Draft Treasury Management Strategy

2022-23

1.0 INTRODUCTION

The Council carries out its treasury management activities in accordance with the Chartered Institute of Public Finance and Accountancy's (CIPFA) *Treasury Management in the Public Services: Code of Practice (2017) (the 'Code')*. In December 2021 CIPFA launched a new addition to the code with full implementation from 2023-24. These require the Council to set out the policies and objectives of its treasury management activities and to manage its treasury risks in accordance with the Code.

CIPFA has adopted the following as its definition of treasury management activities:

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

The definition of 'Investments' above includes:

- Treasury Management investments (held for the prudent management of financial affairs), and
- Non-Treasury Investments, undertaken as part of a Capital Strategy either in the course of provision of services; or made for commercial reasons purely to make a financial gain. These are managed outside of normal treasury management activity

In addition, the Welsh Government (WG) issued revised *Guidance on Local Authority Investments* in November 2019 that requires the Authority to approve an investment strategy before the start of each financial year. This Strategy fulfils the Authority's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the WG Guidance. In accordance with the WG Guidance Council would be asked to approve a revised Treasury Management Strategy (TMS) should the assumptions on which it is based change significantly. This might be for example a large unexpected change in interest rates, in the Council's Capital Programme, or in the level of its investment balance, or a material loss in the fair value of a non-financial investment identified as part of the year end accounts preparation and audit process, or a change in Accounting Standards.

Local authorities are required to separately approve a Capital Strategy for capital expenditure and financing, treasury management and non-treasury investments. The Council's Capital Strategy includes the Prudential Indicators along with details regarding the Council's non-treasury investments. The CIPFA Code requires the Council to set a number of Treasury Management Indicators, which are forward looking parameters and enable the Council to measure and manage its exposure to treasury management risks, which are integral to the TMS. The Capital Strategy and TMS should be read in conjunction with each other as borrowing and investments are directly impacted upon by capital plans.

The Council has an integrated TMS where borrowing and investments are managed in accordance with best professional practice, which is assessed either from internal expertise or consultation with our external advisers. The Council borrows money either to meet short term cash flow needs or to fund capital schemes approved within the capital programme. Therefore any actual loans taken are not generally associated with particular items of expenditure or assets. The Council is exposed to financial risks including the potential loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Council's TMS. Should these change significantly, a revised TMS will be presented to Council for approval. A half year review of treasury management performance will also be presented to Council for approval as will an annual report for the financial year.

The Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to Cabinet, and for the execution and administration of treasury management decisions to the Section 151 Officer, who will act in accordance with the organisation's strategy, Treasury Management Practices (TMP) and CIPFA's *Standard of Professional Practice on Treasury Management*. Quarterly reports will be presented to Cabinet. The Council nominates the Governance and Audit Committee to be responsible for ensuring effective scrutiny of the Treasury Management Strategy and policies and regular reports will be presented to the committee for their consideration.

2.0 ECONOMIC CONTEXT

Economic background: The ongoing impact on the UK from coronavirus, together with higher inflation, higher interest rates, and the country's trade position post-Brexit, will be major influences on the Council's treasury management strategy for 2022-23.

The Bank of England increased the Bank Rate to 0.25% in December 2021 while maintaining its Quantitative Easing programme at £895 billion. The Monetary Policy Committee (MPC) voted 8-1 in favour of raising rates, and unanimously to maintain the asset purchase programme.

Within the announcement the MPC noted that the pace of the global recovery was broadly in line with its November Monetary Policy Report. Prior to the emergence of the Omicron coronavirus variant, the Bank also considered the UK economy to be evolving in line with expectations, however with the increased uncertainty and risk to activity the new variant presents, the Bank revised down its estimates for Q4 GDP growth to 0.6% from 1.0%. Inflation was projected to be higher than previously forecast, with CPI likely to remain above 5% throughout the winter and peak at 6% in April 2022. The labour market was generally performing better than previously forecast and the Bank of England now expects the unemployment rate to fall to 4% compared to 4.5% forecast previously but notes that Omicron could weaken the demand for labour.

Credit outlook: Since the start of 2021, relatively benign credit conditions have led to credit default swap (CDS) prices for the larger UK banks to remain low and had

steadily edged down throughout the year up until mid-November when the emergence of Omicron has caused them to rise modestly. However, the generally improved economic outlook during 2021 helped bank profitability and reduced the level of impairments many had made as provisions for bad loans. However, the relatively recent removal of coronavirus-related business support measures by the government means the full impact on bank balance sheets may not be known for some time.

The improved economic picture during 2021 led the credit rating agencies to reflect this in their assessment of the outlook for the UK sovereign as well as several financial institutions, revising them from negative to stable and even making a handful of rating upgrades.

Looking ahead, while there is still the chance of bank losses from bad loans as government and central bank support is removed, the institutions on the Council's counterparty list are well-capitalised and general credit conditions across the sector are expected to remain benign. Duration limits for counterparties on the Authority's lending list are under regular review and will continue to reflect economic conditions and the credit outlook.

Interest rate forecast: The Council's treasury management adviser Arlingclose is forecasting that the Bank Rate will continue to rise in the first quarter of 2022 to subdue inflationary pressures and the perceived desire by the Bank of England to move away from emergency levels of interest rates.

Investors continue to price in multiple rises in Bank Rate over the next forecast horizon, and Arlingclose believes that although interest rates will rise again, the increases will not be to the extent predicted by financial markets. In the near-term, the risks around Arlingclose's central case are to the upside while over the medium-term the risks become more balanced.

Yields are expected to remain broadly at current levels over the medium-term, with the 5, 10 and 20 year gilt yields expected to average around 0.65%, 0.90%, and 1.15% respectively. The risks around for short and medium-term yields are initially to the upside but shifts lower later, while for long-term yields the risk is to the upside. However, as ever, there will almost certainly be short-term volatility due to economic and political uncertainty and events.

A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix A.

3.0 EXTERNAL DEBT AND INVESTMENT POSITION

As at 31 December 2021, the Council held £96.87 million of borrowing and £77.50 million of investments. The external debt and investment position is shown in Table 1 below and more detail is provided in sections 4.0 Borrowing Strategy and 5.0 Investment Strategy.

Table 1: Council's external debt and investment position as at 31 December 2021

	Principal as at 31/12/2021 £m	Average Rate 31/12/2021 %
External Long Term Borrowing		
Public Works Loan Board	(77.62)	4.70
Lender's Option Borrower's Option	(19.25)	4.65
Total External Long Term Borrowing	**(96.87)**	**4.69**
Other Long Term Liabilities		
Private Finance Initiative*	(14.96)	
Other Long Term Liabilities	(2.37)	
Total Other Long Term Liabilities	**(17.33)**	
Total Gross Debt	**(114.20)**	
Treasury Investments		
Debt Management Office	10.30	0.01
Local Authorities	41.50	0.15
Banks	12.40	0.10
Money Market Funds**	13.30	0.10
Total Treasury Investments	**77.50**	**0.11**
Net Debt	**(36.70)**	

* (PFI) arrangement for the provision of a Secondary School in Maesteg 12 years remaining term
**the funds provide instant access

The current profile of repayment of the Council's long term debt is set out in the chart below. This assumes that all loans will run to their final maturity. However the Council holds £19.25 million of Lender's Option Borrower's Option loans that may be rescheduled ahead of their maturity of 22 January 2054.

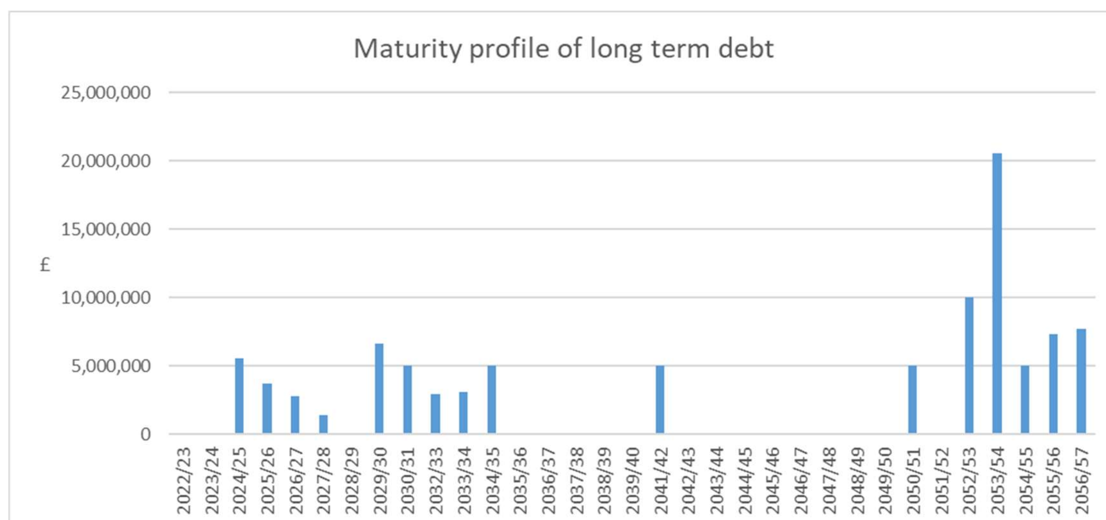

Table 2 below shows forecast changes in borrowing and investments and has been produced using estimates of capital spend and forecasts on usable reserves for the current financial year and the next three years. The Table shows that the Loans Capital Financing Requirement (CFR), which is the Council's need to borrow to fund capital expenditure, is anticipated to increase from current levels moving forward, which is due to additional prudential borrowing needed to support the Capital Programme.

Table 2: Balance sheet summary and forecast

	31 March 21 Actual £m	31 March 22 Estimate £m	31 March 23 Estimate £m	31 March 24 Estimate £m	31 March 25 Estimate £m
Capital Financing Requirement	172.97	181.49	191.92	189.74	187.46
Less: Other Debt Liabilities	(15.57)	(14.77)	(13.90)	(12.97)	(11.97)
Loans Capital Financing Requirement	**157.40**	**166.73**	**178.02**	**176.77**	**175.48**
Less: External Borrowing *	(96.87)	(96.87)	(102.91)	(107.75)	(111.82)
Internal Borrowing	**60.53**	**69.86**	**75.11**	**69.02**	**63.67**
Less: Usable Reserves	(114.43)	(103.70)	(78.81)	(73.51)	(66.50)
Plus: Working Capital	8.55	8.55	8.55	8.55	8.55
New Borrowing Requirement **	**0.00**	**0.00**	**4.84**	**4.06**	**5.72**

*The accounting practice followed by the Council requires financial instruments in the accounts (debt and investments) to be measured in a method compliant with International Financial Reporting Standards (IFRS) so these figures will differ from other figures in the TMS which are based on the actual amounts borrowed and invested
** Any surplus borrowing requirement will be invested in line with the investment strategy

Where a Council finances capital expenditure by borrowing it must put aside revenue resources to repay that debt in later years, known as 'Minimum Revenue Provision' or MRP. The *Local Authority (Capital Finance and Accounting) (Amendment) (Wales) Regulations 2008* requires the Council to produce and approve an Annual Minimum Revenue Provision (MRP) Statement before the start of the financial year that details the methodology for the charge as detailed in the Council's Capital Strategy. 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. This strategy is prudent as investment returns are low and counterparty risk is relatively high. The Council is forecasting an increased CFR due to the increased level of prudential borrowing in the capital programme. Also there is a change to the accounting for leases under International Financial Reporting Standard (IFRS) 16 due to be implemented from April 2022. This new standard will require that operating leases are brought onto the balance sheet as a 'right of use' asset and a lease liability created. Whilst the asset and liability values will be equal, the impact of this is that it will increase the Council's liabilities and therefore its borrowing requirement. The current estimate is that the borrowing requirement will increase by approximately £14 million from 2022-23 to 2024-25. A further impact of this change will be that interest charges will be recognised as a financing cost in the comprehensive income and expenditure statement rather than as lease payments within directorate budgets. The overall interest charge will not change, only its presentation within the financial statements.

Liability benchmark: To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated. A liability benchmark is a tool which helps to assess the lowest borrowing options available to an authority, by looking at debt levels in relation to future liquidity to plan for financing. This assumes the same forecasts as Table 2 above, but that cash and investment balances are kept at a minimum level of £10 million at each year-end to maintain sufficient liquidity but minimise credit risk. CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. Table 3 below shows that the Council anticipates its borrowing will be below the liability benchmark as a result of using reserves in the short-term to fund capital expenditure, known as internal borrowing. It should be noted that this is a short-term position and as reserves are used for the purpose they were set aside, the need to borrow will become necessary. More detail is provided in the Capital Strategy.

Table 3: Liability benchmark

	31 March 21 Actual £m	31 March 22 Estimate £m	31 March 23 Estimate £m	31 March 24 Estimate £m	31 March 25 Estimate £m
Loans Capital Financing Requirement	157.40	166.73	178.02	176.77	175.48
Less: Usable Reserves	(114.43)	(103.70)	(78.81)	(73.51)	(66.50)
Less: Working Capital Deficit	8.55	8.55	8.55	8.55	8.55
Less: Minimum Investments	(10.00)	(10.00)	(10.00)	(10.00)	(10.00)
Liability Benchmark	**41.52**	**61.58**	**97.75**	**101.81**	**107.53**

4.0 BORROWING STRATEGY

The Council currently holds £96.87 million of loans as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in Table 2 above shows that the Council will have a new borrowing need over the next three years as detailed in Table 4 below:

Table 4: New Borrowing

	31 March 21 Actual £m	31 March 22 Estimate £m	31 March 23 Estimate £m	31 March 24 Estimate £m	31 March 25 Estimate £m
New Borrowing	0.00	0.00	4.84	4.06	5.72

This borrowing need will be monitored on an on-going basis and any new borrowing will be considered alongside any changes in the Capital Programme that may affect the level of borrowing required.

The Section 151 Officer will monitor and update the liability benchmark assumptions on an on-going basis and report any significant changes within the treasury management monitoring reports to Cabinet, Governance and Audit Committee and

Council as appropriate. This could be as a result of changes in the level of usable reserves at year end, slippage within the Capital Programme or changes within the working capital assumptions.

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

Therefore the major **objectives** to be followed in 2022-23 are:

- to minimise the revenue costs of debt
- to manage the Council's debt maturity profile i.e. to leave no one future year with a high level of repayments that could cause problems in re-borrowing
- to secure funding in any one year at the cheapest cost commensurate with future risk
- to monitor and review the level of variable interest rate loans in order to take greater advantage of interest rate movement
- to reschedule debt if appropriate, in order to take advantage of potential savings as interest rates change
- to optimise the use of all capital resources including borrowing, both supported and unsupported, usable capital receipts, revenue contributions to capital and grants and contributions

Given the significant cuts to public expenditure in recent years and in particular to local government funding, the Council's **borrowing strategy** continues to address the key issue of affordability, without compromising the longer-term stability of the debt portfolio. The uncertainty over future interest rates increases the risks associated with treasury activity. As a result the Council will take a cautious approach to its Treasury Strategy. 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 borrow short term instead.

The Section 151 Officer will take the most appropriate form of borrowing depending on the prevailing interest rates at the time. However, with long term rates forecast to rise modestly in future years, any such short term savings will need to be balanced against the potential longer term costs. The Council's treasury management advisers will assist the Council with this 'cost of carry' and breakeven analysis. The last time the Council took long term borrowing was £5 million from the Public Works Loan Board (PWLB) in March 2012. However the Council will consider long term loans from other sources including banks, pension funds and other local authorities. The Council will also 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. As detailed above, it is anticipated that there will be a requirement for new long term borrowing in 2022-23 and for the subsequent two years. It is anticipated that this would be from the PWLB and for estimate purposes it has been assumed that this will be over 30 years.

HM Treasury issued revised lending terms for PWLB borrowing by local authorities in November 2020. As a condition of accessing the PWLB, local authorities will be asked to confirm that there is no intention to buy investment assets primarily for yield in the current **or next two** financial years. Local authorities' Section 151 Officers, or equivalent, will be required to confirm that capital expenditure plans are current and that the plans are within acceptable use of the PWLB. In December 2021 CIPFA published a new edition of the Prudential Code for Capital Finance in Local Authorities (the Prudential Code). This update includes a significant change in the Code, which is that in order to comply with the Code, an authority must not borrow to invest primarily for financial return. The Code does not require existing commercial investments, including property, to be sold. However, it does set out that authorities who have a need to borrow should review options for exiting their financial investments for commercial purposes. Given the investment and borrowing requirement to support the Capital Programme, the Council does not intend to invest purely for financial return.

Alternatively, the Council could arrange forward starting loans during 2022-23 where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period. In addition, the Council may borrow short term (normally for up to one month) to cover unexpected cash flow shortages.

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

- PWLB and any successor body
- any institution approved for investments (see Investment Strategy 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 the Council's Pension Fund)
- capital market bond investors
- special purpose companies created to enable local authority bond issues

Other sources of debt finance: In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- leasing
- hire purchase
- Private Finance Initiative
- Mutual Investment Models (for the development of public infrastructure in Wales)
- sale and leaseback

The Council has previously raised the majority of its long-term borrowing from the PWLB, but will consider long-term loans from other sources such as Welsh Government and local authority loans and bank loans, which may be available at more favourable rates. The PWLB lending rates increased by 1% in October 2019, but this rate rise was reversed from 26 November 2020 following the outcome of the Comprehensive Spending Review on 25 November 2020.

LOBOs: The £19.25 million shown in Table 1 above, relates to Lender's Option Borrower's Option (LOBO) loans which have a maturity date of 2054, however these may be re-scheduled in advance of this maturity date. The LOBO rate and term may vary in the future depending upon the prevailing market rates, the lender exercising their option to increase rates at one of the bi-annual trigger points and therefore the Council being given the option to accept the increase or to repay the loan without incurring a penalty. There are two trigger points in 2022-23 and although the Council understands that the lender is unlikely to exercise this option in the current low interest rate environment, an element of refinancing risk remains and the Council would take the option to repay these loans at no cost if it has the opportunity to do so in the future.

Short term and variable rate loans: These loans expose the Council to the risk of short term interest rate rises should interest rates change.

Debt rescheduling: The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some higher rate loans with new loans at lower interest rates, or repay loans without replacement, where this is expected to lead to an overall saving or reduction in risk.

Treasury Management Indicators:
The local authority measures and manages its exposures to treasury management risks using the following indicators;

- Maturity Structure of Borrowing (Table 5)
- Principal sums invested for periods longer than a year (Table 8)
- Interest Rate exposures (Table 10)

Maturity structure of borrowing indicator: This indicator is set for the forthcoming financial year to control the Council's exposure to refinancing risk with respect to the maturity of the Council's external borrowing and has been set to allow for the possible restructuring of long term debt where this is expected to lead to an overall saving or reduction in risk. It is the amount of projected borrowing maturing in each period as a percentage of total projected borrowing. The upper and lower limits on the maturity structure of borrowing will be:

Table 5: Treasury Management Indicator Maturity Structure of Borrowing 2022-23

Refinancing rate risk indicator Maturity structure of borrowing 2022-23	Upper limit	lower limit
Under 12 months	50%	0%
12 months and within 24 months	25%	0%
24 months and within 5 years	25%	0%
5 years and within 10 years	40%	0%
10 years and within 20 years	50%	0%
20 years and above	60%	25%

5.0 INVESTMENT STRATEGY

The preparation each year of an Investment Strategy is central to the Welsh Government Statutory Guidance on Local Authority Investments. It encourages the formulation of policies for the prudent investment of the surplus funds that authorities hold on behalf of their communities. In addition, the need for the Strategy to be approved by full Council ensures that these policies are subject to the scrutiny of elected Members: this is particularly important as, since 2004, central government no longer closely regulates local government investment.

The Council holds surplus funds representing income received in advance of expenditure plus balances and reserves and, as shown in Table 1 in Section 3 above, the balance at 31 December 2021 was £77.50 million. Investments are estimated to drop to between £30 and £40 million by 31 March 2022. This is on the assumption of the contribution of Earmarked Reserves and Capital Receipts to the Capital Programme in the final quarter of 2021-22. The estimated figure for investments above does not make any provision for any additional funding received from WG e.g. Business grants or hardship funds during the last quarter of 2021-22. Based on its cash flow forecasts, the Council anticipates its investment balances in 2022-23 to range between £40 million to £80 million with an average investment rate of between 0.1% to 1.00% depending on the Bank Rate and investment types, which will be reviewed at the half year stage and reported to Council. However, should the Council need to invest in the Debt Management Office (DMO), interest rates may be negative meaning the Council will get back less than it invested. However, the Council will only seek to invest in investments with negative interest rates if the maximum investment limit is already reached for all other investment types and is therefore a last resort. The actual balance varies because of the cash flow during the year in respect of when income is received (such as specific grant income, housing benefits subsidy and Revenue Support Grant) and payments are made (such as salaries and wages, major capital expenditure and loan repayments).

The Council holds investment properties with a view to securing a financial return, such as rental income. Given recent changes to the rules for accessing PWLB borrowing, the Council is unlikely to consider any further investment opportunities. As at 31 December 2021, the Council owned £5.090 million of investment properties with an expected return of £0.452 million for 2021-22. This includes rental discounts as a result of Covid-19. Income excluding discounts would normally be £0.459 million and this is what we would anticipate for 2022-23, representing a rate of return of 9.01%. The lessees are responsible for maintenance of these assets.

Both the CIPFA Code and the Welsh Government Guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments while seeking the highest rate of return, or yield. The Council's main objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal to or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested. However, this may not always be possible.

The major **objectives** are:

- to maintain capital **security**
- to maintain portfolio **liquidity** so funds are available when expenditure is needed
- to achieve the **yield** on investments commensurate with the proper levels of security and liquidity

Negative interest rates: The COVID-19 pandemic increased the risk that the Bank of England would set its Bank Rate at, or below, zero. Whilst this has not yet happened, very short term interest rates with the DMO have recently been negative at times. Since investments cannot pay negative income, negative rates will be applied by reducing the value of investments. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

Strategy: The Council's investments have historically been placed in mainly short term bank and building society unsecured deposits and local and central government. However, investments may be made with any public or private sector organisations that meet the credit criteria detailed below. Given the increasing risk and very low returns from short-term unsecured bank investments, the Council will consider further diversifying into more secure and/or higher yielding asset classes during 2022-23, as appropriate, in consultation with the Council's treasury management advisers. The majority of the Council's surplus cash is currently invested in Money Market Funds (MMF) and with other local authorities but the Council will continue to look at investment options in line with the limits detailed below.

With short term interest rates currently much lower than long-term rates, due consideration will also be given to using surplus funds to make early repayments of long term borrowing if appropriate opportunities become available as referred to in section 4.0 Borrowing Strategy.

Business Models: Under IFRS 9 (Financial Instruments), the accounting for certain investments depends on the Council's "business model" for managing them. The Council aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore these investments will continue to be accounted for at amortised cost.

Approved counterparties: The Council may invest its surplus funds with any of the counterparty types shown in Table 6 below, subject to the cash limits and the time limits shown. **These cash/time limits are per counterparty and relate to principal only and exclude any accrued interest.**

Table 6: Approved investment counterparties and limits

These limits must be read in conjunction with the notes immediately below the Table. The combined secured and unsecured investments in any one bank must not exceed the cash limit for secured investments:

Sector	Time limit	Counterparty limit	Sector limit
The UK Government	50 years	Unlimited	n/a
Local authorities & other government entities	25 years	£12,000,000	Unlimited
Secured investments *	25 years	£6,000,000	Unlimited
Banks (unsecured) *	13 months	£3,000,000	Unlimited
Building societies (unsecured) *	13 months	£3,000,000	£6,000,000
Registered providers (unsecured) *	5 years	£5,000,000	£5,000,000
Money market funds *	n/a	£6,000,000	Unlimited
Strategic pooled funds	n/a	£6,000,000	£6,000,000
Real estate investment trusts	n/a	£3,000,000	£6,000,000
Other investments *	5 years	£3,000,000	£6,000,000

***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. **Schedule A** shows the equivalence Table for credit ratings for three of the main rating agencies Fitch, Moody's and Standard & Poor's and explains the different investment grades.

For entities without published credit ratings, investments may be made where external advice indicates the entity to be of similar credit quality.

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. Where additional amounts received into our accounts with our own bankers are received too late in the day to make an investment the same day, the limit in Table 6 will not apply as this does not count as an investment.

Banks and building societies secured: Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they 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 highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits.

Government: Loans, 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 Central 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.

Corporates: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made following an external credit assessment and consultation with the Council's treasury management advisers.

Registered providers: Loans and bonds issued by, guaranteed by, or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are tightly regulated by the Welsh Government and as providers of public services, they retain the likelihood of receiving government support if needed.

Pooled funds: Shares or units in diversified investment vehicles consisting of any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds, that offer same-day liquidity and very low or no volatility, will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period can be used for longer investment periods. 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.

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. As these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.

Operational bank accounts: The Council may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk

of a bank bail-in, and balances will therefore be kept to a minimum. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.

Risk assessment and credit ratings: Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify the Council of changes as they occur.

Long-term ratings are expressed on a scale from AAA (the highest quality) through to D (indicating default). Ratings of BBB- and above are described as investment grade, while ratings of BB+ and below are described as speculative grade. The Council's credit rating criteria are set to ensure that it is very unlikely the Council will hold speculative grade investments, despite the possibility of repeated downgrades.

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
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty

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

Other information on the security of investments: The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Council's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations as happened in 2008 and 2020, it is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a

reduction in the level of investment income earned, but will protect the principal sum invested.

Specified investments: The *Welsh Government Statutory Guidance on Local Government Investments* defines specified investments as those:

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

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

Non-specified investments: Any investment that does not fall into the criteria detailed above under the Specified investments definition. The Council does not intend to make any investments denominated in foreign currencies nor any defined as capital expenditure. Non-specified investments will therefore be limited to:

- long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement
- investments with bodies and schemes not meeting the definition on high credit quality

The *Welsh Government Statutory Guidance on Local Government Investments* requires the Council's Investment Strategy to set an overall limit for non-specified investments which is currently set at £20 million. Table 7 below shows the non-specified categories and the relevant limits and although the total of the individual limits exceed £20 million, at any one point in time a **maximum of £20 million** could be invested in these non-specified investments.

Table 7: Non-specified investment limits

	Category Cash limit
Total long-term investments	£15m
Total investments without credit ratings or rated below the Council's definition of "high credit quality" (A-) (except the UK Government and UK local authorities)	£10m
Total investments (except pooled funds)with institutions domiciled in foreign countries with a sovereign rating below AA+	£3m
Total Non-Specified Investments Outstanding	£20m

Principal sums invested for periods longer than a year: All investments longer than 365 days (non-specified) will be made with a cautious approach to cash flow requirements and advice from the Council's treasury management advisers will be sought as necessary.

Where the Council invests, or plans to invest, for periods longer than a year, an upper limit is set for each forward financial year period for the maturing of such investments. The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of long term investments. The limits on the long term principal sum invested to final maturities beyond the period end will be as shown in Table 8 below.

Table 8: Treasury Management Indicator Principal sums invested for periods longer than a year

Price risk indicator	2022-23 £m	2023-24 £m	2024-25 £m
Limit on principal invested beyond financial year end	15	10	10

Investment Limits: In addition to the above limits, the combined values of specified and non-specified investments with any one organisation are subject to the approved investment limits detailed in Table 9 below.

Table 9: Investments limits

	Category Cash limit
Any single organisation, except the UK Central and Local Government	£6m
UK Central Government	unlimited
UK Local Authorities (per Authority)	£12m
Any group of organisations under the same ownership	£6m per group
Any group of pooled funds under the same management	£6m per manager
Negotiable instruments held in a broker's nominee account	£10m per broker
Foreign countries	£6m per country
Registered providers and registered social landlords	£5m in total
Unsecured investments with Building Societies	£6m in total
Money market funds (MMF)	Unlimited

A group of banks under the same ownership will be treated as a single organisation for limit purposes. 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.

The combined secured and unsecured investments in any one bank must not exceed the cash limit for secured investments.

Liquidity Management: The Council forecasts on a prudent basis the maximum period for which funds may be committed therefore minimising the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. A limit of £15 million (Table 8 above) has been set for 2022-23 for long term investments and this has been set with reference to the Medium Term Financial Strategy and cash flow forecast as shown in the principal sums invested for periods longer than a year indicator in Table 7 above. This represents just under 18.75% of the maximum amount of investments that the Council anticipates to have at any one point in time in 2022-23.

The Council will seek to 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.

6.0 INTEREST RATE EXPOSURES BORROWING AND INVESTMENTS

The Council is exposed to interest rate movements on its borrowings and investments. Movements in interest rates have a complex impact on the Council, depending on how variable and fixed interest rates move across differing financial instrument periods. For instance, a rise in variable and fixed interest rates would have the following effects:

- borrowings at variable rates – the interest charged to revenue within the Comprehensive Income and Expenditure Statement will rise;
- borrowings at fixed rates – the fixed rate protects the Council from increased interest charges as an equivalent loan would now cost more. The fair value of the borrowing (liability) will fall;
- investments at variable rates – the interest income credited to the Comprehensive Income and Expenditure Statement will rise;
- investments at fixed rates – the fixed rate prevents the Council from receiving higher investment income from the same principal invested. The fair value of the investment (asset) will fall.

An indicator has been set in Table 10 below to measure the net impact over one year on the revenue account of both a 1% rise and a 1% fall in all interest rates for borrowing net of treasury investments. This is calculated on the assumption that maturing loans and investments will be replaced at rates 1% higher or lower than they would otherwise have been on their maturity dates and that the treasury investment and borrowing portfolios remain unchanged over the coming year. Interest rates can move by more than 1% over the course of a year, although such instances are rare.

<u>Table 10: Treasury Management Indicator Interest Rate Exposures</u>

The following Table is based on investments as at 31 December 2021.

Interest rate risk indicator	£'000
One year revenue impact of a 1% rise in interest rates	(537)
One year revenue impact of a 1% fall in interest rates	726

The figure for the 1% fall in interest rates indicator is not the same figure as the 1% increase (but reversed) as the borrowing relates to variable LOBO loans where it is assumed that the lender would only exercise their option if there was an increase in interest rates. All other borrowing does not have a rate reset in the next year and is with the PWLB at fixed rates.

7.0 NON-TREASURY INVESTMENTS

The Council recognises that investment in other financial assets and property primarily for financial return, taken for non-treasury management purposes, requires careful investment management. Such activities include investments in subsidiaries and investments in property.

A schedule of the Council's existing non-treasury investments (currently limited to owned property) is set out in Table 11 below:

Table 11: Non-treasury investments

Non-treasury investments	Fair Value £'000
Bridgend Science Park - Units 1 & 2	3,670
Waterton Cross Land	600
Brynmenyn Industrial Estate Plot 53	250
Village Farm Plots 32,119 & 120	370
Tyrewise Bridgend	200
Total	**5,090**

The Council considers that the scale of its investment properties is proportionate to the resources of the Council, since such investment represents less than 1% of its total long term assets.

In accordance with Welsh Government Investment Guidance, these will be classified as non-treasury investments.

8.0 LOANS TO THIRD PARTIES

The Council may borrow to make grants or loans to third parties for the purpose of capital expenditure. Welsh Government Guidance defines a loan as a written or oral agreement where the Council temporarily transfers cash to a third party, joint venture, subsidiary or associate who agrees a return according to the terms and conditions of receiving the loan, except where the third party is another local authority. Loans are only made after the Council's formal decision making process has been followed. This includes formal approval by Council following advice from the Chief Finance Officer. As part of the formal decision to make the loan, the security for the loan will be assessed as to its adequacy in the event of the third party defaulting on repayment.

The Council can demonstrate that its financial exposure to loans is proportionate by setting the limit as set out in Table 12 below.

Table 12: Loan Limits

Loan limit	£'000
Limit on loans to third parties	2,000

9.0 IFRS9 – LOCAL AUTHORITY OVERRIDE

The Welsh Government legislated in the Local Authorities (Capital Finance and Accounting) (Wales) (Amendment) Regulations 2020 for a statutory override for fair value gains and losses on most pooled investment funds not to be taken to revenue until 2023-24. The statutory override took effect from the 2019-20 financial year. This has the effect of allowing any unrealised capital gains or losses arising from qualifying investments to be held on the balance sheet until 31 March 2023. This will enable Councils to initiate an orderly withdrawal of funds if required.

10.0 REPORTING ARRANGEMENTS

Council will receive the following reports for 2022-23 as standard in line with the requirements of the Code of Practice:

- Annual Treasury Management Strategy
- Mid-Year Treasury Monitoring Report
- Annual Treasury Outturn Report

The Chief Officer – Finance, Performance and Change (the Council's s151 Officer) will inform the Cabinet Member for Finance of any long-term borrowing or repayment undertaken or any significant events that may affect the Council's treasury management activities. They will maintain a list of staff authorised to undertake treasury management transactions on behalf of the Council.

The Chief Officer – Finance, Performance and Change is authorised to approve any movement between borrowing and other long-term liabilities within the Authorised Limit. Any such change will be reported to the next meeting of the Council.

11.0 OTHER ITEMS

In line with the CIPFA Code and Welsh Government guidance the following also forms part of the Council's TMS.

Financial Derivatives: In the absence of any explicit legal power to do so, the Council will not use standalone financial derivatives such as swaps, forwards, futures and

options. Derivatives embedded into loans and investments including pooled funds and forward starting transactions may be used and the risks they present will be managed in line with the overall treasury risk management strategy.

Markets in Financial Instruments Directive II (MIFID II): From January 2018, MIFID II changed the classification of local authority investors. It reclassified local and public authorities as retail investors. The Council has opted up to professional client status with its providers of financial services, including treasury management advisers, banks, building societies and brokers**,** allowing it access to a greater range of services but without the greater regulatory protection afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the Chief Officer – Finance, Performance and Change believes this to be the most appropriate status.

Investment training: The needs of the Council's treasury management staff for training in investment management are assessed every six months as part of the staff appraisal process and also if the responsibilities of individual members of staff change.

Training is received from the Council's treasury management advisers, CIPFA and other bodies in the form of training courses and seminars. The Council also supports personal development so individuals enhance their own knowledge through reading CIPFA guidance, publications and research on the internet.

Investment advisers: Following a re-tender exercise in August 2020 Arlingclose Ltd. were re-appointed as the Council's treasury management advisers. They were awarded a four year contract, to provide advice and information relating to its borrowing and investment activities and capital finance issues. The contract will be reviewed annually and either party may at any time terminate this agreement on 3 months prior written notice. The quality of this service is controlled by having regular meetings with the advisers and regularly reviewing the service provided.

Investment of money borrowed in advance of need: CIPFA's Prudential Code sets out that authorities should never borrow for the explicit purpose of making an investment return. Therefore borrowing in advance of need purely to profit from the investment of the extra sums borrowed is against the principles, however, the Council could potentially borrow in advance of need where this is expected to provide the best long term value for money. Since amounts borrowed will be invested until spent, the Council is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Council's overall management of its treasury risks.

As the Council has an integrated TMS, borrowing is not linked to the financing of specific items of expenditure. The Council's forecast Capital Financing Requirement (CFR) as at 31 March 2022 is in excess of the actual debt of the Council as shown in Table 2 above indicating there is no borrowing in advance of need. More detail is provided in the Prudential Indicators in the Council's Capital Strategy**.**

Schedule A

Credit Rating Equivalence Table

	Description	Fitch Long	Fitch Short	Moody's Long	Moody's Short	Standard & Poor's Long	Standard & Poor's Short
INVESTMENT GRADE	Extremely strong	AAA		Aaa		AAA	
		AA+	F1+	Aa1		AA+	A-1+
	Very strong	AA		Aa2	P-1	AA	
		AA-		Aa3		AA-	
		A+		A1		A+	A-1
	Strong	A	F1	A2		A	
		A-		A3		A-	A-2
		BBB+	F2	Baa1	P-2	BBB+	
	Adequate	BBB		Baa2		BBB	
		BBB-	F3	Baa3	P-3	BBB-	A-3
SPECULATIVE GRADE		BB+		Ba1		BB+	
	Speculative	BB		Ba2		BB	
		BB-	B	Ba3		BB-	B
		B+		B1		B+	
	Very speculative	B		B2		B	
		B-		B3	Not Prime (NP)	B-	
		CCC+		Caa1		CCC+	
		CCC		Caa2		CCC	
	Vulnerable	CCC-	C	Caa3		CCC-	C
		CC		Ca		CC	
		C				C	
	Defaulting	D	D	C		D	D

GLOSSARY

Term	Definition
Amortised Cost	Amortised cost is the amount at which some financial assets or liabilities are measured and consists of: initial recognition amount, subsequent recognition of interest income/expense using the effective interest method, repayments and credit losses
Annuity	A method of repaying a loan where the cash payment remains constant over the life of the loan, but the proportion of interest reduces and the proportion of principal repayment increases over time. Repayment mortgages and personal loans tend to be repaid by the annuity method.
Asset Management	The stewardship of capital assets, including decisions around on-going maintenance and eventual disposal
Authorised limit	The maximum amount of debt that a local authority may legally hold, set annually in advance by the Council itself. One of the *Prudential Indicators*.
BACS	Bankers' automated payment system. UK bulk payments system allowing transfers between bank accounts with two days' notice, for a small charge.
Bail-in	A method of rescuing a failing *financial institution* by cancelling some of its *deposits* and *bonds*. Investors may suffer a reduction in their investment, but may be given shares in the bank as part compensation.
Bail-out	A method of rescuing a failing *financial institution* by the injection of public money. This protects investors at the expense of taxpayers.
Bank	Regulated firm that provides financial services to customers.
Bank of England	The *central bank* of the UK, based in London, sometimes just called 'the bank'.
Bank Rate	The official interest rate set by the *Monetary Policy Committee*, and the rate of interest paid by the *Bank of England* on commercial bank deposits. Colloquially termed the 'base rate'.
Bond	A certificate of *long-term* debt issued by a company, government, or other institution, which is tradable on financial markets
Borrowing	Usually refers to the stock of outstanding loans owned and *bonds* issued.
Broker	Regulated firm that matches either borrowers and lenders (a money broker) or buyers and sellers of *securities* (a stockbroker) with each other in order to facilitate transactions
Brokerage	Fee charged by a *broker*, normally paid by the borrower

Building Society	A mutual organisation that performs similar functions to a *retail bank* but is owned by its customers
Capital	(1) Long-term, as in *capital expenditure* and *capital receipts* *(2) Principal, as in capital gain and capital value* *(3) Investments in financial institutions that will absorb losses before senior unsecured creditors*
Capital Expenditure	Expenditure on the acquisition, creation or enhancement of fixed asset that are expected to provide value for longer than one year, such as property and equipment, plus expenditure defined as capital in legislation such as the purchase of certain investments
Capital Finance	Arranging and managing the cash required to finance *capital expenditure*, and the associated accounting.
Capital Financing Requirement (CFR)	A local authority's underlying need to hold debt for capital purposes, representing the cumulative capital expenditure that has been incurred but not yet financed. The CFR increases with *capital expenditure* and decreases with *capital finance* and *MRP*.
Capital Receipt	Cash obtained from the sale of an item whose purchase would be *capital expenditure*. The law only allows local authorities to spend capital receipts on certain items, such as new capital expenditure. They are therefore held in a capital receipts reserve until spent.
Capital strategy	An annual policy document required by the *Prudential Code* that sets out a local authorities' high-level plans for capital expenditure, debt and investments and its *Prudential Indicators* for the forthcoming financial year.
CIFPA	The Chartered Institute of Public Finance and Accountancy – the professional body for accountants working in the public sector. CIPFA also sets various standards for local government – e.g. Treasury Management Code and Prudential Code
Cost of Carry	When a loan is borrowed in advance of need, the difference between the interest payable on the loan and the income earned from investing the cash in the interim
Counterparty	The other party to a loan, investment or other contract
Counterparty limit	The maximum amount an investor is willing to lend to a *counterparty*, in order to manage *credit risk*.
Credit Default Swap	A credit default swap (CDS) is a financial derivative or contract that allows an investor to "swap" or offset his or her credit risk with that of another investor.

Credit rating	Formal opinion by a *credit rating agency* of a *counterparty's* future ability to meet its financial obligations. As it is only an opinion, there is no guarantee that a highly rated organisation will not default.
Credit rating agency	An organisation that publishes *credit ratings*. The three largest agencies are Fitch, Moody's and Standard & Poor's but there are many smaller ones.
Credit risk	The risk that a *counterparty* will *default* on its financial obligations.
Debt	(1) A contract where one party owes money to another party, such as a *loan*, *deposit*, or *bond*. (2) In the Prudential Code, the total outstanding borrowing plus other long-term liabilities
Default	Failure to meet an obligation under a debt contract, including the repayment of cash, usually as a result of being in financial difficulty
Deposit	A regulated placing of cash with a *financial institution*. Deposits are not tradable on financial markets.
DMO	Debt Management Office – an executive agency of HM Treasury that deals with central government's debt and investments.
Fair value	*IFRS* term for the price that would be obtained by selling an investment, or paid to transfer debt, in a market transaction.
FCA	Financial Conduct Authority – UK agency responsible for regulating financial markets and the conduct of *financial institutions*, *brokers*, *custodians*, *fund managers* and *treasury management advisors*.
Financial institution	A *bank*, *building society* or *credit union*. Sometimes the term also includes insurance companies.
Financial instrument	*IFRS* term for investments, borrowing and other cash payable and receivable.
Financing costs	In the *Prudential Code*, interest payable on *debt* less investment income plus *premiums* less *discounts* plus *MRP*.
Forward deal	An arrangement where a loan or deposit is arranged in advance of the cash being transferred, with the advance period being longer than the standard period (if any) for such a transaction.
GDP	Gross domestic product – the value of the national aggregate production of goods and services in the economy. Increasing GDP is known as economic growth.
General Fund	A local authority reserve that holds the accumulated surplus or deficit on revenue income and expenditure, except on council housing.

Gilt	Bond issued by the UK Government, taking its name from the gilt-edged paper they were originally printed on.
IFRS	International Financial Reporting Standards, the set of accounting rules in use by UK local authorities since 2010.
Impairment	A reduction in the value of an investment caused by the counterparty being in financial difficulty.
Inflation risk	The risk that unexpected changes in inflation rates cause an unplanned loss, for example by costs rising faster than income.
Interest	Compensation for the use of cash paid by borrowers to lenders on debt instruments.
Interest rate risk	The risk that unexpected changes in interest rates cause an unplanned loss, for example by increased payments on borrowing or lower income on investments.
Internal borrowing	A local government term for when actual “external” debt is below the capital financing requirement, indicating that difference has been borrowed from internal resources instead; in reality this is not a form of borrowing.
Investment property	Land and buildings that are held purely for rental income and/or capital growth. Investment properties are not owner-occupied and provide no direct service benefit.
Investment strategy	A document required by investment guidance that sets out a local authority’s investment plans and parameters for the coming year. Sometimes forms part of the authority’s treasury management strategy.
Lease	A contract where one party permits another to make use of an asset in return for a series of payments. It is economically similar to buying the asset and borrowing a loan, and therefore leases are often counted as a type of debt.
Lessee	Party to a lease contract that uses an asset owned by the lessor.
Lessor	Party to a lease contract that own an asset but permits another (the lessee) to use it.
Liability benchmark	Term in CIPFA’s Risk Management Toolkit which refers to the minimum amount of borrowing required to keep investments at a minimum liquidity level. Used to compare against the actual and forecast level of borrowing.
LIBOR	London interbank offer rate - the benchmark interest rate at which banks offer to lend cash to other banks. Published every London working day at 11am for various currencies and terms. Due to be phased out by 2022.
Liquidity risk	The risk that cash will not be available to meet financial obligations, for example when investments cannot be recalled and new loans cannot be borrowed.

Loan	Contract where the lender provides a sum of money (the principal) to a borrower, who agrees to repay it in the future together with interest. Loans are not normally tradable on financial markets. There are specific definitions in government investment guidance.
Loans CFR	The capital financing requirement less the amount met by other long-term liabilities, i.e. the amount to be met by borrowing.
LOBO	Lender's option borrower's option – a long-term loan where the lender has the option to propose an increase in the interest rate on pre-determined dates. The borrower then has the option to either accept the new rate or repay the loan without penalty. LOBOs increase the borrower's interest rate risk and the loan should therefore attract a lower rate of interest initially.
Long-term	Usually means longer than one year.
Market risk	The risk that movements in market variables will have an unexpected impact. Usually split into interest rate risk, price risk and foreign exchange risk.
Maturity	(1) The date when an investment or borrowing is scheduled to be repaid. (2) A type of loan where the principal is only repaid on the maturity date.
MiFID II	The second Markets in Financial Instruments Directive - a legislative framework instituted by the European Union to regulate financial markets in the bloc and improve protections for investors.
Monetary policy	Measures taken by central banks to boost or slow the economy, usually via changes in interest rates. Monetary easing refers to cuts in interest rates, making it cheaper for households and businesses to borrow and hence spend more, boosting the economy, while monetary tightening refers to the opposite. See also fiscal policy and quantitative easing.
Monetary Policy Committee (MPC)	Committee of the Bank of England responsible for implementing monetary policy in the UK by changing Bank Rate and quantitative easing with the aim of keeping CPI inflation at around 2%.
Money market fund (MMF)	A collective investment scheme which invests in a range of short-term assets providing high credit quality and high liquidity. Usually refers to CNAV and LVNAV funds with a WAM under 60 days which offer instant access, but the European Union definition extends to include cash plus funds.

Money markets	The markets for short-term finance, including deposits and T-bills. See also capital markets.
MRP	Minimum revenue provision - an annual amount that local authorities are required to set aside and charge to revenue for the repayment of debt associated with capital expenditure. Local authorities are required by law to have regard to government guidance on MRP.
Net borrowing	Borrowing minus treasury investments.
Net revenue stream	In the Prudential Code, income from general government grants, Council Tax and rates.
Non-specified investments	Government term for investments not meeting the definition of a specified investment or a loan upon which limits must be set. Since 2018, the term does not apply to treasury investments in England. Not applicable in Scotland.
Other long-term liabilities	Prudential Code term for credit arrangements.
Operational boundary	A prudential indicator showing the most likely, prudent, estimated level of external debt, but not the worst-case scenario. Regular breaches of the operational boundary should prompt management action.
Operational risk	The risk that fraud, error or system failure leads to an unexpected loss.
Pension Fund	Ringfenced account for the income, expenditure and investments of the local government pension scheme. Pension fund investments are not considered to be part of treasury management.
Private Finance Initiative (PFI)	A government scheme where a private company designs, builds, finances and operates assets on behalf of the public sector, in exchange for a series of payments, typically over 30 years. Counts as a credit arrangement and debt.
Property fund	A collective investment scheme that mainly invests in property. Due to the costs of buying and selling property, including stamp duty land tax, there is usually a significant fee charged on initial investment, or a significant difference between the bid and offer price.
Prudential borrowing	Another term for unsupported borrowing.
Prudential Code	Developed by CIPFA and introduced in April 2004 as a professional code of practice to support local authority capital investment planning within a clear, affordable, prudent and sustainable framework and in accordance with good professional practice. Local authorities are required by law to have regard to the Prudential Code.

Prudential indicators	Indicators required by the Prudential Code and determined by the local authority to define its capital expenditure and asset management framework. They are designed to support and record local decision making in a manner that is publicly accountable.
PWLB	Public Works Loans Board - a statutory body operating within the DMO that lends money from the National Loans Fund to local authorities and other prescribed bodies and collects the repayments.
Refinancing risk	The risk that maturing loans cannot, be refinanced, or only at higher than expected interest rates leading to an unplanned loss. Managed by maintaining a smooth maturity profile.
Supported borrowing	Borrowing for which the repayment costs are supported by government grant.
T-bill	Treasury bill - a bill issued by a government.
TMS	(1) Treasury management strategy. (2) Treasury management system.
Treasury bill	See T-bill.
Treasury investments	Investments made for treasury management purposes, as opposed to commercial investments and service investments.
Treasury management	The management of an organisation's cash flows, investment and borrowing, with a particular focus on the identification, control and management of risk. Specifically excludes the management of pension fund investments.
Treasury management advisor	Regulated firm providing advice on treasury management, capital finance and related issues.
Treasury Management Code (TM Code)	CIPFA's Code of Practice for Treasury Management in the Public Services and Cross-Sectoral Guidance Notes, to which local authorities are required by law to have regard.
Treasury management indicators	Indicators required by the Treasury Management Code to assist in the management of credit risk, interest rate risk, refinancing risk and price risk.
Treasury management policy statement	Document required by the Treasury Management Code setting out a local authority's definition of and objectives for treasury management.
Treasury management practices (TMPs)	Document required by the Treasury Management Code setting out a local authority's detailed processes and procedures for treasury management.

Treasury management strategy	Annual report required by the Treasury Management Code covering the local authority's treasury management plans for the forthcoming year.
Unsupported borrowing	Borrowing where the cost is self-financed by the local authority. Sometimes called prudential borrowing since it was not permitted until the introduction of the Prudential Code in 2004. See also supported borrowing.
Working capital	The cash surplus or deficit arising from the timing differences between income/expenditure in accounting terms and receipts/payments in cash terms.

Appendix A – Arlingclose Economic & Interest Rate Forecast – December 2021

- The global recovery from the pandemic has entered a more challenging phase. The resurgence in demand has led to the expected rise in inflationary pressure, but disrupted factors of supply are amplifying the effects, increasing the likelihood of lower growth rates ahead. The advent of the Omicron variant of coronavirus is affecting activity and is also a reminder of the potential downside risks.
- Despite relatively buoyant activity survey data, official GDP data indicates that growth was weakening into Quarter 4 of 2021. Other data, however, suggested continued momentum, particularly for November. Retail sales volumes rose 1.4% and the labour market continued to strengthen. The end of furlough did not appear to have had a significant impact on unemployment. Wage growth is elevated.
- The CPI inflation rate rose to 5.1% for November and will rise higher in the near term. While the transitory factors affecting inflation are expected to unwind over time, policymakers' concern is persistent medium term price pressure.
- These factors prompted the Monetary Policy Committee to raise Bank Rate to 0.25% at the December meeting. Short term interest rate expectations remain elevated.
- The outlook, however, appears weaker. Household spending faces pressures from a combination of higher prices and tax rises. In the immediate term, the Omicron variant has already affected growth – Quarter 4 2021 and Quarter 1 2022 activity could be weak at best.
- Longer-term government bond yields remain relatively low despite the more hawkish signals from the Bank of England and the Federal Reserve. Investors are concerned that significant policy tightening in the near term will slow growth and prompt the need for looser policy later. Geo-political and coronavirus risks are also driving safe haven buying. The result is a much flatter yield curve, as short-term yields rise even as long-term yields fall.
- The rise in Bank Rate despite the Omicron variant signals that the Monetary Policy Committee will act to bring inflation down whatever the environment. It has also made clear its intentions to tighten policy further. While the economic outlook will be challenging, the signals from policymakers suggest their preference is to tighten policy unless data indicates a more severe slowdown.

Forecast:

- The Monetary Policy Committee will want to build on the strong message it delivered this month by tightening policy despite Omicron uncertainty.
- Arlingclose therefore expects Bank Rate to rise to 0.50% in Quarter 1 2022, but then remain there. Risks to the forecast are initially weighted to the upside, but becoming more balanced over time. The Arlingclose central forecast remains below the market forward curve.
- Gilt yields will remain broadly flat from current levels. Yields have fallen sharply at the longer end of the yield curve, but expectations of a rise in Bank Rate have maintained short term gilt yields at higher levels.
- Easing expectations for Bank Rate over time could prompt the yield curve to steepen, as investors build in higher inflation expectations.

- The risks around the gilt yield forecasts vary. The risk for short and medium term yields is initially on the upside but shifts lower later. The risk for long-term yields is weighted to the upside.

	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
Official Bank Rate													
Upside risk	0.00	0.00	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk	0.00	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
3-month money market ra													
Upside risk	0.05	0.05	0.25	0.35	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.25	0.55	0.55	0.60	0.60	0.60	0.60	0.65	0.65	0.65	0.65	0.65	0.65
Downside risk	0.00	-0.25	-0.25	-0.30	-0.30	-0.30	-0.30	-0.35	-0.35	-0.35	-0.35	-0.35	-0.35
5yr gilt yield													
Upside risk	0.00	0.35	0.45	0.55	0.55	0.55	0.55	0.55	0.55	0.50	0.50	0.45	0.45
Arlingclose Central Case	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.65	0.70	0.75	0.75
Downside risk	-0.10	-0.20	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.30	-0.35	-0.40	-0.40
10yr gilt yield													
Upside risk	0.10	0.25	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.55	0.55	0.55
Arlingclose Central Case	0.80	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.90	0.90	0.95	0.95
Downside risk	-0.10	-0.25	-0.30	-0.35	-0.35	-0.35	-0.35	-0.35	-0.35	-0.40	-0.40	-0.40	-0.40
20yr gilt yield													
Upside risk	0.30	0.40	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	1.00	1.05	1.10	1.10	1.10	1.10	1.15	1.15	1.15	1.20	1.20	1.20	1.20
Downside risk	-0.15	-0.30	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45
50yr gilt yield													
Upside risk	0.25	0.30	0.40	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.70	0.75	0.80	0.85	0.90	0.95	1.00	1.05	1.05	1.10	1.10	1.15	1.15
Downside risk	-0.15	-0.30	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45

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