

Annual Treasury Management Strategy 2023/24

1. Introduction

Treasury management is the management of the Council's cash flows, borrowing and investments, and the associated risks. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Council's prudent financial management.

Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2021 Edition* (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year. In addition, the former Department of the Environment (DoE) issued Guidance on Local Authority Investments in October 2011 that requires the Council to approve an investment strategy before the start of each financial year. This report fulfils the Council's legal obligation under the *Local Government Finance Act (Northern Ireland) 2011* to have regard to both the CIPFA Code and the DoE Guidance.

This strategy covers the following issues in respect of 2023/24:

- Outlook for interest rates
- Capital Financing Plans
- Establishing the Borrowing Requirement
- Borrowing strategy
- Debt rescheduling
- Investments
- Treasury Management Indicators

2. Outlook for Interest Rates

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

The Bank of England (BoE) increased the Bank Rate by 0.5% to 4% in February 2023. The Council's treasury management adviser Arlingclose forecasts that the Bank Rate will continue to rise in 2023 as the Bank of England attempts to subdue inflation which is significantly above its 2% target. Arlingclose expects Bank Rate to rise to at least 4.25% 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. Capital Financing Plans

It is essential that the level of borrowing is considered within the context of the Council's capital expenditure and plans, as is required by the CIPFA Prudential Code for Capital Finance.

On 28 February 2023, the Council held £44m of borrowing and £21m of treasury investments.

Forecast changes in these sums are shown in the balance sheet analysis in table 1, with the Council planning to increase borrowings over the next three years.

Table 1: Balance sheet summary and forecast

	2022/23 £'000 Estimate	2023/24 £'000 Forecast	2024/25 £'000 Forecast	2025/26 £'000 Forecast
Capital financing requirement (CFR)	132,480	140,307	149,482	145,912
Less: External Borrowing	43,782	53,064	71,447	79,925
Internal Borrowing	88,698	87,243	78,035	65,987
Less: Balance Sheet Resources	102,861	95,360	86,060	75,560
Treasury Investments (new borrowing)	14,163	8,117	8,025	9,573

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

The Council has an increasing CFR due to the capital programme, but minimal investments and may therefore may be required to borrow over £55m over the forecast period. The Council's long term capital expenditure forecasts are currently being developed which may change the above forecasts.

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 Council expects to comply with this recommendation during 2023/24.

Liability benchmark: To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as table 1 above, but that cash and investment balances are kept to a minimum level of £10m at each year-end to maintain sufficient liquidity but minimise credit risk.

Table 2: Liability Benchmark

	2022/23 £'000 Estimate	2023/24 £'000 Forecast	2024/25 £'000 Forecast	2025/26 £'000 Forecast
Capital financing requirement (CFR)	132,480	140,307	149,482	145,912
Less: Balance Sheet Resources	102,861	95,361	86,060	75,561
Net loans requirement	29,619	44,946	63,422	70,351
Plus: Liquidity allowance	10,000	10,000	10,000	10,000
Liability Benchmark	39,619	54,946	73,422	80,351

The Liability Benchmark is effectively the Net Borrowing Requirement of a local authority plus a liquidity allowance.

CIPFA recommends that the optimum position for external borrowing should be at the level of the Liability Benchmark (i.e., all balance sheet resources should be used to maximise internal borrowing). If the outputs show future periods where external loans are less than the Liability Benchmark, then this indicates a borrowing requirement thus identifying where the authority is exposed to interest rate, liquidity and refinancing risks. Conversely where external loans exceed the Liability Benchmark then this will highlight an overborrowed position which will result in excess cash in the organisation requiring investment thus exposing the authority to credit and reinvestment risks and a potential cost of carry. The Council's external debt is relatively close to the liability benchmark. The Council is currently working on long term capital forecasts and the above amounts may change. Given the increases in the bank rate, the level of debt required is closely monitored to minimise any interest rate risk.

4. Establishing the Borrowing Requirement

The starting point for ascertaining the appropriate level of borrowing is the Capital Financing Requirement (CFR). The CFR is derived from the Balance Sheet and represents the Council's underlying need to borrow for a capital purpose, as it takes account of all capital expenditure incurred which is resourced from borrowing.

However, in addition to the debt position created by historic capital expenditure met from borrowing, the Council also has significant values of reserves, provisions and balances supported by cash, which reduce the net indebtedness of the Council. These positive cash flows allow the Council to consider utilising this cash to support capital expenditure in lieu of external borrowing.

If external borrowing is higher than the CFR, this indicates borrowing in advance of immediate need (permitted within the Prudential Code) and borrowing below CFR would indicate internal borrowing (i.e. the level of cash used in lieu of external borrowing)

The relatively high levels of reserves and balances on the Council's balance sheet have therefore enabled the Council to benefit from not having to borrow externally to

the full extent of the underlying need. However, it cannot be assumed that this position can continue into perpetuity and needs to be given active consideration.

The Council currently holds £44 million of loans, a decrease of £5 million on the previous year. The balance sheet forecast in table 1 shows that the Council expects to borrow up to £15m in 2023/24. The Council may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £140 million.

5. Borrowing Strategy

In terms of meeting the external borrowing requirement identified above, one of the most important considerations is the timing, in terms of the potential to save significant interest costs and it is key that this position is proactively managed using all information available to inform decisions. It is essential therefore that the considerations of timing of borrowing form a key element of the borrowing strategy.

It is of course not possible for all borrowing to be undertaken at the lowest rates of interest available, as unforeseen events can significantly alter the path of rates. It is therefore essential that the risks to adverse movements are fully understood and actively managed. One of the key borrowing objectives is to achieve certainty around interest costs, and there is therefore little appetite to undertake variable rate borrowing.

Given the uncertainty around local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead. By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal / 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.

It is recognised that whilst the capital expenditure and financing plans will be a driver of borrowing costs, the management of risk is the prime objective of the borrowing strategy and reduction of interest rate risk and refinancing risk within the portfolio is essential.

The Council remains prepared to undertake the potential borrowing ahead of immediate need (up to three years in advance), if it results in a reduction of interest rate risk within the portfolio. The Council recognises that this may temporarily increase investment balances, and increase net interest costs in the short term, and that these factors will form part of the decision making process when the strategy is executed. It would be necessary to demonstrate value for money when making a decision in respect of borrowing in advance of need, therefore it will only be undertaken if there is a strong view that this is the preferred approach.

The Council has previously raised the majority of its long-term borrowing from the Government Loans Fund via Department of Finance. Government loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Council intends to avoid this activity in order to retain its access to government loans. The Council may look to borrow any long-term loans from other sources such as banks, pensions and local authorities and may utilise money market

brokers to facilitate borrowing from other local authorities for short to medium term borrowing.

6. Debt Rescheduling

The prime objective of any restructuring is to reduce risk in the portfolio, whether that be interest rate or refinancing risk. Any savings that may be created as a result will be considered in the context of the overall risk profile.

Debt restructuring opportunities will be kept under constant review, however the penalties of premature redemption of loans at higher rates than prevailing interest rates mean that there may be significant costs associated with this, which will reduce the attractiveness of opportunities.

7. Investments

Annual Investment Strategy

The Council has regard to the CIPFA Code and Guidance for Local Government Investments for District Councils in Northern Ireland (the Guidance) as cited under Section 25(1) of the Local Government Finance Act (Northern Ireland) 2011 (the Act) when setting the Investment Strategy. The Department recommends that each local authority produce and publish an Annual Investment Strategy, approved by the Council and revised in year as required. This sets out the Council's policies for managing investments and for giving priority to the security and liquidity of those investments. This investment strategy states which instruments the Council may use for investment purposes, making a distinction between specified and non-specified investments. This strategy also determines limits in respect of their overall levels.

The prime objective of the Council's investment strategy is to ensure prudent investment of surplus funds. The Council's investment priorities are the security of capital, liquidity of investments and, within those objectives, to secure optimum performance.

All investments will be made in accordance with the Council's investment policies and prevailing legislation and regulations.

7.1 Specified Investments

An investment is a **specified investment** if:

- The investment is denominated in Sterling and all payments or repayments are payable only in Sterling,
- The investment is not a long term investment (i.e. due to be repaid within 12 months of the date in which it was made or one which the Council may require to be repaid within that period),
- The making of the investment is not defined as capital expenditure by virtue of regulation 12 of the Local Government (Capital Finance and Accounting) (Northern Ireland) Regulations 2011; and
- The investment is made with a body which has been awarded a high credit rating, or is made with one of the following:
 - a) The United Kingdom Government;
 - b) A District Council;

c) A Local Authority in England and Wales or a similar body in Scotland;

The following categories of investments may be used under the definition of specified investments:

- Short term cash deposits
- Call accounts
- Certificates of Deposit (with maturity dates < 1 year)
- UK Government Gilts
- Treasury Bills
- Money Market Funds

The Council considers a high credit rating for money market funds to be those with a long term Fitch Rating of AAA (or the equivalent highest rating from Standard and Poors or Moodys).

The Council will have regard to all 3 rating agencies and considers a high credit rating for other investments to be as follows:

Fitch Credit Rating	Minimum level
Short Term Rating	F1
Long Term Rating	A

Fitch defines these ratings as follows:

A: High credit quality.

'A' ratings denote expectations of low default risk. The capacity for payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to adverse business or economic conditions than is the case for higher ratings.

F1: Highest short-term credit quality.

Indicates the strongest intrinsic capacity for timely payment of financial commitments

7.2 Non-specified Investments

In respect of **non-specified investments**. The following instruments have been identified by the Council.

Category of Non-specified investment
Sterling denominated Foreign Government Securities
Sterling medium term Deposits or Certificates of Deposit
Floating rate Certificates of Deposit
Highly rated Corporate Bonds (including investments in a Corporate Bond Fund)
Sterling Reserve Funds
Index-linked structured deposits
Collateralised deposits
Foreign Currency denominated investments
Deposits with non-rated Building Societies

The Council do not intend on making any investments in the 2023/24 year which meet the definition of non-specified investments and therefore there is no limit set on this within the Investment Strategy.

The CIPFA Code of Practice recommends that the Investment Strategy sets out the maximum period over which investments will be made.

The Director of Finance recommends that a maximum duration of 2 years should be set, although it is only expected that investments over 12 months will be made only in exceptional circumstances.

Regulation 12(1) (d) of the Local Government (Capital Finance and Accounting) Regulations (Northern Ireland) 2011 states that some categories of investment are defined as Capital Expenditure. This relates to the acquisition of share or loan capital in any body corporate. However, in the event that this expenditure is made as an investment for the prudent management of the Council's financial affairs, it shall not be treated as capital expenditure.

The impact of investing in instruments of this nature are such that, unlike other investment instruments, either capital or revenue resources would have to be applied to this expenditure, and once the investment was sold or matured, the income would be a capital receipt.

The Council will monitor any proposals for such investments and will assess a suitable limit within the Investment Strategy.

7.3 Investment Risk

The prime consideration of risk within investments is the loss of capital invested. Therefore investments will only be made with bodies with a high credit rating defined above. Credit ratings will form the primary driver for assessing credit quality, although it is recognised that this is not the only means of assessing credit quality.

Caution will be exercised in determining the creditworthiness of investment counterparties, even if they meet the minimum criteria above.

In the event that any institutions are at the minimum criteria and are on negative rating watch, monies will not be placed with that organisation until such time that the negative outlook is revised.

Geographical limits will be considered to ensure an appropriate spread of risk. Sovereign ratings will be taken account of when placing funds with institutions outside of the UK.

Credit ratings for existing investment counterparties will be monitored on a monthly basis, as well as immediately before new deposits are placed.

Market intelligence will also be considered before entering into any investments with proposed counterparties meeting the minimum criteria.

7.4 Treasury Management Advisers

The Council currently utilise the services of external advisers, Arlingclose, when determining the credit quality of its investment counterparties. The Council recognise that responsibility for the decision to invest with a counterparty rests with the Council as the principle undertaking the transaction.

Credit ratings will be obtained directly from the rating agencies' websites, and officers will regularly read the financial press for information relevant to the credit-worthiness of counterparties.

7.5 Investment Training

The Council recognises that investments, as well as wider treasury management issues require a high level of specialist knowledge. Officers undertaking the decisions are all qualified accountants with many years of experience. However, the Council recognises the need for officers to be kept up to date with developments and through the annual appraisal system will identify any training needs to further enhance the current skills base.

In the event of new Officers joining the function, they will be provided with significant on the job training as well as being provided with the opportunity to attend relevant external training courses.

The Council recognises that although there may be costs involved with sending officers to training courses, when these costs are considered in the context of the size of the portfolios being managed, and the amount of the Council's money at risk, investment in training is a worthwhile area of expenditure.

In addition to the training of officers, in order for elected members to provide effective scrutiny of the strategy and to have the knowledge to make informed decisions regarding the strategy, it is also important that training is provided to Members of the Council.

7.6 Other Investment Considerations

The level of investment balances is not specifically targeted in the strategy; it will be a consequence of the net spending plans of the Council, and the level of external borrowing to be undertaken. To date, balances have remained relatively stable over recent years. However, the introduction of the Prudential Code, and the self regulation of borrowing limits and capital financing strategies, may result in higher or lower levels of balances going forwards as the level of external borrowing is given active consideration.

It should also be noted that the investments are largely as a result of the level of reserves and provisions that the Council has at any one point in time. In addition, there is an amount of working capital (excess of creditors over debtors) as well as being a factor of the extent to which investment balances have been used in lieu of external borrowing.

Investment balances are expected to decrease as further investment balances are used in lieu of external borrowing.

The remaining cash balances that will not be used in lieu of external borrowing will primarily exist to manage cash flow volatility within the Council. It is therefore not expected that investments of a long term strategic nature will be made. Instead the duration of new investments will remain relatively short in order to meet liquidity demands.

The Council recognises that a consequence of short dated investments is that it exposes the portfolio to interest rate risk, which would otherwise be reduced if investments were made of a long term nature. The budget for investment income takes a prudent approach to expected returns from investments.

8. Treasury Management Indicators

The CIPFA Treasury Management Code of Practice requires various indicators to be set within the strategy. This section of the report sets these out in the format required by the Code. Whilst they are required to provide boundaries within which the treasury management operations will be managed, it is also important that there is sufficient flexibility to enable officers to react to unforeseen favourable movements in the financial markets which may present beneficial opportunities to the Council.

8.21 Interest Rate Exposures

The Council is required to set upper limits for both fixed and variable exposures for the forthcoming years. The purpose of this indicator is to contain the Council's exposure to unfavourable movements in interest rates. The indicators are expressed as Fixed Rate Borrowing less Fixed Rate Investments and Variable Rate Borrowing less Variable Rate Investments. The Council defines variable rate investments as including those instruments maturing within each year, as the replacement of those instruments will be subject to prevailing rates of interest. The following table shows the upper limit of fixed rate exposure and the upper limit of variable rate exposure for the forthcoming three years.

	Estimate 2023/24 £'000	Estimate 2024/25 £'000	Estimate 2025/26 £'000
Upper limit of fixed rate exposure	124,307	133,482	129,912
Upper limit of variable rate exposure	3,729	4,004	3,897

8.2 Maturity Structure of Fixed Rate Borrowing

The Council is required to set upper and lower limits of fixed rate borrowing maturing within certain periods, in order to contain the exposure to re-financing risk which may arise if significant proportions of borrowing were maturing within a short period of time. The Council has set the following limits for the forthcoming financial year.

	Lower Limit	Upper Limit
Under 12 months	0.00%	25.00%
12 months – 24 months	0.00%	25.00%
24 months – 5 years	0.00%	50.00%
5 years – 10 years	0.00%	75.00%
10 years and above	0.00%	75.00%

8.3 Total Principal Sums Invested for periods longer than 364 days

The purpose of this indicator is to contain exposure to the possibility of loss that may arise as a result of the Council having to seek early repayment of sums invested.

The Council would not, through its normal course of investment activities, expect to make investments beyond 12 months. However, there may be exceptional circumstances which may result in investments being made up to 2 years in duration, as is referred to within the Annual Investment Strategy.

	Estimate 2023/24	Estimate 2024/25	Estimate 2025/26
Total principal sums invested for longer than 364 days	£2m	£2m	£2m