APPENDIX A

CAPITAL STRATEGY REPORT 2023/24 REDDITCH

Introduction

3.1 This capital strategy report gives a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability. It has been written in an accessible style to enhance members' understanding of these sometimes technical areas.

3.2 Decisions made this year on capital and treasury management will have financial consequences for the Authority for many years into the future. They are therefore subject to both a national regulatory framework and to local policy framework, summarised in this report.

Capital Expenditure and Financing

3.3 Capital expenditure is where the Authority spends money on assets, such as property or vehicles, that will be used for more than one year. In local government this includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets.

3.4 In 2023/24, the Authority is planning capital expenditure of £10.6m for General Fund projects, £37.8m for HRA work, and £23m for regeneration work, most of which is related to Towns Fund grant. This is summarised below:

Table 1: Prudential Indicator: Estimates of Capital Expenditure in £ millions

	2021/22 actual	2022/23 forecast	2023/24 budget	2024/25 budget	2025/26 budget
General Fund services	3.5	6.8	3.0	5.7	1.9
Council housing (HRA)	7.3	14.2	12.6	12.6	12.6
Regeneration Schemes (inlc Towns Fund)	0.0	2.2	9.6	10.5	2.9
TOTAL	10.8	23.2	25.3	28.8	17.5

The Council is still to finalise work required for the adoption of IFRS16 linking to the accounting for leases which must be implemented by the 2024/5 financial year.

3.5 The main General Fund capital projects include Towns Fund regeneration schemes (innovation Centre, Town Square, and Public Realm) totalling £16m to be spend by 2026, and UK Shared Prosperity Funding to be spent by 2025.

Following a change in the Prudential Code, the Authority no longer incurs capital expenditure on investments]

3.6 The Housing Revenue Account (HRA) is a ring-fenced account which ensures that council housing does not subsidise, or is itself subsidised, by other local services. HRA capital expenditure is therefore recorded separately.

3.7 **Governance**: Service managers bid annually to include projects in the Authority's capital programme. Bids are collated by corporate finance who calculate the financing cost (which can be nil if the project is fully externally financed). The Executive appraises all bids based on a comparison of strategic priorities against financing costs and makes recommendations to council. These recommendations are scrutinised by the Budget Scrutiny Working Group. The final capital programme is then presented to Executive and then Council in February each year.

- For full details of the Authority's capital programme, including the project appraisals undertaken, see: 2023/24 MTFP Phase 2 – Executive 7th February 2023.

3.8 All capital expenditure must be financed, either from external sources (government grants and other contributions), the Authority's own resources (revenue, reserves and capital receipts) or debt (borrowing, leasing and Private Finance Initiative). The planned financing of the above expenditure is as follows:

Table 2: Capital financing in £ millions

	2021/22 actual	2022/23 forecast	2023/24 budget	2024/25 budget	2025/26 budget
External sources	2.4	4.7	7.6	10.9	2.9
Capital Receipts	0.0	1.8	4.7	3.5	1.7
Revenue Resources	8.4	16.7	12.9	14.4	10.9
Debt	0.0	0.0	0.0	0.0	1.9
TOTAL	**10.8**	**23.2**	**25.3**	**28.8**	**17.5**

The Council is still to finalise work required for the adoption of IFRS16 linking to the accounting for leases which must be implemented by the 2024/5 financial year.

3.9 Debt is only a temporary source of finance, since loans and leases must be repaid, and this is therefore replaced over time by other financing, usually from revenue which is known as minimum revenue provision (MRP). Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance. Planned MRP and use of capital receipts are as follows:

Table 3: Replacement of prior years' debt finance in £ millions

	2021/22 actual	2022/23 forecast	2023/24 budget	2024/25 budget	2025/26 budget
Minimum Revenue Provision	1.0	0.9	1.0	0.9	1.2
Capital Receipts	0.0	0.0	0.0	0.0	0.0

➢ The Authority's minimum revenue provision statement is available as part of these papers.

3.10 The Authority's cumulative outstanding amount of debt finance is measured by the capital financing requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP and capital receipts used to replace debt. The CFR is expected to increase by £1m during 2023/24. Based on the above figures for expenditure and financing, the Authority's estimated CFR is as follows:

Table 4: Prudential Indicator: Estimates of Capital Financing Requirement in £ millions

	2021/22 actual	2022/23 forecast	2023/24 budget	2024/25 budget	2025/26 budget
General Fund	15.1	11.0	1.7	-1.2	6.3
HRA	122.2	122.2	122.2	122.2	122.2
Regeneration	0.0	2.2	9.6	10.5	2.9
TOTAL CFR	**137.3**	**135.4**	**133.5**	**131.5**	**131.4**

The Council is still to finalise work required for the adoption of IFRS16 linking to the accounting for leases which must be implemented by the 2024/5 financial year.

3.11 **Asset management:** To ensure that capital assets continue to be of long-term use, the Authority has an asset management strategy in place: Individual properties and associated land will be further evaluated to determine:

- The operational necessity and benefit.
- Projected costs of ensuring all elements of the buildings continue to meet legislative requirements and performance standards.
- Planned and cyclical maintenance costs for elements nearing the end of their 'life' expectancy, ensuring service provision is maintained without unnecessary interruption. Costs associated with meeting future EPC rating minimum requirements.
- Rent levels (and net costs for each building) and revised leases.
- Alternative or rationalised portfolio or joint enterprises for service delivery

By evaluation of all factors cited above, informed decisions can be made to determine which assets are:

- No longer cost effective to run, where outlay exceeds earning potential
- No longer viable for effective service delivery
- Surplus to requirements

Asset considerations will be presented to Executive on a half yearly basis, for approval for disposal, unless there is an urgent requirement for a decision.

The Authority's asset management strategy can be read here: Executive 25th October 2022.

3.12 **Asset disposals:** When a capital asset is no longer needed, it may be sold so that the proceeds, known as capital receipts, can be spent on new assets or to repay debt. The Authority is currently also permitted to spend capital receipts "flexibly" on service transformation projects until 2023/24 although none are planned. Repayments of capital grants, loans and investments also generate capital receipts. The Authority plans to receive £9.9m of capital receipts(%.1m linked to right to buy receipts) in the coming financial year as follows:

Table 5: Capital receipts receivable in £ millions

	2021/22 actual	2022/23 forecast	2023/24 budget	2024/25 budget	2025/26 budget
Asset Sales	0.000	1.800	4.700	3.500	1.700
Loans etc Repaid	0	0	0	0	0

- Further details of planned asset disposals are on set out in the 3.11 above:

<u>Treasury Management</u>

3.13 Treasury management is concerned with keeping sufficient but not excessive cash available to meet the Authority's spending needs, while managing the risks involved. Surplus cash is invested until required, while a shortage of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account. The Authority is typically cash rich in the short-term as revenue income is received before it is spent, but cash poor in the long-term as capital expenditure is incurred before being financed. The revenue cash surpluses are offset against capital cash shortfalls to reduce overall borrowing.

3.14 Due to decisions taken in the past, the Authority currently has £104m borrowing at an average interest rate of 3.42 % and £35m treasury investments at an average rate of 0.08%.

3.15 **Borrowing strategy:** The Authority's main objectives when borrowing are to achieve a low but certain cost of finance while retaining flexibility should plans change in future. These objectives are often conflicting, and the Authority therefore seeks to strike a balance between cheaper short-term loans and long-term fixed rate loans where the future cost is known but higher.

3.16 The Authority does not borrow to invest for the primary purpose of financial return and therefore retains full access to the Public Works Loans Board.

3.17 Projected levels of the Authority's total outstanding debt (which comprises borrowing, PFI liabilities, leases and transferred debt are shown below, compared with the capital financing requirement (see above).

Table 6: Prudential Indicator: Gross Debt and the Capital Financing Requirement in £ millions

	31.3.2022 actual	31.3.2023 forecast	31.3.2024 budget	31.3.2025 budget	31.3.2026 budget
Debt HRA	103.9	103.9	103.9	103.9	103.9
Debt General Fund (incl. PFI & leases)	0.0	0.0	0.0	0.0	0.0
Capital Financing Requirement	137.3	135.4	133.5	131.5	131.4

3.18 Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term. As can be seen from table 6, the Authority expects to comply with this in the medium term.

3.19 Liability benchmark: To compare the Authority's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes that cash and investment balances are kept to a minimum level of £0.2m at each year-end. This benchmark is currently negative give the Council internal resources and will only turn positive in 2025/26.

Table 7: Borrowing and the Liability Benchmark in £ millions

	31.3.2022 actual	31.3.2023 forecast	31.3.2024 forecast	31.3.2025 forecast	31.3.2026 forecast
Outstanding borrowing - General Fund	0.0	0.0	0.0	0.0	0.0
Liability benchmark	**-3.4**	**-2.5**	**-1.8**	**-2.9**	**-2.2**

3.20 The table shows that the Authority expects to remain borrowed above its liability benchmark. This is because cash outflows to date have been below the assumptions made when the loans were borrowed.

3.21 Affordable borrowing limit: The Authority is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year and to keep it under review. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach the limit.

Table 8: Prudential Indicators: Authorised limit and operational boundary for external debt in £m

	2021/22 limit	2022/23 limit	2023/24 limit	2024/25 limit	2025/26 limit
Authorised limit - borrowing	170	175	180	185	190
Authorised limit - PFI and leases	1.5	1.5	1.5	1.5	1.5
Authorised limit - total external debt	171.5	176.5	181.5	186.5	186.5
Operational boundary - borrowing	160	165	170	175	180
Operational boundary - PFI and leases	1.5	1.5	1.5	1.5	1.5
Operational boundary - total external debt	161.5	166.5	171.5	176.5	176.5

3.22 **Treasury investment strategy:** Treasury investments arise from receiving cash before it is paid out again. Investments made for service reasons or for pure financial gain are not generally considered to be part of treasury management.

3.23 The Authority's policy on treasury investments is to prioritise security and liquidity over yield, that is to focus on minimising risk rather than maximising returns. Cash that is likely to be spent in the near term is invested securely, for example with the government, other local authorities or selected high-quality banks, to minimise the risk of loss. Money that will be held for longer terms is invested more widely, including in bonds, shares and property, to balance the risk of loss against the risk of receiving returns below inflation. Both near-term and longer-term investments may be held in pooled funds, where an external fund manager makes decisions on which particular investments to buy and the Authority may request its money back at short notice.

Table 9: Treasury management investments in £millions

	2021/22 actual	2022/23 forecast	2023/24 budget	2024/25 budget	2025/26 budget
Near-term investments	34	35	30	20	20
Longer-term investments	0	0	0	0	0
TOTAL	**34**	**35**	**30**	**20**	**20**

- ➢ Further details on treasury investments are in Treasury Management Strategy part of this appendix.

3.24 **Risk management:** The effective management and control of risk are prime objectives of the Authority's treasury management activities. The treasury management strategy therefore sets out various indicators and limits to constrain the risk of unexpected losses and details the extent to which financial derivatives may be used to manage treasury risks.

- ➢ The treasury management prudential indicators are in the treasury management strategy which are part of these appendices.

3.25 **Governance:** Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Director of Finance and staff, who must act in line with the treasury management strategy approved by Council. Half Yearly reports on treasury management activity are presented to Executive. The Audit, Governance and Standards Committee is responsible for scrutinising treasury management decisions.

Investments for Service Purposes

3.26 The Authority can make investments to assist local public services, including making loans to local service providers, local small businesses to promote economic growth, the Authority's subsidiaries that provide services. Total investments for service purposes are currently valued at £0m

3.27 **Risk management:** In light of the public service objective, the Authority is willing to take more risk than with treasury investments, however it still plans for such investments to break even after all costs.. A limit of £2.5m is placed on total investments for service purposes to ensure that plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services .

3.28 **Governance:** Decisions on service investments are made by the relevant service manager in consultation with the Director of Finance and must meet the criteria and limits laid down in the investment strategy. Most loans and shares are capital expenditure and purchases will therefore also be approved as part of the capital programme. The relevant service director is responsible for ensuring that adequate due diligence is carried out before investment is made.

- Further details on service investments are in the Treasury Management Strategy.

Commercial Activities

3.29 With central government financial support for local public services declining, and the Change in PWLB regulations, the Council does not invest in commercial property purely or mainly for financial gain. It has Towns Funding of over £15m to deliver schemes over the next three years and an Office Complex in Oak Tree Park within the Borough (due to shortage) but these are both regeneration in nature.

3.30 **Risk management:** The Council will not make investments in commercial property purely or mainly for financial gain in the future. It might for re-generational purposes and if that is the case once regeneration have been delivered the Authority will assesses the risk of loss before entering into commercial agreements by using specialist advice to understand the market and the potential future demands of the market and the customers in it. It will also use benchmarking data from the market to determine future potential risks which need to be planned for. External advice will be sought from credible sources eg acknowledged experts in their fields, and officers ensure that they fully understand any information given to them before decision or advice is taken

In 2019 the Council did invest in property at Oak Tree Park Offices. The biggest issue facing Redditch's office market is the obsolesce of existing stock. By investing in existing premises, the Council has control over the condition and quality of its assets and therefore contributes to a supply of offices that are fit for purpose and attractive to the end occupiers. Therefore although a return is made this investment is for regenerative purposes

3.31 **Governance:** Decisions on commercial investments are made by Head of Finance and Customer Services in line with the criteria and limits approved by Council in the Investment strategy. Property and most other commercial investments are also capital expenditure and purchases will therefore also be approved as part of the capital programme. The Head of Finance and Customer Services is responsible for ensuring that adequate due diligence is carried out before investment is made.

Table 10: Prudential indicator: Net income from commercial and service investments to net revenue stream

	2021/22 actual	2022/23 forecast	2023/24 budget	2024/25 budget	2025/26 budget
Total net income	0	0	0	0	0
Proportion of net Revenue Stream	0%	0%	0%	0%	0%

Liabilities

3.33 In addition to debt of £104m detailed above, the Authority is committed to making future payments to cover its pension fund deficit (valued at £5.2m), It has also set aside £0.5m to cover risks of Insurance Claims.

3.24 **Governance:** Decisions on incurring new discretional liabilities are taken by service managers in consultation with the Interim Director of Finance. The risk of liabilities crystallising and requiring payment is monitored by Audit, Governance and Standards Committee. New liabilities exceeding £0.5m are reported to full council for approval/notification as appropriate.

Revenue Budget Implications

3.35 In addition to debt of £104m detailed above, the Authority is committed to making future payments to cover its pension fund deficit (which is in a deficit position of £5.179m as per the 2022 Triennial revaluation and the backlog will be cleared in 2037). It has also set aside £3.2m for Business Rates Appeals via a reserve.

Table 11: Prudential Indicator: Proportion of financing costs to net revenue stream

	2021/22 forecast	2022/23 budget	2023/24 budget	2024/25 budget	2025/26 budget
Financing costs (£m)	1.1	1.1	1.0	0.9	1.2
Proportion of net revenue stream	10.48%	10.48%	9.56%	9.09%	11.47%

The Council is still to finalise work required for the adoption of IFRS16 linking to the accounting for leases which must be implemented by the 2024/5 financial year.

3.36 **Sustainability:** Due to the very long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred in the next few years will extend for up to 50 years into the future. The Director of Finance] is satisfied that that the proposed capital programme is prudent, affordable and sustainable because of the current Medium Term Financial Plan (MTFP) forecasts which show that the Council is financially sustainable over that period.

Knowledge and Skills

3.37 The Authority employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Executive Director of Finance and Head of Service are qualified accountant with significant experience. The Authority pays for junior staff to study towards relevant professional qualifications including CIPFA and AAT.

3.38 Where Authority staff do not have the knowledge and skills required, use is made of external advisers and consultants that are specialists in their field. The Authority currently employs Arlingclose Limited as treasury management advisers, and Bruton Knowles as property consultants. This approach is more cost effective than employing such staff directly, and ensures that the Authority has access to knowledge and skills commensurate with its risk appetite.

- ➢ Further details on staff training can be found in the HR Employee Development section of the website.

APPENDIX B

TREASURY MANAGEMENT STRATEGY REPORT 2023/24

Introduction

3.1 Treasury management is the management of the Authority's cash flows, borrowing and investments, and the associated risks. The Authority 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 Authority's prudent financial management.

3.2 Treasury risk management at the Authority 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 Authority to approve a treasury management strategy before the start of each financial year. This report fulfils the Authority's legal obligation under the *Local Government Act 2003* to have regard to the CIPFA Code.

3.3 Investments held for service purposes or for commercial profit are considered in a different report, the Investment Strategy.

External Context

Economic background:

3.4 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.

3.5 The Bank of England (BoE) increased Bank Rate by 0.75% to 3.0% in November 2022, the largest single rate hike since 1989 and the eighth successive rise since December 2021. The decision was voted for by a 7-2 majority of the Monetary Policy Committee (MPC), with one of the two dissenters voting for a 0.50% rise and the other for just a 0.25% rise.

3.6 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.

3.7 The UK economy grew by 0.2% between April and June 2022, but 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.

3.8 CPI inflation is expected to peak 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 with a peak of 5.25%. However the BoE has stated it considers 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.

3.9 The labour market remains tight for now, with the most recent statistics showing the unemployment rate fell to 3.5%, driven mostly by a shrinking labour force. Earnings were up strongly in nominal terms by 6% for total pay and 5.4% for regular pay but factoring in inflation means real total pay was -2.4% and regular pay -2.9%. Looking forward, the 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.

3.10 Interest rates have also been rising sharply in the US, with the Federal Reserve increasing the range on its key interest rate by 0.75% in November 2022 to 3.75%-4.0%. This was the fourth successive 0.75% rise 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 8%. GDP grew at an annualised rate of 2.6% between July and September 2022, a better-than-expected rise, 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.

3.11 Inflation has been rising consistently in the Euro Zone since the start of the year, hitting an annual rate of 10.7% in October 2022. Economic growth has been weakening with an expansion of just 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 0.75% in October, the third major increase in a row, taking its main refinancing rate to 2% and deposit facility rate to 1.5%.

Credit outlook:

3.12 Credit default swap (CDS) prices have followed an upward trend throughout the year, 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.

3.13 CDS price volatility has been higher in 2022 compared to 2021 and this year has seen a divergence in prices between ringfenced (retail) and non-ringfenced (investment) banking entities once again.

3.14 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.

3.15 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.

3.16 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 (November 2022):

3.17 The Authority's treasury management adviser Arlingclose forecasts that Bank Rate will continue to rise in 2022 and 2023 as the Bank of England attempts to subdue inflation which is significantly above its 2% target.

3.18 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.

3.19 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 3.6%, 3.7%, and 3.9% respectively over the 3-year period to September 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.

3.20 A more detailed economic and interest rate forecast provided by Arlingclose is in Appendix A.

3.21 For the purpose of setting the budget, it has been assumed that new treasury investments will be made at an average rate of 2.00%, and that new long-term loans will be borrowed at an average rate of 4.57% which is the PWLB rate for 40 year debt on the 16th January 2022.

Local Context

3.22 On 31st December 2022, the Authority held £103.9m of borrowing and £29m of treasury investments. This is set out in further detail in this report. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance sheet summary and forecast

	31.3.22 Actual £m	31.3.23 Estimate £m	31.3.24 Forecast £m	31.3.25 Forecast £m	31.3.26 Forecast £m
General Fund CFR	15.1	13.2	11.3	9.3	9.2
Investments CFR	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Total CFR	**15.1**	**13.2**	**11.3**	**9.3**	**9.2**
Less: External borrowing **	0.0	0.0	0.0	0.0	0.0
Internal (over) borrowing	**15.1**	**13.2**	**11.3**	**9.3**	**9.2**
Less: Usable reserves	**-12.5**	**-9.7**	**-7.1**	**-6.2**	**-5.5**
Less: Working capital	-6.2	-6.2	-6.2	-6.2	-6.2
Treasury investments (or New borrowing)	**3.6**	**2.7**	**2.0**	**3.1**	**2.4**

* leases that form part of the Authority's total debt
** shows only loans to which the Authority is committed and excludes optional refinancing

3.23 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 Authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

The Authority has an increasing CFR due to the capital programme, but minimal investments and will not need to borrow in the short term to finance its capital programme until 2025/26.

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

3.25 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 £0.2m at each year-end to maintain sufficient liquidity but minimise credit risk.

3.26 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

	31.3.21 Actual £m	31.3.22 Estimate £m	31.3.23 Forecast £m	31.3.24 Forecast £m	31.3.25 Forecast £m
CFR	15.1	13.2	11.3	9.3	9.2
Less: Usable reserves	-12.5	-9.7	-7.1	-6.2	-5.5
Less: Working capital	-6.2	-6.2	-6.2	-6.2	-6.2
Plus: Minimum investments	0.2	0.2	0.2	0.2	0.2
Liability Benchmark	**-3.4**	**-2.5**	**-1.8**	**-2.9**	**-2.2**

3.27 Following on from the medium-term forecasts in table 2 above, the long-term liability benchmark assumes capital expenditure funded by internal resources.

Borrowing Strategy

3.28 The Authority currently holds £104 million of loans, no change on the previous year, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 1 shows that the Authority does not expect to need to borrow in 2023/24. The Authority may also borrow additional sums to pre-fund future years' approved requirements, providing this does not exceed the authorised limit for borrowing.

3.29 **Objectives:** The Authority'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 Authority's long-term plans change is a secondary objective.

3.30 **Strategy:** Given the significant cuts to public expenditure and in particular to local government funding, the Authority'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.

3.31 By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce 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 Authority with this 'cost of carry' and breakeven analysis. Its output may determine whether the Authority 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.

3.32 The Authority 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 Authority intends to avoid this activity in order to retain its access to PWLB loans.

3.33 Alternatively, the Authority 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.

3.34 In addition, the Authority may borrow short-term loans to cover unplanned cash flow shortages.

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

3.36 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
- Private Finance Initiative
- sale and leaseback

3.27 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].

3.29 **Short-term and variable rate loans**: These loans leave the Authority 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. Financial derivatives may be used to manage this interest rate risk (see section below).

3.30 **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 Authority 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

3.31 The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Authority's treasury investment balance has ranged between £20 and £40 million, and similar levels are expected to be maintained in the forthcoming year.

3.21 **Objectives:** The CIPFA Code requires the Authority 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 Authority'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 Authority 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. Redditch Borough Council aims to be a responsible investor and will consider environmental, social and governance (ESG) issues when investing.

3.33 **Strategy:** As demonstrated by the liability benchmark above, the Authority expects to be a funding borrowing from internal resources 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.

3.34 The CIPFA Code does not permit local authorities to both borrow and invest long-term for cash flow management. But the Authority may make long-term investments for treasury risk management purposes, including to manage interest rate risk by investing sums borrowed in advance for the capital programme for up to three years; to manage inflation risk by investing usable reserves in instruments whose value rises with inflation; and to manage price risk by adding diversification to the strategic pooled fund portfolio.

3.35 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 Authority'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 Authority 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.

3.36 Business models: Under the IFRS 9 standard, the accounting for certain investments depends on the Authority's "business model" for managing them. The Authority aims to achieve value from its 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.

3.37 Approved counterparties: The Authority may invest its surplus funds with any of the counterparty types in table 3 below, subject to the limits shown.

Table 3: Treasury investment counterparties and limits

Credit rating	Banks unsecured	Banks secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£3 m 5 years	£3m 20 years	£3m 50 years	£3m 20 years	£1m 20 years
AA+	£3m 5 years	£3m 10 years	£3m 25 years	£3m 10 years	£1m 10 years
AA	£3m 4 years	£3m 5 years	£3m 15 years	£3m 5 years	£1m 10 years
AA-	£3m 3 years	£3m 4 years	£3m 10 years	£3m 4 years	£1m 10 years
A+	£3m 2 years	£3m 3 years	£3m 5 years	£3m 3 years	£1m 5 years
A	£3m 13 months	£3m 2 years	£3m 5 years	£3m 2 years	£1m 5 years
A-	£3m 6 months	£3m 13 months	£3m 5 years	£3m 13 months	£1m 5 years
None	£1.5m 6 months	n/a	£3m 25 years	£1m 5 years	£500k 5 years

Pooled funds and real estate investment trusts	£2.5m per fund or trust

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

3.39 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 £500,000 per counterparty as part of a diversified pool e.g. via a peer-to-peer platform.

3.40 **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.

3.41 **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.

3.42 **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.

3.43 **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.

3.44 **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 Authority will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

3.45 **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 Authority 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 Authority's investment objectives will be monitored regularly.

3.46 **Real estate investment trusts:** 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.

3.47 **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 Authority's investment at risk.

3.48 **Operational bank accounts:** The Authority 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 £2.0m per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Authority maintaining operational continuity.

3.49 **Risk assessment and credit ratings**: Credit ratings are obtained and monitored by the Authority'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.

3.50 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.

3.51 **Other information on the security of investments**: The Authority 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 Authority'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.

3.52 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 Authority 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 Authority'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.

3.53 **Investment limits**: The Authority's revenue reserves available to cover investment losses are forecast to be £9.7 million on 31st March 2023 and £7.1 million on 31st March 2024. In order that no more than 45% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £5.0 million. A group of entities under the same ownership will be treated as a single organisation for limit purposes.

3.54 Credit risk exposures arising from non-treasury investments, financial derivatives and balances greater than £2m in operational bank accounts count against the relevant investment limits.

3.55 Limits are also placed on fund managers, investments in brokers' nominee accounts and foreign countries as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table 4: Additional investment limits

	Cash limit
Any single organisation, except the UK Central Government	£5m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£5m per group
Any group of pooled funds under the same management	£5m per manager
Negotiable instruments held in a broker's nominee account	£5m per broker
Foreign countries	£5m per country
Registered providers and registered social landlords	£2.5m in total
Unsecured investments with building societies	£2.5m in total
Loans to unrated corporates	£1m in total
Money market funds	£20m in total
Real estate investment trusts	£2.5m in total

3.55 **Liquidity management**: The Authority uses detail spreadsheets 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 Authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Authority's medium-term financial plan and cash flow forecast.

3.56 The Authority will spread its liquid cash over at least four providers (e.g. bank accounts 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

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

3.58 **Security:** The Authority 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**

3.59 **Liquidity:** The Authority 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	£2.5m

3.61 **Interest rate exposures**: This indicator is set to control the Authority'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
Upper limit on one-year revenue impact of a 1% rise in interest rates	£500,000
Upper limit on one-year revenue impact of a 1% fall in interest rates	£500,000

3.62 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.

3.63 **Maturity structure of borrowing:** This indicator is set to control the Authority'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 above	50%	0%

The Council has not taken out debt financing for a number of years, therefore all debt is presently over 10 years old. This revised ratio gives flexibility for new debt that will possibly be required. Time periods start on the first day of each financial year.

3.64 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.

3.65 **Long-term treasury management investments:** The purpose of this indicator is to control the Authority'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	No fixed date
Limit on principal invested beyond year end	£1.5m	£1m	£0.5m	£0m

3.66 Long-term investments with no fixed maturity date include strategic pooled funds and real estate investment trusts but exclude money market funds and bank accounts with no fixed maturity date as these are considered short-term.

Related Matters

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

3.68 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 1 of the *Localism Act 2011* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

3.69 The Authority 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 Authority 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.

3.70 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.

3.71 In line with the CIPFA Code, the Authority will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.

3.72 Housing Revenue Account: On 1st April 2012, the Authority notionally split each of its existing long-term loans into General Fund and HRA pools. In the 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 each month and interest transferred between the General Fund and HRA at the Authority's average interest rate on investments, adjusted for credit risk.

3.73 **External Funds:** The Council does invest funds for its fully owned subsidiary Rubicon.

3.74 **Markets in Financial Instruments Directive**: The Authority has retained retail client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a smaller range of services but with the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Authority's treasury management activities, the Director of Finance believes this to be the most appropriate status.

Financial Implications

3.75 The budget for investment income in 2023/24 is £0.670 million, based on an average investment portfolio of £30 million at an interest rate of 2.0%. The budget for debt interest paid in 2023/24 is £0.448m million, based on an average general fund debt portfolio of £12 million at an average interest rate of 3.42%. If actual levels of investments and borrowing, or actual interest rates, differ from those forecast, performance against budget will be correspondingly different

3.76 Where investment income exceeds budget, e.g. from higher risk investments including pooled funds, or debt interest paid falls below budget, e.g. from cheap short-term borrowing, then 50% of the revenue savings will be transferred to a treasury management reserve to cover the risk of capital losses or higher interest rates payable in future years.

Other Options Considered

3.77 The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Director of Finance, having consulted the Executive Member for Finance and Enabling, 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

Appendix A – Arlingclose Economic & Interest Rate Forecast – November 2022

Underlying assumptions:

- UK interest rate expectations have eased following the mini-budget, with a growing expectation that UK fiscal policy will now be tightened to restore investor confidence, adding to the pressure on household finances. The peak for UK interest rates will therefore be lower, although the path for interest rates and gilt yields remain highly uncertain.
- Globally, economic growth is slowing as inflation and tighter monetary policy depress activity. Inflation, however, continues to run hot, raising expectations that policymakers, particularly in the US, will err on the side of caution, continue to increase rates and tighten economies into recession.
- The new Chancellor dismantled the mini-budget, calming bond markets and broadly removing the premium evident since the first Tory leadership election. Support for retail energy bills will be less generous, causing a lower but more prolonged peak in inflation. This will have ramifications for both growth and inflation expectations.
- The UK economy is already experiencing recessionary conditions, with business activity and household spending falling. Tighter monetary and fiscal policy, alongside high inflation will bear down on household disposable income. The short- to medium-term outlook for the UK economy is bleak, with the BoE projecting a protracted recession.
- Demand for labour remains strong, although there are some signs of easing. The decline in the active workforce has fed through into higher wage growth, which could prolong higher inflation. The development of the UK labour market will be a key influence on MPC decisions. It is difficult to see labour market strength remaining given the current economic outlook.
- Global bond yields have steadied somewhat as attention turns towards a possible turning point in US monetary policy. Stubborn US inflation and strong labour markets mean that the Federal Reserve remains hawkish, creating inflationary risks for other central banks breaking ranks.
- However, in a departure from Fed and ECB policy, in November the BoE attempted to explicitly talk down interest rate expectations, underlining the damage current market expectations will do to the UK economy, and the probable resulting inflation undershoot in the medium term. This did not stop the Governor affirming that there will be further rises in Bank Rate.

Forecast:

- The MPC remains concerned about inflation but sees the path for Bank Rate to be below that priced into markets.
- Following the exceptional 75bp rise in November, Arlingclose believes the MPC will slow the rate of increase at the next few meetings. Arlingclose now expects Bank Rate to peak at 4.25%, with a further 50bp rise in December and smaller rises in 2023.

- The UK economy likely entered into recession in Q3, which will continue for some time. Once inflation has fallen from the peak, the MPC will cut Bank Rate.
- Arlingclose expects gilt yields to remain broadly steady despite the MPC's attempt to push down on interest rate expectations. Without a weakening in the inflation outlook, investors will price in higher inflation expectations given signs of a softer monetary policy stance.
- Gilt yields face pressures to both sides from hawkish US/EZ central bank policy on one hand to the weak global economic outlook on the other. BoE bond sales will maintain yields at a higher level than would otherwise be the case.

	Current	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25
Official Bank Rate													
Upside risk	0.00	0.25	0.50	0.75	1.00	1.00	1.00	1.25	1.50	1.75	1.50	1.25	1.25
Arlingclose Central Case	3.00	3.50	4.00	4.25	4.25	4.25	4.25	4.00	3.75	3.50	3.50	3.50	3.50
Downside risk	0.00	0.25	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00
3-month money market rate													
Upside risk	0.00	0.25	0.50	0.75	1.00	1.00	1.00	1.25	1.50	1.75	1.50	1.25	1.25
Arlingclose Central Case	3.00	3.90	4.40	4.40	4.40	4.35	4.30	4.25	4.00	3.75	3.75	3.75	3.75
Downside risk	0.00	0.25	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00
5yr gilt yield													
Upside risk	0.00	0.60	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.36	3.65	3.90	3.90	3.90	3.90	3.80	3.70	3.60	3.50	3.40	3.30	3.20
Downside risk	0.00	0.70	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
10yr gilt yield													
Upside risk	0.00	0.60	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.46	3.70	3.75	3.75	3.75	3.70	3.70	3.70	3.70	3.70	3.70	3.70	3.70
Downside risk	0.00	0.70	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
20yr gilt yield													
Upside risk	0.00	0.60	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.88	4.00	4.00	4.00	4.00	4.00	3.90	3.90	3.90	3.90	3.90	3.90	3.90
Downside risk	0.00	0.70	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
50yr gilt yield													
Upside risk	0.00	0.60	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.24	3.40	3.40	3.40	3.40	3.40	3.30	3.30	3.30	3.30	3.30	3.30	3.30
Downside risk	0.00	0.70	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00

PWLB Standard Rate (Maturity Loans) = Gilt yield + 1.00%
PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%
UKIB Rate (Maturity Loans) = Gilt yield + 0.60%

Appendix B – Existing Investment & Debt Portfolio Position

	31.12.22 **Actual portfolio £m**	31.3.22 **Average rate %**
External borrowing:		
Public Works Loan Board	**98.9**	**3.35**
Local authorities		
LOBO loans from banks		
Other loans	**5.0**	**4.71**
Total external borrowing	**103.9**	**3.42**
Other long-term liabilities:		
Private Finance Initiative		
Leases		
Transferred Debt		
Total other long-term liabilities	0	0
Total gross external debt	**103.9**	**3.42**
Treasury investments:		
The UK Government	**19.7**	
Local authorities		
Other government entities		
Secured investments		
Banks (unsecured)		
Building societies (unsecured)		
Registered providers (unsecured)		
Money market funds	**9.1**	
Strategic pooled funds		
Real estate investment trusts		
Other investments		
Total treasury investments	**28.8**	**1.56**
Net debt	**75.1**	

APPENDIX C

Annual Minimum Revenue Provision Statement 2023/24

Introduction

3.1 Where the Authority finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The *Local Government Act 2003* requires the Authority to have regard to the former Ministry of Housing, Communities and Local Government's *Guidance on Minimum Revenue Provision* (the MHCLG Guidance) most recently issued in 2018.

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

3.3 The MHCLG Guidance requires the Authority to approve an Annual MRP Statement each year and recommends a number of options for calculating a prudent amount of MRP. The following statement incorporates options recommended in the Guidance as well as locally determined prudent methods.

- For unsupported capital expenditure incurred after 31st March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant asset as the principal repayment on an annuity with an annual interest rate of 4%, starting in the year after the asset becomes operational. MRP on purchases of freehold land will be charged over 50 years. MRP on expenditure not related to fixed assets but which has been capitalised by regulation or direction will be charged over 20 years.
- For assets acquired by leases MRP will be determined as being equal to the element of the rent or charge that goes to write down the balance sheet liability.
- When former operating leases are brought onto the balance sheet due to the adoption of the *IFRS 16 Leases* accounting standard, and the asset values have been adjusted for accruals, prepayments, premiums and/or incentives, then the annual MRP charges will be adjusted so that the total charge to revenue remains unaffected by the new standard.
- For capital expenditure loans to third parties that are repaid in annual or more frequent instalments of principal, the Council will make nil MRP, but will instead apply the capital receipts arising from principal repayments to reduce the capital financing requirement instead. In years where there is no principal repayment, MRP will be charged in accordance with the MRP policy for the assets funded by the loan, including where appropriate, delaying MRP until the year after the assets become operational. While this is not one of the options in the MHCLG Guidance, it is thought to be a prudent approach since it ensures that the capital expenditure incurred on the loan is fully funded over the life of the assets.

- There is no requirement to charge MRP where the Capital Financing Requirement (CFR) is nil or negative at the end of the preceding financial year
- Where the council makes a capital contribution or loan to another entity or where responsibility for a council asset with borrowing attached is transferred to a third party, then no MRP will be set aside if:
    - the payments are appropriately covered by assets
    - there are detailed plans demonstrating that all the expenditure will be recovered in an appropriately short time frame

To ensure that this remains a prudent approach the Council will review the expenditure and income regularly to determine if the income or asset values have decreased to the point that MRP needs to be provided for. Should evidence emerge which suggests the expenditure will no longer be recovered MRP will be provided for.

- Where the council uses internal borrowing and receipts of rental income are greater than the MRP calculated then as there are sufficient revenues to repay the capital cost no MRP will be set aside.

3.4 Capital expenditure incurred during 2023/24 will not be subject to a MRP charge until 2024/25 or later.

3.5 Based on the Authority's latest estimate of its capital financing requirement (CFR) on 31st March 2023, the budget for MRP has been set as follows:

:

	31.03.2023 Estimated CFR £m	**2023/24 Estimated MRP £**
Capital expenditure before 01.04.2008		
Supported capital expenditure after 31.03.2008		
Unsupported capital expenditure after 31.03.2008	19.8	910.000
Leases and Private Finance Initiative		
Transferred debt		
Loans to other bodies repaid in instalments		Nil
Voluntary overpayment (or use of prior year overpayments)	n/a	
Total General Fund		**910,000**
Assets in the Housing Revenue Account	**23.3**	
HRA subsidy reform payment	**98.9**	
Total Housing Revenue Account	**122.2**	**0**
Total	**143.0**	**910,000**

APPENDIX D

INVESTMENT STRATEGY REPORT 2023/24

Introduction

3.1 The Authority 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).

3.2 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

3.3 The Authority 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 central 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. The balance of treasury management investments is expected to fluctuate between £20m and £40m during the 2023/24 financial year.

3.4 Contribution: The contribution that these investments make to the objectives of the Authority is to support effective treasury management activities.

3.5 Further details: Full details of the Authority's policies and its plan for 2023/24 for treasury management investments are covered in a separate document, the treasury management strategy, which is part of these appendices.

Service Investments: Loans

3.6 Contribution: The Council will lend money to its subsidiaries, local businesses, local charities, housing associations, to support local public services and stimulate local economic growth.

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

Table 1: Loans for service purposes in £ millions

Category of borrower	31.3.2022 actual			2023/24
	Balance owing	Loss allowance	Net figure in accounts	Approved Limit
Subsidiaries			0	1.0
Suppliers			0	0
Parish councils			0	0
Local businesses			0	0.5
Local charities			0	0.5
Housing associations			0	1.0
Local residents			0	0
Employees			0	0
TOTAL			**0**	**3.0**

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

3.9 **Risk assessment:** The Authority assesses the risk of loss before entering into and whilst holding service loans by using specialist advice to understand the market and the potential future demands of the market and the customers in it. It will also use benchmarking data from the market to determine future potential risks which need to be planned for. External advice is only sought from credible sources eg acknowledged experts in their fields, and officers ensure that they fully understand any information given to them before decision or advice is taken.

<u>Commercial Investments: Property</u>

3.10 **Contribution:** The Council has Towns Fund Funding of over £15m to regenerate the Town Centre and deliver an Innovation Centre. Although these schemes will generate an income stream at the end of the process their main purpose, as per the Grant requirements, is for regeneration. As set out in the Capital Strategy it invested in offices at Oak Tree Part in 2019 for regenerative purposes (See Asset Strategy). Fully let these premises will generate £76k per annum. The Council does not invest in property for commercial gain.

Table 3: Property held for investment purposes in £ millions

Property	Actual	31.3.2022 actual		31.3.2023 expected	
	Purchase cost	Gains or (losses)	Value in accounts	Gains or (losses)	Value in accounts
N/a	**0**	**0**	**0**	**0**	**0**
TOTAL	**0**	**0**	**0**	**0**	**0**

3.16 **Security:** In accordance with government guidance, the Authority considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs.

3.17 Where value in accounts is at or above purchase cost: A fair value assessment of the Authority's investment property portfolio has been made within the past twelve months, and the underlying assets provide security for capital investment. Should the 2022/23 year end accounts preparation and audit process value these properties below their purchase cost, then an updated investment strategy will be presented to full council detailing the impact of the loss on the security of investments and any revenue consequences arising therefrom.

3.18 Where value in accounts is below purchase cost: The fair value of the Authority's investment property portfolio is no longer sufficient to provide security against loss, and the Authority is therefore taking mitigating actions to protect the capital invested.

3.19 **Risk assessment:** The Authority assesses the risk of loss before entering into and whilst holding property investments by involving specialist advisors with expertise in the type of property being purchased, looking at historic data and speaking to other councils undertaking similar activities.

3.20 **Liquidity:** 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. To ensure that the invested funds can be accessed when they are needed, for example to repay capital borrowed, the Authority the Authority ensures that properties purchased are in an active market where there is demonstrable demand to ensure that the authority does not purchase assets which it will not be able to sell on at a later date.

Loan Commitments and Financial Guarantees

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

Proportionality

3.24 The Authority does not plan to become dependent on profit generating investment activity to achieve a balanced revenue budget.

Borrowing in Advance of Need

3.25 Government guidance is 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 Authority would only not follow this guidance if interest rate forecasts and treasury advisor guidance set out that it was more cost effective, **in terms of significantly reduced debt interest charges**, for the Council to borrow for the **Approved 3 year capital programme** at a point of time rather than when that expenditure is taking place over that 3 year period. It is unlikely that this will happen however the option should not be closed off. Funds would be invested The Authority's policies in investing the money borrowed, including management of the risks, would be as per normal short term Treasury Investments.

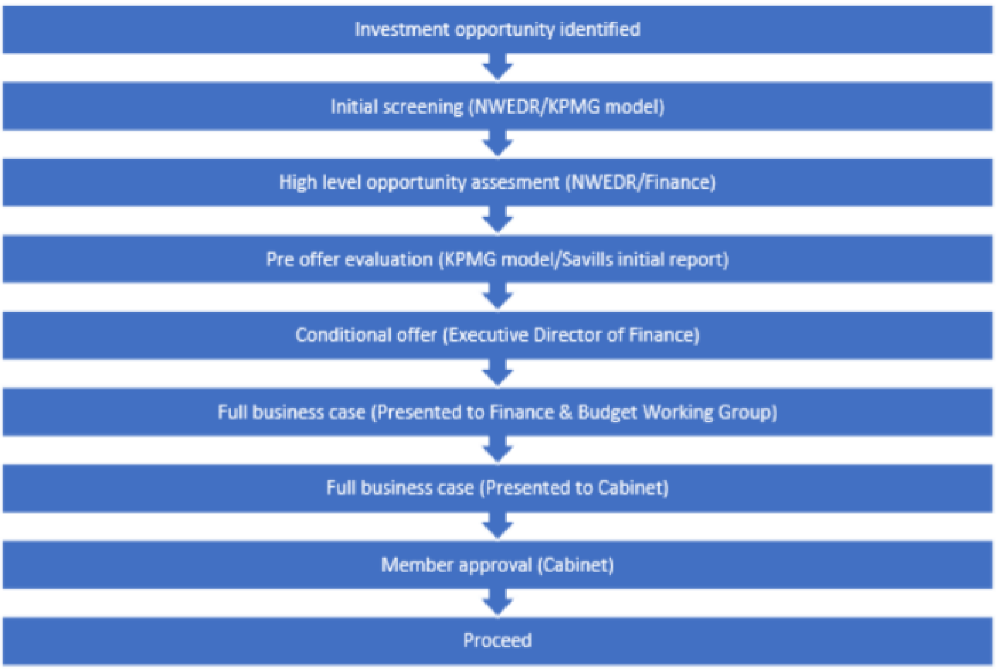
Capacity, Skills and Culture

3.26 **Elected members and statutory officers**: Member training will take place annually as part of the induction process. External advisors will provide reports to support investment decisions with officers ensuring that they fully understand them and can relate them to the strategic objectives and risk profile of the authority.

3.27 **Commercial deals:** Significant work has been undertaken using external advisors and relevant training courses have been attended to ensure that officers are fully aware of the code and statutory requirements of a local authority which is investing.

KPMG have developed a modelling tool for the authority to use when assessing potential purchases as a precursor to engaging with external consultants to ensure that potential purchases are likely to make sense from the perspective of the authority before incurring advisor costs. However, following an internal review of policy, it has been decided that the council may wish to make purchases which do not make a financial return or may indeed make a loss in the short term. On these occasions a business case will be developed which specifies the non-financial benefits of the investment. These are likely to be regenerative schemes for the greater good of the area with an intended long term impact. The regenerative and redevelopment benefits which will flow from the investment will be taken into account in the development of the business case, so if the net investment yield falls below 0.75% it can still proceed if these benefits are deemed to outweigh the lower than target yield.

3.28 **Corporate governance:** when investment decisions are to be made, they are to be led by the Council's Executive Director of Finance in consultation with the Corporate Management Team. They will assess the potential investment opportunity, consulting North Worcestershire Economic Development and Regeneration (NWEDR) and using the KPMG finance appraisal model, and should they decide it presents a strong opportunity for the authority and complies with the relevant criteria a conditional offer can be made. A business case will then be developed and presented ensuring that once greater detail is included, it makes a satisfactory income yield and/or economic redevelopment and regeneration impact. When the business case is completed, if it is still compliant with the council criteria, it will be presented to Executive for approval before purchase is completed.



Once a purchase has been made, the Director of Finance will provide quarterly updates, in line with finance and performance monitoring reports, on the status of the investment.

Investment Indicators

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

3.30 Total risk exposure: The first indicator shows the Authority's total exposure to potential investment losses. This includes amounts the Authority is contractually committed to lend but have yet to be drawn down and guarantees the Authority has issued over third party loans.

Table 5: Total investment exposure in £millions

Total investment exposure	31.03.2022 Actual	31.03.2023 Forecast	31.03.2024 Forecast
Treasury management investments	35	30	20
Service investments: Loans			
Service investments: Shares			
Commercial investments: Property	0	0	0
TOTAL INVESTMENTS	**35**	**30**	**20**
Commitments to lend			
Guarantees issued on loans			
TOTAL EXPOSURE	**35**	**30**	**20**

3.31 How investments are funded: Government guidance is that these indicators should include how investments are funded. Since the Authority 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 Authority's investments are funded by usable reserves and income received in advance of expenditure.

Table 6: Investments funded by borrowing in £millions

Investments funded by borrowing	**31.03.2022 Actual**	**31.03.2023 Forecast**	**31.03.2024 Forecast**
Treasury management investments	0	0	0
Service investments: Loans	0	0	0
Service investments: Shares	0	0	0
Commercial investments: Property	0	0	0
TOTAL FUNDED BY BORROWING	0	0	0

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

Table 7: Investment rate of return (net of all costs)

Investments net rate of return	**2021/22 Actual**	**2022/23 Forecast**	**2023/24 Forecast**
Treasury management investments	0.08%	1.56%	2.0%
Service investments: Loans			
Service investments: Shares			
Commercial investments: Property			
ALL INVESTMENTS	**0.08%**	**1.56%**	**2.0%**

Table 8: Other investment indicators

Indicator	**2021/22 Actual**	**2022/23 Forecast**	**2023/24 Forecast**
e.g. Debt to net service expenditure ratio	0%	0%	0%