



**FLINTSHIRE COUNTY COUNCIL**

**TREASURY MANAGEMENT  
STRATEGY**

**2023/24**

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# Treasury Management Strategy Report 2023/24

The Council is recommended to:

- Adopt CIPFA's Treasury Management in the Public Services: Code of Practice 2021 edition (the CIPFA Code)
- approve the Treasury Management Strategy for 2023/24
- approve the Treasury Management Indicators for 2023/24

## **1.0 Introduction**

In April 2019 the Council adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice, 2017 Edition* (the CIPFA Code) which requires the Council to approve a Treasury Management Strategy before the start of each financial year.

The Institute published a revised version of the CIPFA code in December 2021. The Council is requested to formally adopt the Treasury Management in the Public Services: Code of Practice 2021 edition.

In addition, the Welsh Government (WG) issues guidance on local authority investments that requires the Council to approve an investment strategy before the start of each financial year. WG updated this guidance in November 2019.

This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and WG Guidance.

The successful identification, monitoring and control of risk are central to the Council's Treasury Management Strategy as 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 impact of changing interest rates.

In accordance with WG Guidance, the Council will be asked to approve a revised Treasury Management Strategy should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large, unexpected change in interest rates, in the Council's capital programme or in the level of its investment balance.

## **2.0 Economic Context (including interest rate forecast) – as provided by Arlingclose Ltd, December 2022**

**Economic background:** 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 Authority's treasury management strategy for 2023/24.

The Bank of England (BoE) increased 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 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 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 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.

Interest rates have also been rising sharply in the US, with the Federal Reserve increasing the range on its key interest rate by 0.5% in December 2022 to 4.25%-4.5%. This rise follows four successive 0.75% rises in a pace of tightening that has seen rates increase from 0.25%-0.50% in March 2022. Annual inflation has been slowing in the US but remains above 7%. GDP grew at an annualised rate of 3.2% (revised up from 2.9%) between July and September 2022, but with official interest rates expected to rise even further in the coming months, a recession in the region is widely expected at some point during 2023.

Inflation rose consistently in the Euro Zone since the start of the year, hitting a peak annual rate of 10.6% in October 2022, before declining to 10.1% in November. Economic growth has been weakening with an upwardly revised expansion of 0.3% (from 0.2%) in the three months to September 2022. As with the UK and US, the European Central Bank has been on an interest rate

tightening cycle, pushing up its three key interest rates by 0.50% in December, following two consecutive 0.75% rises, taking its main refinancing rate to 2.5% and deposit facility rate to 2.0%.

**Credit outlook:** Credit default swap (CDS) prices have generally followed an upward trend throughout 2022, indicating higher credit risk. They have been boosted by the war in Ukraine, increasing economic and political uncertainty and a weaker global and UK outlook, but remain well below the levels seen at the beginning of the Covid-19 pandemic.

CDS price volatility was higher in 2022 compared to 2021 and the divergence in prices between ringfenced (retail) and non-ringfenced (investment) banking entities has emerged once again.

The weakening economic picture during 2022 led the credit rating agencies to reflect this in their assessment of the outlook for the UK sovereign as well as several local authorities and financial institutions, revising them from to negative from stable.

There are competing tensions in the banking sector which could impact bank balance sheet strength going forward. The weakening economic outlook and likely recessions in many regions increase the possibility of a deterioration in the quality of banks' assets, while higher interest rates provide a boost to net income and profitability.

However, the institutions on our adviser Arlingclose's counterparty list remain well-capitalised and their counterparty advice on both recommended institutions and maximum duration remain under constant review and will continue to reflect economic conditions and the credit outlook.

**Interest rate forecast:** The Authority's treasury management adviser Arlingclose forecasts that Bank Rate will continue to rise in 2023 as the Bank of England attempts to subdue inflation which is significantly above its 2% 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 under its central case, with the risks in the near- and medium-term to the upside should inflation not evolve as the Bank forecasts and remains persistently higher.

Yields are expected to remain broadly at current levels over the medium-term, with 5, 10 and 20 year gilt yields expected to average around 3.5%, 3.5%, and 3.85% respectively over the 3-year period to December 2025. The risks for short, medium and longer-term yields are judged to be broadly balanced over the forecast horizon. As ever, there will undoubtedly be short-term volatility due to economic and political uncertainty and events.

**Table 1: Interest rate forecast**

	Bank Rate	3-month Money Market Rate	5-year Gilt Yield	20-year Gilt Yield	50-year Gilt Yield
Q1 2023	3.50	3.00	3.43	3.86	3.46
Q2 2023	4.00	4.40	3.60	3.85	3.60
Q3 2023	4.25	4.40	3.80	3.85	3.60
Q4 2023	4.25	4.40	3.80	3.85	3.60
Q1 2024	4.25	4.35	3.80	3.85	3.60
Q2 2024	4.25	4.30	3.70	3.85	3.60
Q3 2024	4.00	4.25	3.60	3.85	3.60
Q4 2024	3.75	4.00	3.50	3.85	3.60
Q1 2025	3.50	3.75	3.40	3.85	3.60
Q2 2025	3.25	3.50	3.30	3.85	3.60
Q3 2025	3.28	3.40	3.30	3.85	3.60

For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 3.9%, and that new long-term loans will be borrowed at an average rate of 4.6%.

### **3.0 Current Treasury Portfolio**

The Council's treasury portfolio as at 31<sup>st</sup> December 2022 was as follows:

**Table 2: Current Treasury Portfolio**

	Principal £m	Interest rate %
<b>Investments:</b>		
Call accounts	1.0	0.80
Money market funds	17.4	3.28
Short-term deposits	10.0	3.34
Long-term deposits	0.0	n/a
<b>Total Investments</b>	<b>28.4</b>	
<b>Borrowing:</b>		
Short-term loans	0.0	n/a
Long-term PWLB loans (fixed)	268.4	4.60
Long-term market loans (LOBOs)	18.9	4.53
Other Government loans	4.4	0.00
<b>Total Borrowing</b>	<b>291.7</b>	
<b>Net Borrowing</b>	<b>263.3</b>	

#### **4.0 Local Context**

Forecast changes in the sums in section 3 are shown in the balance sheet analysis in the table below.

**Table 3: Balance Sheet Summary and Forecast**

	<b>31.3.22 Actual £m</b>	<b>31.3.23 Estimate £m</b>	<b>31.3.24 Estimate £m</b>	<b>31.3.25 Estimate £m</b>	<b>31.3.26 Estimate £m</b>
Council Fund Capital Financing Requirement (Borrowing only)	217	220	240	262	274
Housing Revenue Account Capital Financing Requirement (Borrowing only)	132	134	143	154	161
<b>Capital Financing Requirement (Borrowing only)</b>	<b>349</b>	<b>354</b>	<b>383</b>	<b>416</b>	<b>435</b>
Less: Current ST borrowing	(10)	(290)	(285)	(278)	(273)
Less: Current LT borrowing	(294)				
<b>Funding Required</b>	<b>45</b>	<b>64</b>	<b>98</b>	<b>138</b>	<b>162</b>
Less: Usable reserves	(109)	(78)	(59)	(52)	(49)
Adj: Working capital	14	10	10	10	10
<b>Investments / (New borrowing)</b>	<b>50</b>	<b>4</b>	<b>(49)</b>	<b>(96)</b>	<b>(123)</b>

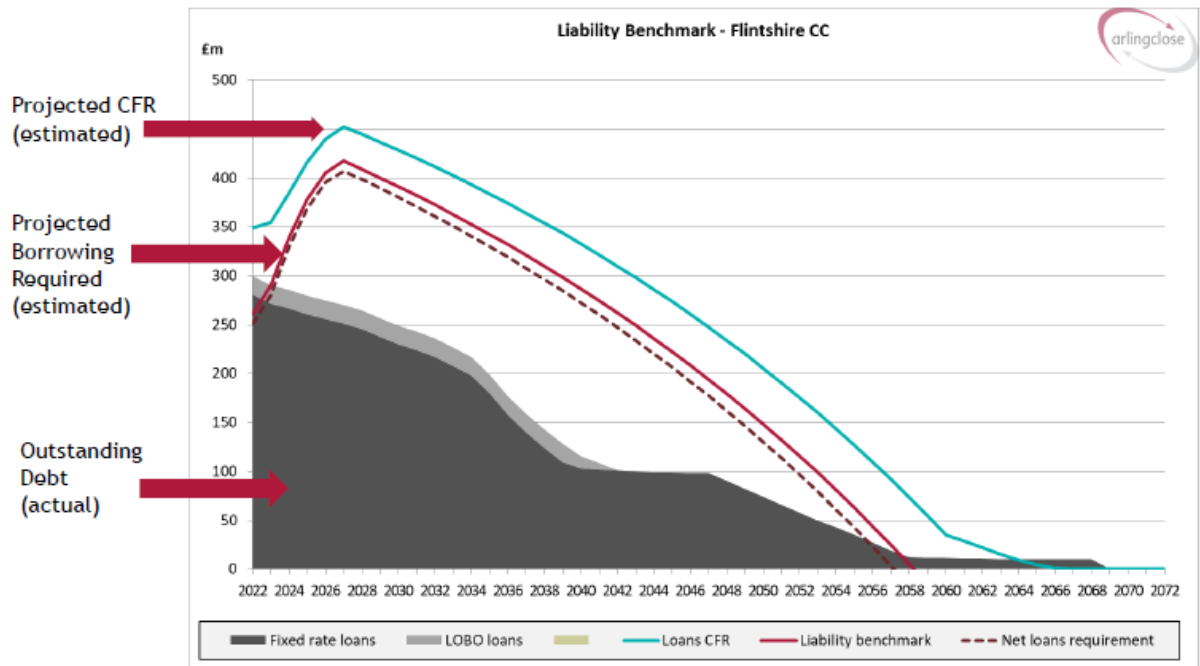
The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while balance sheet resources are the underlying resources available for investment. The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes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

Table 3 shows the Council's CFR increases during 2023/23, this is linked with the capital programme (examples of schemes funded by borrowing include the Sustainable Communities for Learning schools programme, redevelopment of Theatr Clwyd and the HRA capital programme, which includes building new social housing). The level of reserves the Council has is expected to fall in 2022/23 as funding earmarked for specific purposes falls due for payment. The combination of the increase in capital expenditure and a reduction in reserves, results in a sustained requirement for new borrowing over the medium term.

**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 3 above, but that cash and investment balances are kept to a minimum level to maintain sufficient 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 4: Liability Benchmark - Flintshire County Council (December 2022)**



The graph in Table 4 shows the Council’s anticipated liability benchmark over the next 50 years, being the net requirement for borrowing after considering resources available from reserves and working capital. The rise in the liability benchmark corresponds with the need to borrow to fund the increase in capital expenditure described above. The strategy in 2023/24, the same as in previous years, is to ensure that any new borrowing undertaken does not exceed the liability benchmark and cause the council to borrow more than it needs.

**Budget implications**

The budget for investment income in 2023/24 is £1.2m, based on an average investment portfolio of £30.4m at an average interest rate of 3.9%. The budget for interest on long-term loans in 2023/24 is £14.4m, based on long-term loans of £331m at an average interest rate of 4.55%. The budget for interest on short-term loans is £1.8m based on an average of the costs for the last 3 years. Interest paid will be apportioned between the Council Fund and the HRA. If levels of investments, borrowing and interest rates differ from those forecast, performance against budget will be correspondingly different.



## **5.0 Borrowing Strategy**

As at 31<sup>st</sup> December 2022, the Council held £291.7m of long-term loans, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in section 4 shows that the Council expects to need to undertake new borrowing during 2023/24.

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

The Council's capital expenditure plans will continue to be monitored throughout 2023/24 to inform and confirm the Council's long-term borrowing need (figures in section 4 are an estimate). This is to ensure that the Council does not commit to long-term borrowing too early and borrow unnecessarily which will be costly. The use of short-term borrowing will assist with such. This will be balanced against securing low long term interest rates currently being forecast.

Given the significant cuts to public expenditure and in particular to local government funding, 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 lower than long-term rates, it is likely to be more cost effective in the short-term to use internal resources and to borrow short-term instead.

By doing so, the Council is able to reduce net borrowing costs (despite forgone investment income) and reduce overall treasury risk, credit risk as a result of bail-in legislation in particular. The benefit of internal and short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when the 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 costs in the short-term.

The Council has previously raised the majority of its long-term borrowing from the PWLB but will consider long-term loans from other sources 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. 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 borrow for short periods of time to cover unexpected cash flow shortages.

### Sources of borrowing

The approved sources of long-term and short-term borrowing will be:

- 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 Clwyd Pension Fund)
- insurance companies
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

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
- Private Finance Initiative
- sale and leaseback
- WG Mutual Investment Model

### 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 will therefore be the subject of a separate report to full Council

### LOBOs

The Council holds £18.95m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. All of these LOBOs have options during 2023/24, and with interest rates having risen recently, there is now a reasonable chance that lenders will exercise their options. If they do, the Council will take the option to repay LOBO loans to reduce refinancing risk in later years.

## Short-term and Variable Rate loans

As at 31<sup>st</sup> December 2022, the Council held no short term (temporary) loans.

Any short-term loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators in section 7. Financial derivatives may be used to manage this interest rate risk (see section 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.

## Planned borrowing strategy for 2023/24

The Corporate Finance Manager will:

- Manage the Council's debt maturity profile, i.e., to leave no one future year with a high level of repayments that could cause problems in re-borrowing with the limits stated in this Strategy Statement. Appendix A analyses the debt portfolio of the Council as at 31<sup>st</sup> December 2022.
- Effect any borrowing that may be required in 2023/24 at the cheapest cost commensurate with future risk based on interest rate forecasts.
- Monitor and review the level of variable interest rate loans in order to take greater advantage of interest rate movements, within the limits stated in this Strategy.
- Continue to monitor options for debt-restructuring and debt re-payment.

The Corporate Finance Manager will monitor the interest rate market and adopt a pragmatic approach to any changing circumstances, reporting any decisions and actions taken under delegated powers to Cabinet via the Governance and Audit Committee.

## **6.0 Treasury Investment Strategy**

The Council holds surplus funds, representing income received in advance of expenditure, plus balances and reserves held. In the past 12 months, the Council's treasury average investment balance was £50.2m with similar or slightly lower levels expected to be maintained in the forthcoming year.

Non-treasury investments, including loans to subsidiaries and purchases of investment property, are not normally considered to be treasury investments, and these are therefore covered separately in Appendix B.

Both the CIPFA Code and the WG Guidance require 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 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. The existing portfolio of strategic pooled funds will be maintained to diversify risk into different sectors and boost investment income.

### **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. When investing in banks and funds, the Council will prioritise banks that are signatories to the UN Principles for Responsible Banking and funds operated by managers that are signatories to the UN Principles for Responsible Investment, the Net Zero Asset Managers Alliance and/or the UK Stewardship Code.

### **Investment criteria and limits**

The Council may invest its surplus funds with any of the counterparties in the following table, subject to the monetary and time limits shown.

**Table 5: Treasury investment counterparties and limits**

This table must be read in conjunction with the notes below

Sector	Time limit	Counterparty limit	Sector limit
The UK Government	50 years	Unlimited	n/a
Local authorities & other government entities	25 years	£4m	Unlimited
Secured investments *	25 years	£3m	Unlimited
Banks (unsecured) *	13 months	£3m	Unlimited
Building societies (unsecured) *	13 months	£3m	Unlimited
Registered providers (unsecured) *	5 years	£2m	Unlimited
Money market funds *	n/a	£4m	Unlimited
Strategic pooled funds	n/a	£1m	£5m
Real estate investment trusts	n/a	£1m	£1m
Other investments *	5 years	£2m	£10m

**\* 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.

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 £100k per counterparty as part of a diversified pool.

**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.

**Secured investments:** Investments secured on the borrower's assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher

of the collateral credit rating and the counterparty credit rating will be used. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments.

**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 Welsh Government. 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. 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.

**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.

**Real estate investment trusts (REITs):** Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.

**Other investments:** This category covers treasury investments not listed above, for example unsecured corporate bonds and company loans. Non-bank companies cannot be bailed-in but can become insolvent placing the Council's investment at risk.

**Operational bank accounts:** The Council may incur operational exposures, for example through 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 as low as possible. 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.

### 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. The credit rating agencies in current use are listed in the Treasury Management Practices document.

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 rating is on review for possible downgrade (also known as "negative watch") so that it is likely to fall below the above criteria, then no further investments will be made in 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 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, via the Debt Management Office for example, or with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

## Specified investments

The WG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement unless the counterparty is a local authority,
- not defined as capital expenditure by legislation, and
- invested with one of:
  - the UK Government,
  - a UK local authority, parish council or community council, or
  - a body or investment scheme of 'high credit quality'.

The Council defines 'high credit quality' organisations as those having a credit rating of A- or higher that are, domiciled in the UK, or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds 'high credit quality' is defined as those having a credit rating of A- or higher.

## Non-Specified Investments

Any financial investment not meeting the definition of a specified investment is classed as non-specified. The Council does not intend to make any investments in foreign currencies. Given the wide definition of a loan, this category only applies to units in pooled funds and shares in companies. Limits on non-specified investments are shown in the table below. The Council confirms that its current non-specified investments remain within these limits.

**Table 6: Non-Specified Investment Limits**

	Cash Limit
Total invested in pooled funds without credit rating	£5m
Shares in real estate investment trusts	£1m
Shares in local organisations	£1m
<b>Total non-specified investments</b>	<b>£7m</b>

## Foreign countries

Investments in foreign countries will be limited to a maximum of £5 million per foreign country. Investments in countries whose lowest sovereign rating is not AAA will be limited to one year's duration. No country limit will apply to investments in the UK, irrespective of the sovereign credit rating.

## Liquidity management

The Council uses purpose-built cash flow forecasting software to determine the maximum period for which funds may prudently be committed. 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.

### Business models

Under the new International Financial Reporting Standard (IFRS) 9, the accounting for certain investments depends on the Council's 'business model' for managing them. The Council aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

## **7.0 Treasury Management Prudential Indicators**

The Council measures and manages its exposures to treasury management risks using the following indicators. The Council is asked to approve the following indicators:

### Interest rate exposures

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:

<b>Interest rate risk indicator</b>	<b>2023/24 £m</b>	<b>2024/25 £m</b>	<b>2025/26 £m</b>
Upper limit on one-year revenue impact of a 1% rise in interest rates	0.114	0.166	0.213
Upper limit on one-year revenue impact of a 1% fall in interest rates	0.032	0.024	(0.023)

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.

Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate.

### 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 fixed rate borrowing will be:

	<b>Lower</b>	<b>Upper</b>
Under 12 months	0%	20%
12 months and within 24 months	0%	20%
24 months and within five years	0%	30%
Five years and within 10 years	0%	50%
10 years and above	0%	100%

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 the long-term treasury management investments will be:

Price risk indicator	2023/24	2024/25	2025/26
Limit on total principal invested beyond year end	£5m	£5m	£5m

Any long-term investments carried forward from previous years will be included in each year’s limit.

Borrowing limits

The Council is being asked to approve these Prudential Indicators as part of the Capital Strategy report. However, they are repeated here for completeness.

	2023/24	2024/25	2025/26
Operational boundary – borrowing	£383m	£419m	£439m
Operational boundary – other long-term liabilities	<u>£20m</u>	<u>£20m</u>	<u>£20m</u>
Operational boundary – TOTAL	£403m	£439m	£459m
Authorised limit – borrowing	£403m	£439m	£459m
Authorised limit – other long-term liabilities	<u>£35m</u>	<u>£35m</u>	<u>£35m</u>
Authorised limit – TOTAL	£438m	£474m	£494m

**8.0 Other Matters**

The CIPFA Code requires the Council to include the following in its treasury management strategy.

Financial derivatives:

Local authorities have previously made 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 24 of the Local Government and Elections (Wales) Act 2021 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).

The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded

derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria, assessed using the appropriate credit rating for derivative exposures. An allowance for credit risk calculated using the methodology in the Treasury Management Practices document will count against the counterparty credit limit and the relevant foreign country limit.

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.

### Policy on Apportioning Interest to HRA

The Council has adopted a single pool of loans which funds the capital expenditure of both Council Fund and HRA activities. The interest payable and other costs/income arising from long term loans (e.g., premiums and discounts on early redemption) is apportioned between the revenue accounts using the average Capital Financing Requirement (which measures the underlying need to borrow to fund capital expenditure) during the year.

Given that the HRA has minimal level of reserves compared to the total level of reserves held by the Council, any interest received on investments will be credited to the Council Fund revenue account.

### Markets in Financial Instruments Directive

The Council has opted up to professional client with its providers of financial services, including advisers, banks, and brokers, allowing it access to a 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 Corporate Finance Manager believes this to be the most appropriate status.

### Welsh Government Guidance

The WG Investment Guidance requires the Council to note the following matters each year as part of the investment strategy:

Treasury Management Advisers: The Council's treasury management adviser, Arlingclose continues to provide advice and information on the Council's investment and borrowing activities, although responsibility for final decision making remains with the Council and its officers. The services received include:

- advice and guidance on relevant policies, strategies and reports,
- advice on investment decisions,
- notification of credit ratings and changes,
- other information on credit quality,
- advice on debt management decisions,

- accounting advice,
- reports on treasury performance,
- forecasts of interest rates, and
- training courses.

The quality of this service is controlled by Financial Procedure Rules and Contract Procedure Rules.

### Capacity and skills training

The needs of the Council's treasury management team for training in treasury management are assessed as part of the employee appraisal process, and additionally when the responsibilities of individual members of the treasury team change.

Employees regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA. Relevant employees are also encouraged to study professional qualifications from CIPFA and other appropriate organisations.

Training for elected Members is provided by Arlingclose on an annual basis and by the treasury management team on an ongoing basis.

Training ensures that those elected members and statutory officers involved in the investments decision-making process have appropriate capacity, skills and information to enable them to: 1. take informed decisions as to whether to enter into a specific investment; 2. assess individual investments in the context of the strategic objectives and risk profile of the Council; and 3. understand how the quantum of these decisions have changed the overall risk exposure of the Council.

The Council is reviewing steps taken to ensure that those negotiating commercial deals are aware of the core principles of the prudential framework and of the regulatory regime within which local authorities operate.

### Investment of Money Borrowed in Advance of Need

Welsh Government guidance states that local authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed.

The Council will not borrow more than or in advance of their needs to profit from the investment but may, from time to time, borrow in advance of need, where this is expected to provide the best long-term value for money for example in a climate of rising interest rates. Since amounts borrowed will be invested until spent, the Council is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Council's overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit of £438 million. The maximum period between borrowing and expenditure is expected to be two years, although the Council is not required to link particular loans with particular items of expenditure.

### Climate change

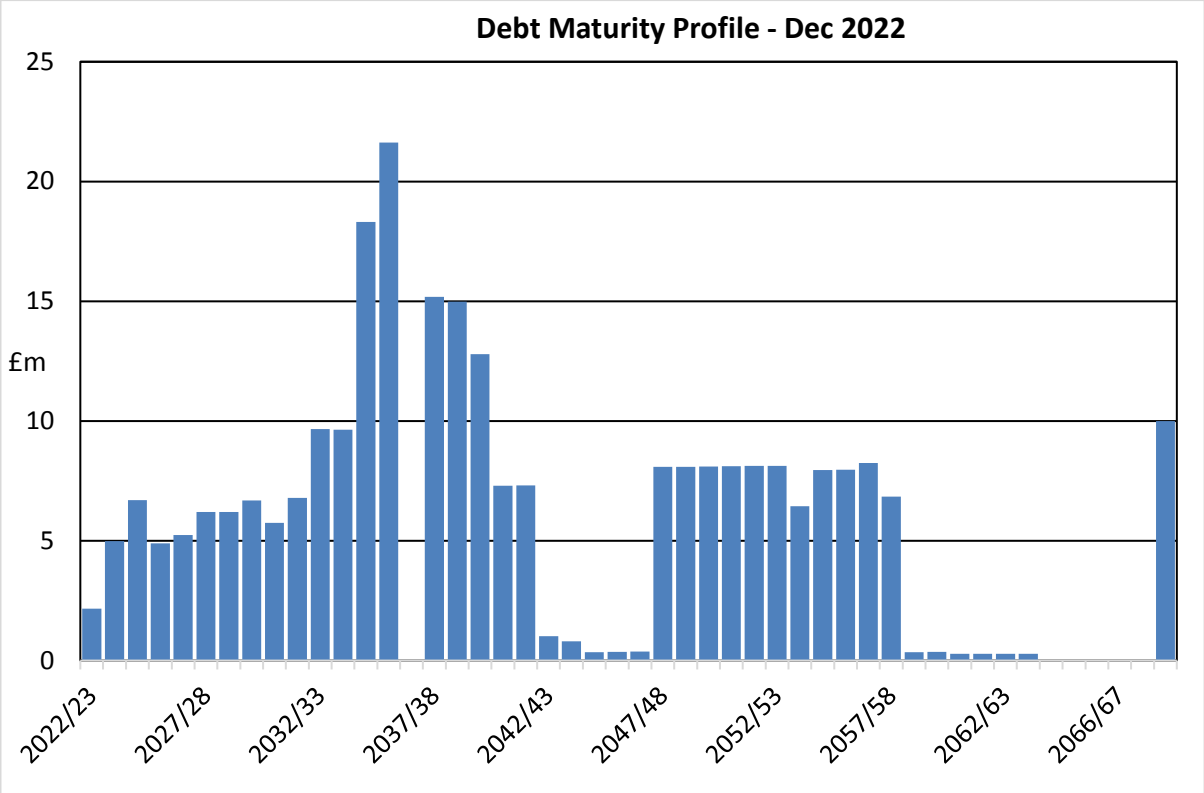
WG has set out its legal commitment to achieve net zero emissions by 2050 and work towards a net zero public sector in Wales by 2030. One of the Council's key priorities within the Council Plan is to become a net zero carbon Council by 2030. The Council has developed a Climate Change Strategy and action plan which sets the initial route map to support this wider decarbonisation actions across the County. The Council will continue to reviewing with Arlingclose what options are available for investments that support a low carbon economy.

### **Other Options Considered**

The WG Investment Guidance and the CIPFA Code of Practice do not prescribe any particular treasury management strategy for local authorities to adopt. The Corporate Finance Manager 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 in the following table.

<b>Alternative</b>	<b>Impact on income and expenditure</b>	<b>Impact on risk management</b>
Invest in a narrower range of counterparties and/or for shorter periods.	Interest income will be lower	Reduced risk of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer periods.	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 will 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 will 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 will be less certain

**APPENDIX A – DEBT MATURITY PROFILE**



## **APPENDIX B: Additional requirements of Welsh Government Investment Guidance – Non-Treasury Investments**

The Welsh Government (WG) published revised Investment Guidance in November 2019 which places additional reporting requirements upon local authorities and covers investments that are not part of treasury management. In this appendix the Council sets out the information required to comply with the WG guidance for non-treasury investments.

The Council has given loans to wholly owned companies for service purposes and has historical non-financial investments in property defined as Investment Properties within the Council's Statement of Accounts. The Council considers both to be non-treasury investments.

### **Loans to Wholly Owned Subsidiaries**

The WG guidance defines a loan as a written or oral agreement where the Council temporarily transfers cash to a third party, joint venture, subsidiary or associate who agrees a return according to the terms and conditions of receiving the loan, except where the third party is another local authority.

#### Contribution

The Council's investments in the form of loans to wholly owned companies contribute to its service delivery objectives and/or to promote wellbeing as follows:

The Council has embarked on an ambitious house building programme as part of its Strategic Housing and Regeneration Programme (SHARP). Over a 5-year period 500 new homes will be built at a range of sites across the county, a mixture of new council houses and affordable homes, alongside commissioning a range of linked regeneration initiatives and community benefits.

Affordable homes are being developed through the Council's wholly owned subsidiary North East Wales Homes Limited (NEW Homes) in partnership with the Council. Affordable homes for rent are built or purchased by NEW Homes funded by loans from the Council. New affordable homes for rent have been built in Flint, Penyffordd (Holywell), Dobshell, Bryn-y-Baal, Northop and Saltney.

#### Controls and Limits

The Council considers that its financial exposure to loans to wholly owned companies is proportionate and has set the limits in table B1. The Council's loan book is currently within these self-assessed limits.

NEW Homes was established on 3<sup>rd</sup> April 2014 to own, lease and manage properties with the aim of increasing the quantity and quality of affordable housing across the county.

NEW Homes is a company limited by shares, wholly owned by the Council (1 at £1 par value), established under section 95 of the Local Government Act 2003. The Council has a high level of control over NEW Homes as the single shareholder, approving:

- the issue of share capital
- the distribution of trading surplus
- the annual business plan
- any asset disposals
- any borrowing against assets
- appointment of directors to the board

**Table B1: Loan limits**

<b>Borrower</b>	<b>Cash Limit</b>
Wholly owned companies	£40m
Treasury management investments meeting the definition of a loan	Unlimited

The Council, as required, has considered allowing for an ‘expected credit loss’ model for loans and receivables as set out in IFRS 9: *Financial Instruments*, as adopted by proper practices, to measure the credit risk of its loan portfolio. When calculated, the expected credit loss was very small. Given the high level of control the Council has over NEW Homes and the security arrangements, the Council decided against setting up a provision for expected credit loss from the loans to NEW Homes.

Appropriate consideration is given to state aid rules and competition law. The Council sought specific legal and finance advice to ensure existing and future loans are compliant with State Aid regulations. The rates applied are below what NEW Homes would receive on the open market, and therefore are granted to NEW Homes under the Services of General Economic Interest Decision (a State Aid exemption). Arrangements are in place to monitor and ensure that the amount of aid granted through the loan does not exceed the net cost of providing the Service of General Economic Interest. A deed of entrustment is in place to clearly set out the requirements of both parties.

### Liquidity

The Council has borrowed from the PWLB to on-lend at a small margin to NEW Homes on the same terms and conditions, therefore the impact on the Council’s Treasury Management activities is limited.

The length of the loans has been determined by assessing the cash flow of each housing development scheme to ensure over the long-term affordable rents are sufficient to repay borrowing, interest, management costs, cyclical maintenance costs and reasonable allowances for voids and bad debts. Most schemes require an annuity loan commitment of 45 years, the maximum the Council would commit to is 50 years.

Agreements are in place ensuring that the Council has security on all NEW Homes properties which includes properties built using the loan funding and also other properties that NEW Homes owns outright (acquired from developers as part of Section 106 Planning Act agreements to provide affordable housing). In the event of a default, the Council could either sell the properties to repay its borrowing or include them within the Housing Revenue Account and continue to rent at social housing rent levels.



Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice and can take a considerable period to sell in certain market conditions. The Council accepts that the invested funds have been invested in NEW Homes for the length of the loans – approx. 45 years – and cannot readily be accessed for other purposes.

Yield (net profit)

The loans generate a small income for the Council as there is a margin of approx. 0.25% charged to NEW Homes on the Council’s borrowing rate from the PWLB. The income makes a very small contribution to achieving a balanced revenue budget. The yield as a proportion of net revenue budget is less than 0.015%.

**Investment Properties**

The Welsh Government guidance includes an investment category covering non-financial assets held primarily or partially to generate a profit, primarily investment property. Proper accounting practice defines an investment property as those that are held solely to earn rent and / or for capital appreciation.

The Council has a portfolio of investment properties, in the form of agricultural property and industrial units. Although these are classified as investment properties, they are legacy assets, and the council is managing down its agricultural portfolio and is reviewing its position in regard to industrial units.

Contribution

The Council’s investments, in the form of investment properties, contribute to its service delivery objectives and/or to promote wellbeing by providing a net financial surplus that is reinvested into local public services.

Security

The Welsh Government guidance requires that security is determined by comparing each asset’s purchase price to its fair value using the model in International Accounting Standard 40: *Investment Property*, as adapted by proper practices.

As the Council’s investment portfolio is of a historic nature, built up over many years, property purchase prices are not readily available to compare with current fair values. The table below shows the fair values of the current portfolio over the last 5 years demonstrating that the historic capital invested has remained stable over the past 5 years.

**Table B2: Fair Value of Investment Properties**

	31.3.2022 £m	31.3.2021 £m	31.3.2020 £m	31.3.2019 £m	31.3.2018 £m
Fair Value Inv. Properties	27.6	25.2	25.0	25.2	25.2

## Liquidity

The Council's investment properties are historical investment decisions and therefore will have limited impact on the Council's liquidity. No recent investment has taken place in investment properties, and therefore there is no recent borrowing associated.

## Yield (net profit)

The profit generated by investment activity makes a small contribution to achieving a balanced revenue budget. Table B3 below details the extent to which funding expenditure to meet the service delivery objectives and or promote wellbeing in the Council is dependent on achieving the expected yield over the life cycle of the Medium-Term Financial Plan.

**Table B3: Proportionality of Investment Properties**

	2021/22 Actual £m	2022/23 Budget £m	2023/24 Budget £m
Net Revenue Budget	297.457	326.682	346.251
Net Investment income	1.63	1.69	1.69
Proportion	0.55%	0.52%	0.49%