General Fund was debt free.

Commercial Investments: Loans

Contribution

The Council also provided an Investment Loan of £30.0 million to Qualis in September 2020. This was a key part of the Qualis Business Plan and was important part of helping to establish the company in its infancy.

The loan was utilised for the acquisition of commercial property outside the district, providing a key income stream to Qualis, which in turn enables the company to service the interest payments on a 10-Year maturity loan; the Council makes a margin on the interest payments.

Table 2: Commercial Loans

Category of Borrower	**31/03/22 Actual**			**Total Approved Limit**
	Balance Owing	**Loss Allowance**	**Net Figure in Accounts**	
	£000's	**£000's**	**£000's**	**£000's**
Subsidiaries (Qualis):				
Investment Loan	30,000	(476)	29,524	30,000
TOTAL	**30,000**	**(476)**	**(29,524)**	**(30,000)**

Security

In order to protect the Council's interests, both "floating" and "fixed" charges were included in the legal agreement for the Investment Loan, which would be activated in the event of a payment default by Qualis.

Risk Assessment

As with Service Loans, the Council assesses the risk of loss before committing to, and whilst holding, Commercial Loans. In this instance, given that Qualis was a fledgling company in September 2020, detailed consideration was also given to the Business Plan before the Council committed to granting the Investment Loan.

Loan Commitments and Financial Guarantees

Although not strictly counted as investments, since no money has exchanged hands yet, loan commitments and financial guarantees carry similar risks to the Council and are included here for completeness.

The Council became "self-financing" in respect of its retained housing stock from April 2012. The self-financing regime applied to all authorities and replaced the former Housing Subsidy system whereby the Council made annual payments to the Government funded from its HRA. Its introduction entailed a one-off redistribution of 'debt' between local authorities, and locally this resulted in the Council taking on PWLB loans, which it is required to service (instead of making Housing Subsidy payments).

If the HRA is unable to repay the debt at any point in the future, the Council (through its General Fund) is liable to repay any remaining balance. The remaining balance on the HRA debt as 31st March 2022 was £153.656 million.

The Council has also provided a guarantee (to the Essex County Pension Fund) on pension costs for 38 'TUPE protected' employees that transferred to Qualis in October 2020, as part of the transfer of the Housing Repairs service. If Qualis is unable to meet its liabilities incurred, through its participation in the Local Government Pension Scheme (LGPS), the Council is obliged to meet those costs on its behalf.

Proportionality

Table 4 below shows the extent to which the expenditure planned to meet the service delivery objectives of the Council is dependent on achieving the expected net profit from investments over the lifecycle of the MTFP. Should it fail to achieve the expected net profit, the Council's ongoing financial planning process includes short-term measures such as budget contingencies (e.g., a contingency of £0.713 million has been included in the 2023/24 final draft budget to cover for potential slippage in the forecast drawdown profile for Qualis Service Loans. The rolling MTFP also acts as an early warning sign, which enables the Cabinet and senior officers to be both proactive and reactive as financial circumstances dictate. This includes making suitable adjustments to spending priorities and targeting efficiency savings in order to reduce net expenditure.

Table 4: Proportionality of Investments

Description	2021/22 Actual £000's	2022/23 Forecast £000's	2023/24 Budget £000's	2024/25 MTFP £000's	2025/26 MTFP £000's
Investment Income	8,902	10,468	11,491	12,097	12,434
Gross Service Expenditure	70,101	70,306	71,832	74,392	74,535
Proportion	13%	15%	16%	16%	17%

Borrowing in Advance of Need

Government guidance is that local authorities must not borrow more than or in advance of their needs purely in order to profit from the extra sums borrowed. The Council follows this guidance and does not borrow more than or in advance of need.

Capacity, Skills, and Culture

Statutory Officers and Elected Members

The Council employs professionally qualified and experienced staff in senior positions with responsibility for making investment decisions. In particular, the Section 151 Officer, who is the strategic lead on the Council's finances, is a qualified (CIPFA) accountant with many years of experience, whereas the Deputy Section 151 Officer, who leads on operational matters, is also a qualified (ACCA) accountant, also with many years of experience. The Council is committed to the ongoing professional development of the other officers within the Finance function, which includes a commitment towards general professional development (e.g., through CIPFA, ACCA and AAT), as well focussed professional training in specialist areas including Treasury Management.

The Section 151 Officer maintains personal oversight on the negotiation of all major commercial deals and achieves oversight and control of all other commercial deals through the governance process; this extends to personally signing off significant financial commitments.

The Council also acknowledges the importance of ensuring that Members have appropriate capacity, skills, and information to effectively undertake their role on the Audit and Governance Committee and have arranged training in the past from the Council's Treasury Management advisors, Arlingclose.

Investment Indicators

The Council has set the following quantitative indicators to allow Members and the public to assess the Council's total risk exposure as a result of its investment decisions.

Total Risk Exposure

The first indicator shows the Council's total exposure to potential investment losses. This includes the amounts that the Council is committed to lend but have yet to be drawn down.

Table 5: Total Investment Exposure

Total Investment Exposure	31/03/2022 Actual	31/03/2023 Forecast	31/03/2024 Forecast
	£000's	£000's	£000's
Treasury Management Investments	18,700	14,961	14,977
Service Investments: Loans	29,906	35,967	70,076
Service Investments: Shares	0*	0*	0*
Commercial Investments: Property	162,006	163,325	163,325
Commercial Investments: Loans	30,000	30,000	30,000
TOTAL INVESTMENTS	**240,612**	**244,253**	**278,378**
Commitments to Lend	92,218	85,618	47,538
Guarantees Issued on Loans	0	0	0
TOTAL EXPOSURE	**332,830**	**329,871**	**325,916**

**De minimis (single share in Qualis) - loss allowances excluded*

How Investments are Funded

Government guidance is that these indicators should include how these investments are funded. Since the Council does not normally associate particular assets with particular liabilities, this guidance is difficult to comply with. However, the following investments could be described as being funded by borrowing. The remainder of the Council's investments are funded by usable reserves and income received in advance of expenditure.

Table 6: Investments Funded by Borrowing

Investments Funded by Borrowing	31/03/2022 Actual	31/03/2023 Forecast	31/03/2024 Forecast
	£000's	£000's	£000's
Treasury Management Investments	6,956	0	0
Service Investments: Loans	29,906	35,967	70,076
Service Investments: Shares	0	0	0
Commercial Investments: Property	27,525	28,828	28,828
Commercial Investments: Loans	30,000	30,000	30,000
TOTAL FUNDED BY BORROWING	**94,387**	**94,795**	**128,904**

Rate of Return

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. It should be noted 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 7: Investment Rate of Return

Investments Net Rate of Return	31/03/2022 Actual	31/03/2023 Forecast	31/03/2024 Forecast
	£000's	£000's	£000's
Treasury Management Investments	0.06%	2.93%	3.19%
Service Investments: Loans	4.23%	4.35%	2.74%
Service Investments: Shares	0	0	0
Commercial Investments: Property	4.65%	5.20%	5.29%
Commercial Investments: Loans	1.94%	1.94%	1.94%
ALL INVESTMENTS	**3.90%**	**4.54%**	**4.17%**