South Downs
National Park Authority

Agenda Item 13

Report PR21/22-34

Report to	**South Downs National Park Policy & Resources Committee**
Date	**17 February 2022**
By	**Chief Finance Officer / Head of Business Services**
Title of Report	**Treasury Management Strategy 2022/23**
Decision	

Recommendation: The Committee is recommended to:

1. **Recommend that the National Park Authority ("NPA") approves the Treasury Management Strategy 2022/23 as set out in Appendix 1 comprising the:**
   - **Treasury Management Policy Statement 2022/23;**
   - **Borrowing Strategy 2022/23;**
   - **Prudential and Treasury Indicators 2022/23 to 2024/25;**
   - **Minimum Revenue Provision Policy Statement; and**
   - **Annual Investment Strategy 2022/23 including the benchmark risk factor of 0.05%.**

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1. Introduction

1.1 Part 1 of the Local Government Act 2003 requires the Authority to adopt and comply with requirements issued by the Chartered Institute of Public Finance & Accountancy (CIPFA) and investment guidance issued by the Secretary of State. This report is presented in order to comply with the requirements of:

- The CIPFA Code of Practice on Treasury Management in the Public Services;
- The CIPFA Prudential Code for Capital Finance in Local Authorities; and
- The Department for Levelling Up, Housing and Communities' (DLUHC) Guidance on Local Government Investments and Minimum Revenue Provision.

1.2 In accordance with Financial Procedures, Policy & Resources Committee will receive an annual strategy on treasury management policies and activities in advance of the financial year for recommendation to the Authority.

1.3 This report proposes the Treasury Management Strategy 2022/23 as set out in **Appendix 1** comprising of the:

- Treasury Management Policy Statement 2022/23;
- Treasury Management Practices 2022/23;

- Borrowing Strategy for 2022/23;
- Prudential and Treasury Indicators 2022/23 to 2024/25;
- Minimum Revenue Provision Policy Statement; and
- Annual Investment Strategy 2022/23, including the benchmark risk factor of 0.05%.

2. Policy Context

2.1 The Treasury Management Strategy supports the Authority's overall financial objectives and reflects its risk appetite as a public authority, focusing on security and liquidity over yield. The Treasury Management Strategy will accommodate the Authority's financing and investment requirements in pursuit of Partnership Management Plan objectives and approved capital programme investments.

3. Issues for consideration

Treasury Management Policy Statement and Practices 2022/23

3.1 The Code of Practice on Treasury Management published by CIPFA ("the Code") has been produced to satisfy a number of key purposes for treasury management including:

- to assist in the development and maintenance of firm foundations and clear objectives;
- to emphasise the overriding importance of effective risk management as the foundation;
- to encourage the pursuit of value for money;

3.2 To help facilitate the standardisation and codification of policies and practices. The Treasury Management Policy Statement set out in section 2 of **Appendix 1** complies with the requirements of the Code. All monies will be invested by the Authority's treasury team and investment income will be reported as part of quarterly monitoring.

Borrowing Strategy

3.3 The Treasury Management Strategy incorporates the annual Investment Strategy, Borrowing Strategy, Prudential and Treasury Indicators and a Minimum Revenue Provision Policy Statement as set out in sections 4, 5 and 6 of **Appendix 1**. The inclusion of these documents reflects the anticipated requirement of the Authority to undertake borrowing to meet its capital funding requirements.

3.4 A key function of treasury management is to ensure that the Authority's capital plans are appropriately funded by managing the longer-term cash flow requirements. The borrowing strategy identifies the anticipated borrowing need to meet capital plans whilst focusing on meeting this borrowing need from internal borrowing where possible i.e. avoiding external borrowing by utilising the Authority's own cash flow balances. This will reduce the net revenue cost of borrowing and reduce counterparty risk within the Authority's investment portfolio by reducing the portfolio size. The balance between internal and external borrowing will need to be continuously reviewed to consider long term interest rate forecasts and the 'cost of carry' (the difference between borrowing costs and investment rates) to reduce the risk of revenue loss between borrowing costs and investment returns.

3.5 The Authority is required to 'have regard to' the Prudential Code and to set up Prudential Indicators to ensure that the Authority's capital investment plans are affordable, prudent and sustainable. The Code sets out the indicators that must be used. Alongside additional indicators set to measure treasury performance. The Treasury Indicators have been calculated and determined by officers in compliance with the Treasury Management Code of Practice.

3.6 Where borrowing is undertaken, the Authority is required to pay off an element of its accumulated capital spend each year through a revenue charge known as the Minimum Revenue Provision (MRP). DLUHC regulations require the Authority to approve an MRP Statement in advance of each year.

Annual Investment Strategy 2022/23

3.7 The Annual Investment Strategy as set out in section 7 of Appendix 1 sets out the parameters within which the Authority's cash balances and reserves will be invested. The strategy concentrates on two key areas:

a) capital security through investment in institutions with the highest credit ratings, and;

b) liquidity by limiting the maximum period of investment.

3.8 The Annual Investment Strategy complies with the investment guide issued by the Secretary of State.

3.9 The Annual Investment Strategy was updated in 2020/21 to include short-dated bond funds as permitted instruments in response to a review that was undertaken of the expected level of reserves and anticipated capital programme. This review determined that a proportion of cash would be available to invest in instruments with an investment time horizon of up to three years. Exploration of the use of such funds has been paused in response to the uncertainty around the economic impact of the pandemic. Given that the Authority's cash balances are also higher than budgeted, which is mitigating against lower interest rates, the Authority is not in a position of needing to expose itself to potentially higher levels of risk to sustain its budgetary position. The use of such funds will be kept under review during 2022/23 and, in the meantime, markets will continue to be monitored both internally and through the external advisers.

3.10 The Annual Investment Strategy was amended at the National Park Authority meeting on 16 December 2021 to add new counterparties to the approved list which allows the Authority to broaden its investments over a wider group of counterparties whilst enhancing the investment returns that the authority is able to achieve. These changes are now reflected in Table 8 of **Appendix 1**.

3.11 The investment strategy details the criteria used for selecting suitable counterparties for investing funds. The strategy recommends a weighted average benchmark risk indicator of 0.05% (unchanged from 2020/21). This risk indicator represents the probability of capital loss within the authority's investment portfolio. A risk factor of 0.00% cannot be achieved and the benchmark is a simple target that measures investment risk based on the financial standing of counterparties and the length of each investment based on historic default rates. The risk factor is a way of setting a parameter and monitoring the on-going security of the authority's portfolio but does not equate to an expected loss in the portfolio.

3.12 The Authority's bank balance continues to be maintained at £50,000. This process simply limits the risk of exposure to the Authority's operational bank but does not reflect an expectation of loss.

3.13 The Prudential Code states that decisions around capital expenditure, investment and borrowing should align with the processes established for the setting of an authority's budget and prescribes that ultimate responsibility for implementation lies with the Authority. Officers will present a Capital Strategy alongside the 2022/23 Budget Report.

Upcoming Changes to the Prudential Framework

3.14 Following consultation with Local Authorities, CIPFA published the revised Treasury and Prudential codes on 20 December 2021. To ensure Local Authorities can implement the

code changes in a smooth and orderly fashion, formal adoption is not required until 2023/24. An overview of the changes is included within Section 7 of **Appendix 1**.

Economic Background

3.15 **Appendix 2** to this report provides an economic overview provided by Brighton & Hove City Council's Treasury Advisors, Link Asset Services.

Treasury Management Function

3.16 The Authority's treasury management and Section 151 function is provided through a service contract with Brighton & Hove City Council. The treasury function complies with all statutory powers and regulatory requirements and is carried out by staff with relevant training and qualifications to undertake the duties and responsibilities allocated to them.

3.17 The Authority's day to day cash requirements are currently invested in Brighton & Hove City Council. This is considered the most cost effective way to run the service for the Authority, and has the following added benefits:

a) The Authority is able to have access to daily liquidity to manage day-to-day cash flow requirements;

b) By investing in Brighton & Hove City Council, the Authority benefits from enhanced rates as the average rate earned on the whole of the Brighton & Hove City Council's investment portfolio is payable to the Authority on its balances, including investments held on a longer term basis. The Authority, investing alone, would have barriers in investing in instruments that are readily open to larger authorities such as Brighton & Hove City Council. This is particularly relevant in the current climate of low investment returns due to the low Bank base rate.

3.18 This report is presented by both the Section 151 Chief Finance Officer and the Head of Business Services. The Head of Business Services is a qualified accountant and is able, if necessary, to seek independent advice from other treasury specialists other than from Brighton & Hove City Council.

4. Options & cost implications

4.1 The Treasury Management Strategy recommended in this report seeks to minimise the cost of external borrowing and optimise return on the Authority's investments, subject to ensuring the security of the Authority's resources.

5. Next steps

5.1 This report makes recommendations for Authority approval of the Treasury Management Strategy 2022/23. The Authority will be asked to approve these documents at its meeting of 24 March 2022.

5.2 Quarterly update reports and an annual report after the close of the financial year, in the form prescribed in the treasury management policies will be submitted to the Policy & Resources Committee.

6. Other implications

Implication	Yes/No
Will further decisions be required by another committee/full authority?	Yes - This report makes recommendations for full Authority approval.

Implication	Yes/No
Does the proposal raise any Resource implications?	Yes – Policy & Resources Committee will be advised at least four times a year on the financial implications arising from the Treasury Management activity.
How does the proposal represent Value for Money?	The Treasury Management Strategy recommended in this report seeks to minimise the cost of external borrowing and optimise return on the Authority's investments, subject to ensuring the security of the Authority's resources.
Which Partnership Management Plan Outcomes/Corporate plan objectives does this deliver against	This strategy document enables/provides the framework for the effective and efficient financial management of the Authority.
Links to other projects or partner organisations	Brighton & Hove City Council (contracted Treasury Management service provider).
How does this decision contribute to the Authority's climate change objectives	N/A (no direct contribution but indirectly supports the activities of the Authority which deliver climate change objectives).
Are there any Social Value implications arising from the proposal?	No
Have you taken regard of the South Downs National Park Authority's equality duty as contained within the Equality Act 2010?	Yes – there are no implications arising directly from the report.
Are there any Human Rights implications arising from the proposal?	No
Are there any Crime & Disorder implications arising from the proposal?	No
Are there any Health & Safety implications arising from the proposal?	No
Are there any Data Protection implications?	No
Are there any Sustainability implications based on the 5 principles set out in the SDNPA Sustainability Strategy? 1. Living within environmental limits	The Authority's investments are undertaken in accordance with its ethical investment policy, which is unchanged from last year, as set out in **Appendix 1**. There are no other sustainability implications arising from this report.

Implication	Yes/No
2. Ensuring a strong healthy and just society 3. Achieving a sustainable economy 4. Promoting good governance 5. Using sound science responsibly	

7. Risks Associated with the Proposed Decision

7.1 A risk assessment is contained within the treasury management practices set out in **Appendix 1** of this report.

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Appendices
1. Treasury Management Strategy 2022/23
2. Economic Overview

SDNPA Consultees: Chief Executive; Director of Countryside Policy and Management; Director of Planning; Chief Finance Officer; Monitoring Officer; Legal Services, Business Service Manager

External Consultees: None

Background Documents: This report is presented in accordance with the Authority's Financial Regulations and Financial Procedures

South Downs National Park Authority

Treasury Management Strategy 2022/23

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4. Prudential and Treasury Indicators 2022/23 to 2024/25
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6. Annual Investment Strategy 2022/23
7. Other Treasury Matters

1. Introduction

The Authority is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in counterparties or instruments commensurate with the Authority's risk appetite, prioritising adequate liquidity before considering investment return.

The second main function of the treasury management service is the funding of the Authority's capital plans. These capital plans provide a guide to the borrowing need of the Authority, essentially the longer-term cash flow planning, to ensure that the Authority can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn down may be restructured to meet risk or cost objectives.

The Authority is required to receive and approve its prudential and treasury indicators, and treasury strategy which covers the following:

- Treasury Management Policy Statement;
- a borrowing strategy (including prudential indicators) to ensure that sufficient cash is available to meet the capital investment plans the capital investment plans;
- a Minimum Revenue Provision (MRP) policy (how residual capital expenditure is charged to revenue over time); and
- an Annual Investment Strategy (the parameters on how investments are to be managed).

2. Treasury Management Policy Statement 2022/23

The following paragraphs set out the Authority's Treasury Management Policy Statement for the year commencing 1 April 2022:

1. The Authority defines its treasury management activities as:

"The management of the organisation's cash flows, its banking, money market and capital market transactions; the effective management of the risks associated with those activities and the pursuit of optimum performance consistent with those risks."

2. The Authority regards the successful identification, monitoring and management of risk to be the prime criteria by which the effectiveness of its treasury management activities will be

measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the Authority.

3. The Authority acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving best value in treasury management and to employing suitable performance measurement techniques within the context of effective risk management.

3. Borrowing Strategy

The capital expenditure plans of the Authority are set out in the approved Capital Strategy. The treasury management function of the Authority ensures that the Authority's cash is managed in accordance with the relevant professional codes so that sufficient cash is available to meet the capital expenditure plans.

Any capital investment that is not funded from new and/or existing resources (e.g. capital grants, receipts from asset sales, revenue contributions or earmarked reserves) increases the Authority's need to borrow, represented by the Authority's Capital Financing Requirement (CFR). However, external borrowing does not have to take place immediately to finance related capital expenditure: the Authority can utilise cash being held for other purposes (such as earmarked reserves and working capital balances) to temporarily defer the need for external borrowing. This is known as 'internal borrowing' or 'under-borrowing'.

The Authority's primary objective is to strike an appropriate balance between securing cost certainty and securing low interest rates.

Borrowing Strategy for 2021/22

The Authority's capital programme 2022/23 to 2024/25 forecasts a total capital investment of £0.562m, £0.362m of which will be met from existing or new resources. The increase in the borrowing need over this period is therefore £0.200m as shown in **Table 1** below.

2021/22 Estimate £'000	Table 1: Borrowing Need	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000	Total
2,414	Capital Expenditure	522	20	20	**562**
(1,374)	Financed by New / Existing Resources	(322)	(20)	(20)	**(362)**
1,040	**Borrowing Need**	**200**	**0**	**0**	**200**

The strategy will initially focus on meeting the borrowing need from internal borrowing i.e. avoiding external borrowing by utilising the Authority's own surplus cash flows. This will reduce the net revenue cost of borrowing and reduce counterparty risk within the Authority's investment portfolio by reducing the portfolio size. The internal borrowing position needs to be closely monitored and continually reviewed to avoid incurring higher borrowing costs in the future at a time when the authority may not be able to avoid new borrowing to finance capital expenditure.

There will remain a cost of carry (the difference between borrowing costs and investment returns) to any new long-term borrowing that causes a temporary increase in cash balances which will, most likely, lead to an additional short-term revenue cost.

Table 2 below shows the movement in the Authority's Capital Financing Requirement (CFR) and compares this to the expected external debt level. This demonstrates that the CFR is expected to be entirely internally borrowed over the period.

2022/23 Estimate £'000	Table 2: Change in the CFR compared to External Debt	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000
0	External Debt at 1 April	0	0	0
0	Expected change in Debt	0	0	0
0	**External Debt at 31 March**	**0**	**0**	**0**
0	CFR* at 1 April	1,040	1,214	1,214
1,040	Borrowing need (Table 1)	200	0	0
0	MRP	-26	-26	-31
1,040	**CFR* at 31 March**	**1,214**	**1,188**	**1,183**
1,040	**Under / (Over) borrowing**	**1,214**	**1,188**	**1,183**

**The CFR in Table 2 above shows the underlying need to borrow and excludes leases arrangements (which is included in the CFR figure in the Prudential Indicators in Section 4)*

Policy on Borrowing in Advance of Need

The Authority will not borrow purely in order to profit from investment of extra sums borrowed. Any decision to borrow in advance will be within approved Capital Financing Requirement estimates and will be considered carefully to ensure that value for money can be demonstrated and that the Authority can ensure the security of such funds. Risks associated with any borrowing-in-advance activity will be subject to prior appraisal and subsequent reporting.

Debt Rescheduling

Should the Authority carry debt in future, opportunities for debt rescheduling will be considered as a matter of course where there is a clear difference between new borrowing and repayment rates which could result in savings.

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhancing the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Interest Rate Risk & Continual Review

The Authority's total borrowing need of £0.200 million as identified in Table 1 is the extent to which the Authority is subject to interest rate risk over the next three years. Officers will review the need to borrow taking into consideration the potential increases in borrowing costs, the need to finance new capital expenditure, the need to refinance maturing debt (if any), availability of internal borrowing, and the cost of carry that might incur a revenue loss between borrowing costs and investment returns. The Chief Finance Officer will therefore continue to monitor interest rates in financial markets and adopt a proactive approach to changing circumstances.

4. Prudential and Treasury Indicators 2022/23 to 2024/25

The Authority's capital expenditure plans are a key driver to treasury management activities. The output of the capital expenditure plans are reflected in prudential indicators. The Authority is required to 'have regard to' the Prudential Code and to set up Prudential Indicators to ensure that the Authority's capital investment plans are affordable, prudent and sustainable. The Code sets out the indicators that must be used but does not suggest limits, as these are for the authority to set itself.

The Prudential Indicators to 2022/23 to 2024/25 are set out in **Table 3** below:

Table 3: Prudential Indicators	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000
Capital Expenditure Capital expenditure plans	522	20	20
Capital Financing Requirement Measures the underlying need to borrow for capital purposes	1,364	1,333	1,302
Ratio of financing costs to new revenue stream* Identifies the trend in the cost of capital (borrowing and other long-term obligation costs net of investment income) against revenue stream	-0.37%	-0.40%	-0.73%

* The ratio of financing costs to net revenue stream illustrates the percentage of the net revenue budget being used to finance the authority's borrowing. This includes interest costs relating to the Authority's borrowing portfolio and MRP, net of the investment income from the Authority's investment portfolio. A negative ratio illustrates a net contribution to the Authority as anticipated investment income is greater than the anticipated cost of borrowing.

The Treasury Management Code requires that a number of indicators are set for treasury performance in addition to the Prudential Indicators which fall under the Prudential Code. The Treasury Indicators for 2022/23 to 2024/25 are set out in Tables 4 & 5 below. The Treasury Indicators have been calculated and determined by officers in compliance with the Treasury Management Code of Practice.

Table 4: Treasury Performance Indicators	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000
Authorised Limit for External Debt* The Authority is expected to set a maximum authorised limit for external debt. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Authority.	1,500	1,500	1,500
Operational boundary for external debt* The Authority is required to set an operational boundary for external debt. This is the limit that external debt is not normally expected to exceed. This indicator can be breached temporarily for operational reasons.	1,700	1,700	1,700
Principal Sums invested for longer than 365 days	0	0	0

* From 2022/23 The Authorised Limit and Operational Boundary includes an estimate for leases that will be bought onto the balance sheet under a change in leasing accounting regulations.

Table 5: Maturity Structure of fixed interest rate borrowing **The Authority needs to set upper and lower limits with respect of the maturity structure of its borrowing.**	**Lower Limit**	**Upper Limit**
Under 12 months	0%	40%
12 months to 2 years	0%	40%
2 years to 5 years	0%	50%
5 years to 10 years	0%	75%
Over 10 years	40%	100%

5. Minimum Revenue Provision Policy Statement

The authority is required to pay off an element of the accumulated capital spend each year (the Capital Financing Requirement - CFR) through a revenue charge (the Minimum Revenue Provision - MRP). Department of Levelling up, Housing & Community (DULHC) regulations require the Authority to approve an MRP Statement in advance of each year if borrowing has been undertaken. A variety of options are available, so long as the principle of any option selected ensures a prudent provision to redeem its debt liability over a period commensurate with that over which the capital expenditure is estimated to provide benefits (i.e. estimated useful life of the asset being financed).

The Authority is recommended to approve the following MRP Statement for 2022/23:

For all debt where the government has provided revenue support (supported capital expenditure), the MRP policy will be:

- Provision on a straight line basis over 50 years.

For all debt where the government does not provide revenue support:

- Where the debt relates to an asset, the Authority will set aside a sum equivalent to repaying the debt over the life of the asset either in equal instalments or on an annuity basis over a maximum life of 50 years. The method to be adopted will be determined according to which is the most financially beneficial to the Authority over the life of the asset.

- Where the debt relates to expenditure which is subject to a capitalisation direction issued by the government, the Authority will set aside a sum equivalent to repaying the debt over a period consistent with the nature of the expenditure on an annuity basis.

- In the case of assets under construction, MRP will be delayed until the relevant asset becomes operational.

Where the debt relates to capital loans to a third party:

- The repayments of principal will be set aside as capital receipts to finance the initial capital advance in lieu of making an MRP.

There is the option to charge more than the prudent provision of MRP each year through a Voluntary Revenue Provision (VRP).

6. Annual Investment Strategy 2022/23

This Strategy complies with guidance to be issued by the Secretary of State on investments.

Investments will be made with reference to the core balance, cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

Greater returns are usually achievable by investing for longer periods. While most cash balances are required in order to manage the peaks and troughs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

The annual investment strategy sets out the parameters within which the Authority's cash balances and reserves will be invested. The strategy concentrates on two key areas:

a) capital security through investment in institutions with the highest credit ratings, and;
b) liquidity by limiting the maximum period of investment.

Investment classification (regulatory)

The investment guidance issued by the Secretary of State requires the Authority to identify investments as either 'specified' or 'non-specified'.

This authority has defined the list of types of investment instruments that the treasury management team are authorised to use.

- **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year. The limits and permitted instruments for specified investments are listed within Table 6.
- **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use. The limits and permitted instruments for non-specified investments are listed within Table 7.

Criteria to be used for creating / managing approved counterparty lists / limits

Each counterparty included on the Authority's approved lending list must meet the criteria set out below. Without the prior approval of the NPA, no investment will be made in an instrument that falls outside the list below.

Credit ratings will be based on those issued periodically by the Fitch Ratings Group, Moody's and Standard & Poors.

Table 6 below summarises the types of specified investment counterparties available to the Authority, and the maximum amount and maturity periods that can be placed with each of these. A full list of the Authority's counterparties and the current limits for 2021/22 are provided at **Table 8.**
When assessing credit ratings to ascertain limits for each counterparty, the lowest short and long term ratings from each of the three ratings agencies is applied. For simplicity, the ratings for Standard & Poor's are used in the tables below.

Table 6: Criteria for Specified Investments	Country/ Domicile	Minimum Capital Requirements	Min. Credit Criteria (L/term / S/term)	Max. Amount	Max. maturity period
UK Banks & Building Societies	UK	Must meet minimum credit criteria	AA- / A-1+	£10m	12 months
UK Banks & Building Societies	UK	Must meet minimum credit criteria	A / A-1	£5m	12 months
UK Banks & Building Societies	UK	Must meet minimum credit criteria	BBB / A-2	£5m	6 months
Debt Management and Deposit Facilities (DMADF)	UK	N/A	N/A	£5m	12 months
UK Local Authorities (excluding Brighton & Hove City Council)	UK	N/A	UK Sovereign Rating	£5m	12 months
Brighton & Hove City Council*	UK	N/A	N/A	N/A	Liquid
Non-rated Building Societies	UK	Must have an asset base of at least £5bn at the time of investment	N/A	£5m	6 months
Money Market Funds (CNAV and LVNAV)	UK/Ireland/ EU domiciled	Must meet minimum credit criteria	AAA	£5m	Liquid

* The amount invested in Brighton & Hove City Council will be the amount available for investment less investment made in any other approved counterparty.

Table 7: Criteria for Non-Specified Investments	Country/ Domicile	Min. Credit Criteria	Max. Amount	Max. maturity period
Short Date Bond Funds	UK/Ireland/ EU domiciled	Short Dated bond funds are not rated. A selection process will evaluate relative risks & returns. Security of the Authority's money and fund volatility will be key measures of suitability.	£2m	Liquid

<u>Maximum permitted investment by counterparty / sector</u>

The maximum amount invested in any one counterparty will be established in accordance with the criteria set out **Tables 6 and 7** above, based on each counterparty's credit rating.

The maximum amount invested in any one sector will be 100%, with the exception of the building society sector where the maximum limit will be 75%.

Where practicable, no one counterparty may have more than 75% of the relevant sector total at the time the investment is made.

Approved methodology for changing limits and adding / removing counterparties

A counterparty shall be removed from the Authority's list where a change in their credit rating results in a failure to meet the minimum credit rating set out in "Criteria to be used for creating / managing approved counterparty lists / limits" above.

A counterparty's exposure limit and investment period will be reviewed and (changed where necessary) in accordance with the criteria set out in **Tables 6 and 7** following notification of a change in that counterparty's credit rating or a view expressed by the credit rating agency warrants a change.

A counterparty's exposure limit will also be reviewed where information contained in the financial press or other similar publications indicates a possible worsening in credit worthiness of a counterparty. The review may lead to the suspension of a counterparty where it is considered appropriate to do so by the Section 151 Officer.

Full individual listings of UK Bank and Building Society counterparties and counterparty limits

A full list of UK Bank and Building Society counterparties, together with counterparty limits, is set out in **Table 8.**

Table 8 – Schedule of Counterparties and counterparty limits

Lloyds Banking Group:

Institution	Lending Limit	Duration limit (months)
Lloyds Bank PLC (RFB)	£5m	12
Lloyds Bank Corporate Markets PLC (NRFB)	£5m	12
**Total max. exposure to Lloyds Banking Group	£5m	12

Barclays Banking Group:

Institution	Lending Limit	Duration limit (months)
Barclays Bank UK PLC (RFB)	£5m	12
**Total max. exposure to Barclays Banking Group:	£5m	12

RBS/Natwest Group:

Institution	Lending Limit	Duration limit (months)
National Westminster Bank PLC (RFB)	£5m	6
The Royal Bank of Scotland PLC	£5m	6
**Total max. exposure to RBS/Natwest Group:	£5m	6

HSBC Group:

Institution	Lending Limit	Duration limit (months)
HSBC UK Bank PLC (RFB)	£10m	12
**Total max. exposure to HSBC Group:	£10m	12
Goldman Sachs International Bank	£5m	12
Santander UK PLC	£5m	12
Standard Chartered Bank	£5m	12

UK Building Societies

Institution	Lending Limit	Duration limit (months)
Nationwide	£5m	12

** Where there are multiple counterparties within a banking group, exposure to the overall group will be the largest limit, but exposure to individual counterparties within the group will be based on the individual counterparty limit.

Permitted types of investment instrument

All investments will be denominated in Sterling and in fixed term and/or variable term cash deposits, money market funds, short-dated bond funds and open-ended investment companies.

Investment risk

In addition to credit ratings, the Authority will apply additional operational market information before making any specific investment decision. This additional market information will be applied to compare the relative security of different investment counterparties.

The Authority is recommended to agree a benchmark risk factor for 2022/23 of 0.05%. The purpose of the benchmark is to monitor current and trend positions and amend the operational strategy depending on any changes.

Liquidity is achieved by limiting the maximum period for investment and by investing to dates where cash flow demands are known or forecast.

Ethical investment statement

South Downs National Park Authority, in making investments through its treasury management function, fully supports the ethos of socially responsible investments. The Authority will actively seek to communicate this support to those institutions invested in as well as those it is considering investing in by:

- encouraging those institutions to adopt and publicise policies on socially responsible investments;
- requesting those institutions to apply the Authority's deposits in a socially responsible manner.

7. Other Treasury Matters

Banking Services

Lloyds Bank plc currently provides banking services for the Authority.

Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. Training was last provided for members of the Policy & Resources Committee prior to the pandemic and therefore further training will be arranged in the coming year, using video conferencing if necessary.

The training needs of treasury management officers are periodically reviewed and training arranged as required.

Policy on the use of External Service Providers

Brighton & Hove City Council uses Link Asset Services as its external treasury management advisors on behalf of the Authority.

The Authority recognises that responsibility for treasury management decisions remains with the council (as Treasury Management provider) at all times and will ensure that undue reliance is not placed upon our external service providers. It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Treasury Management service will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subject to regular review.

Lending to Third Parties

The Authority has the power to lend monies to third parties subject to a number of criteria. These are not treasury type investments, rather they are policy investments. Any activity will only take place after relevant due diligence has been undertaken, as described in the Capital Strategy.

Updates to Accounting Requirements

- **IFRS 9 – local authority override – English local authorities**

  The DLUHC enacted a statutory over-ride from 1 April 2018 for a five year period until 31 March 2023 following the introduction of IFRS 9 and the requirement for any capital gains or losses on marketable funds to be chargeable in year. This has the effect of allowing any capital losses on funds to be held on the balance sheet until 31 March 2023, allowing authorities to initiate an orderly withdrawal of funds if required.

  The Authority doesn't currently invest in any funds that will be impacted by this change.

- **IFRS 16 – Leasing**

  The CIPFA Code of Practice and Guidance notes for 2022/23 will incorporate the requirement to account for all leases onto the Authority's balance sheet. This has the following impact to this paper:

  - The Authority's Capital Financing Requirement authorised limit and operational boundary for 2022/23 onwards has been increased to reflect the estimated effect of this change. These limits can be amended during 2022/23 and bought to full Authority to amend during the year if the limits need to be increased following some more detailed work on the leases to be bought onto the balance sheet.
  - The MRP policy statement incorporates the policy for the provision for the principal element of lease payments in preparation for accounting for leases under IFRS16.

Updates to Treasury and Prudential Codes

Following consultation with Local Authorities, CIPFA published the revised Treasury and Prudential codes on 20 December 2021. To ensure Local Authorities can implement the code changes in a smooth and orderly fashion, formal adoption is not required until 2023/24. The revised codes will have the following implications:

- The requirement for authorities to classify all investments and the relevant investment income into one of the three categories of treasury management, service delivery or commercial investments;
- A prohibition for authorities to borrow to invest primarily for financial return (to include commercial investments);

- a requirement for the Authority to adopt a new debt liability benchmark treasury indicator to support the financing risk management of the capital financing requirement;
- clarify what CIPFA expects an authority to borrow for and what they do not view as appropriate. This will include the requirement to set a proportionate approach to commercial and service capital investment;
- requirement to address Environmental, Social and Governance (ESG) issues within the Capital Strategy;
- require implementation of a policy to review commercial investments (including property) on an annual basis, with a view to divest where appropriate;
- create new Investment Practices to manage risks associated with non-treasury investment (similar to the current Treasury Management Practices);
- ensure that any long term treasury investment is supported by a business model;
- a requirement to effectively manage liquidity and longer term cash flow requirements;
- amendment to Treasury Management Practice 1 (TMP1) to address ESG policy within the treasury management risk framework;
- amendment to the knowledge and skills register for individuals involved in the treasury management function - to be proportionate to the size and complexity of the treasury management conducted by each authority;
- a new requirement to clarify reporting requirements for service and commercial investment, (especially where supported by borrowing/leverage).

Members will be updated on how all these changes will impact the current approach and any changes required will be formally adopted within the 2023/24 Treasury Management Strategy report.

ECONOMIC OVERVIEW & INTEREST RATE VIEW

Provided by Link Asset Services

Brighton & Hove City Council has appointed Link Group as its treasury advisor and part of their service is to assist the Authority to formulate a view on interest rates. Link provided the following forecasts on 20 December 2021. These are forecasts for certainty rates, gilt yields plus 80 basis points (bps).

Link Group Interest Rate View 20.12.21

	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
Bank Rate	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25
3 month ave earnings	0.20	0.30	0.50	0.50	0.60	0.70	0.80	0.90	0.90	1.00	1.00	1.00	1.00	1.00
6 month ave earnings	0.40	0.50	0.60	0.60	0.70	0.80	0.90	1.00	1.00	1.10	1.10	1.10	1.10	1.10
12 month ave earnings	0.70	0.70	0.70	0.70	0.80	0.90	1.00	1.10	1.10	1.20	1.20	1.20	1.20	1.20
5yr PWLB	1.40	1.50	1.50	1.60	1.60	1.70	1.80	1.80	1.80	1.90	1.90	1.90	2.00	2.00
10yr PWLB	1.60	1.70	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10	2.20	2.30
25yr PWLB	1.80	1.90	2.00	2.10	2.10	2.20	2.20	2.0	2.30	2.30	2.40	2.40	2.50	2.50
50yr PWLB	1.50	1.70	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.20	2.20	2.30	2.30

Over the last two years, the coronavirus outbreak has caused huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings until raising it to 0.25% at its meeting on 16th December 2021.

As shown in the forecast table above, the forecast for Bank Rate now includes four increases, one in December 2021 to 0.25%, then quarter 2 of 2022 to 0.50%, quarter 1 of 2023 to 0.75%, quarter 1 of 2024 to 1.00% and, finally, one in quarter 1 of 2025 to 1.25%.

The UK - The Bank of England MPC surprised market expectations for a second consecutive meeting in December, raising Bank Rate by 0.15% to 0.25%. In doing so, it became the first major central bank to raise official policy rates since the onset of the pandemic.

The Committee voted 8-1 for the change in the policy rate with only well-established "dove" corporation, Silvana Tenreyro, dissenting. Meanwhile, the Committee voted unanimously to keep the current QE programme unchanged. The minutes showed that the Bank now expects inflation to peak at 6% in April, and while Omicron was already having an impact on some sectors, the Committee felt it had to act now because it saw "some signs of greater persistence in domestic costs and price pressures". It also stressed how it had stated at its November meeting that it would raise rates if the economy evolved as expected and that "these conditions had been met".

Looking ahead, unlike in November, there was no reference to inflation being expected to be below the 2% target over its forecast period, which may suggest that the Committee is contemplating raising rates further than it had been at its previous meeting.

While this may underpin market expectations that Bank Rate will rise to 1% in the second half of 2022, the minutes also retained the comment that a "modest tightening" in policy will be required over its 3-year forecast period. Further, it did caveat that inflation could yet prove weaker or stronger than expected. Market expectations for future hikes have increased in the aftermath of the result, with the potential for the next hike in Q1 2022, with a move to 0.75% by May and the 1% level being hit in August / September, compared to November ahead of the meeting. By the close of 2022, markets are now edging nearer to a 1.25% level, with this expectation having picked up since the start of trading this year.

Link has formally reviewed its own forecast in light of the December meeting but has made no change to its Bank Rate forecast, with just modest changes to expectations for longer term yields

which are reflected in the table below. Typically, a rate hike would fully flow through market pricing, especially at the short end of the curve.

Link Asset Services forward view January 2022

It is not expected that Bank Rate will go up fast after the initial rate rise as the supply potential of the economy is not likely to have taken a major hit during the pandemic: it should, therefore, be able to cope well with meeting demand after supply shortages subside over the next year, without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the MPC's 2% target after the spike up to around 5%. The forecast includes four increases in Bank Rate over the three-year forecast period to March 2025, ending at 1.25%. However, it is likely that these forecasts will need changing within a relatively short timeframe for the following reasons:

- We do not know how severe an impact Omicron could have on the economy and whether there will be another lockdown or similar and, if there is, whether there would be significant fiscal support from the Government for businesses and jobs.
- There were already increasing grounds for viewing the economic recovery as running out of steam during the autumn and now into the winter. And then along came Omicron to pose a significant downside threat to economic activity. This could lead into stagflation, or even into recession, which would then pose a dilemma for the MPC as to whether to focus on combating inflation or supporting economic growth through keeping interest rates low.
- Will some current key supply shortages spill over into causing economic activity in some sectors to take a significant hit.
- Rising gas and electricity prices in October and next April and increases in other prices caused by supply shortages and increases in taxation next April, are already going to deflate consumer spending power without the MPC having to take any action on Bank Rate to cool inflation.
- On the other hand, consumers are sitting on over £160bn of excess savings left over from the pandemic so when will they spend this sum, in part or in total.
- It looks as if the economy coped well with the end of furlough on 30th September. It is estimated that there were around 1 million people who came off furlough then and there was not a huge spike up in unemployment. The other side of the coin is that vacancies have been hitting record levels so there is a continuing acute shortage of workers. This is a potential danger area if this shortage drives up wages which then feed through into producer prices and the prices of services i.e., a second-round effect that the MPC would have to act against if it looked like gaining significant momentum.
- If the UK invokes article 16 of the Brexit deal over the dislocation in trading arrangements with Northern Ireland, this has the potential to end up in a no-deal Brexit.

In summary, with the high level of uncertainty prevailing on several different fronts, we expect to have to revise our forecasts again - in line with whatever the new news is.

Forecasts for PWLB rates and gilt and treasury yields

Since the start of 2021, we have seen a lot of volatility in gilt yields, and hence PWLB rates. As the interest forecast table for PWLB certainty rates above shows, there is forecast to be a steady, but slow, rise in both Bank Rate and gilt yields during the forecast period to March 2025, though there will doubtless be a lot of unpredictable volatility during this forecast period.

While monetary policy in the UK will have a major impact on gilt yields, there is also a need to consider the potential impact that rising treasury yields in America could have on our gilt yields. As an average since 2011, there has been a 75% correlation between movements in US 10-year treasury

yields and UK 10-year gilt yields. This is a significant upward RISK exposure to our forecasts for longer term PWLB rates. However, gilt yields and treasury yields do not always move in unison.

There are also possible downside risks from the huge sums of cash that the UK populace have saved during the pandemic; when savings accounts earn little interest, it is likely that some of this cash mountain could end up being invested in bonds and so push up demand for bonds and support their prices i.e., this would help to keep their yields down. How this will interplay with the Bank of England eventually getting round to not reinvesting maturing gilts and then later selling gilts, will be interesting to monitor.

There is likely to be exceptional volatility and unpredictability in respect of gilt yields and PWLB rates due to the following factors:

- How strongly will changes in gilt yields be correlated to changes in US treasury yields (see below)? Over 10 years since 2011 there has been an average 75% correlation between movements in US treasury yields and gilt yields. However, from time to time these two yields can diverge. Lack of spare economic capacity and rising inflationary pressures are viewed as being much greater dangers in the US than in the UK. This could mean that central bank rates will end up rising earlier and higher in the US than in the UK if inflationary pressures were to escalate; the consequent increases in treasury yields could well spill over to cause (lesser) increases in gilt yields. There is, therefore, an upside risk to forecasts for gilt yields due to this correlation. The Link Group forecasts have included a risk of a 75% correlation between the two yields.
- Will the Fed take action to counter increasing treasury yields if they rise beyond a yet unspecified level.
- Would the MPC act to counter increasing gilt yields if they rise beyond a yet unspecified level.
- How strong will inflationary pressures actually turn out to be in both the US and the UK and so put upward pressure on treasury and gilt yields.
- How will central banks implement their new average or sustainable level inflation monetary policies.
- How well will central banks manage the withdrawal of QE purchases of their national bonds i.e., without causing a panic reaction in financial markets as happened in the "taper tantrums" in the US in 2013
- Will exceptional volatility be focused on the short or long-end of the yield curve, or both.

The forecasts are also predicated on an assumption that there is no break-up of the Eurozone or EU within the forecasting period, despite the major challenges that are looming up, and that there are no major ructions in international relations, especially between the US and China / North Korea and Iran, which have a major impact on international trade and world GDP growth.

The balance of risks to medium to long term PWLB rates:

There is a balance of upside risks to forecasts for medium to long term PWLB rates. A new era – a fundamental shift in central bank monetary policy.

- One of the key results of the pandemic has been a fundamental rethinking and shift in monetary policy by major central banks like the Fed, the Bank of England and the ECB, to tolerate a higher level of inflation than in the previous two decades when inflation was the prime target to bear down on so as to stop it going above a target rate. There is now also a greater emphasis on other targets for monetary policy than just inflation, especially on 'achieving broad and inclusive "maximum" employment in its entirety' in the US, before consideration would be given to increasing rates.
- The Fed in America has gone furthest in adopting a monetary policy based on a clear goal of allowing the inflation target to be symmetrical, (rather than a ceiling to keep under), so that

inflation averages out the dips down and surges above the target rate, over an unspecified period.

- The Bank of England has also amended its target for monetary policy so that inflation should be 'sustainably over 2%' before starting on raising Bank Rate and the ECB now has a similar policy.
  - For local authorities, this means that investment interest rates and very short term PWLB rates will not be rising as quickly or as high as in previous decades when the economy recovers from a downturn and the recovery eventually runs out of spare capacity to fuel continuing expansion.
  - Labour market liberalisation since the 1970s has helped to break the wage-price spirals that fuelled high levels of inflation and has now set inflation on a lower path which makes this shift in monetary policy practicable. In addition, recent changes in flexible employment practices, the rise of the gig economy and technological changes, will all help to lower inflationary pressures.
  - Governments will also be concerned to see interest rates stay lower as every rise in central rates will add to the cost of vastly expanded levels of national debt; (in the UK this is £21bn for each 1% rise in rates

Investment and borrowing rates

- Investment returns are expected to improve in 2022/23. However, while markets are pricing in a series of Bank Rate hikes, actual economic circumstances may see the MPC fall short of these elevated expectations.
- Borrowing interest rates fell to historically very low rates as a result of the COVID crisis and the quantitative easing operations of the Bank of England and still remain at historically low levels. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years.
- There will remain a significant cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.