APPENDIX A

Treasury Management Strategy 2023-24

Cyngor Bwrdeistref Sirol Pen-y-bont ar Ogwr

BRIDGEND County Borough Council

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 (2021) ('CIPFA Code')*, which has been updated to reflect changes in an increasingly complex environment and to complement changes to regulations. The CIPFA Code requires 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, including 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.

The Treasury Management Strategy (TMS) has been written with the Welsh Government (WG) Guidance on Local Authority Investments in mind which was first released in November 2019. It 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 TMS should the assumptions on which it is based change significantly. This might be for example, a large, unexpected change in interest rates, the level of its investment balances, 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 will look to borrow money if needed to either 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 (TMPs) 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:

There still continues to be a residual impact on the UK from coronavirus however the current economic situation has been characterised by high oil, gas and commodity prices leading to high inflation. Interest rates have risen in response, all of which is impacting on consumers' "cost of living". With no imminent end in sight to the Russia – Ukraine hostilities and China only now starting to move on from a zero Covid policy there have been severe impacts on global supply chains with little to suggest any imminent change forthcoming.

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's November quarterly Monetary Policy Report forecast a prolonged but shallow recession in the UK with Consumer Price Index (CPI) inflation – the rate of change in prices for goods and services, including housing costs - remaining above 10% in the near-term. While the projected peak of inflation is lower than in the August report, due in part to the government's support package for household energy costs, inflation is expected to remain higher for longer with the economic outlook remaining weak, with unemployment projected to start rising.

The UK economy contracted by 0.3% between July and September 2022 according to the Office for National Statistics, and the Bank of England forecasts Gross Domestic Product (GDP) – an estimate of UK economic growth based on the value of goods and services produced during a given period - will decline 0.75% in the second half of the calendar year due to the squeeze on household income from higher energy costs and goods prices. Growth is then expected to continue to fall throughout 2023 and the first half of 2024.

CPI inflation was 10.5% in December 2022 but is expected to fall sharply to 1.4%, below the 2% target, in two years' time and to 0% in three years' time if the Bank of England's Bank Rate – the rate of interest the Bank of England's Monetary Policy Committee sets to meet the Government's inflation target, which influences the interest rates banks charge people to borrow money or pay on their savings - follows the path implied by financial markets at the time of the November Monetary Policy Report (a peak of 5.25%). However, the Bank of England has said it considers this path to be too high, suggesting that the peak in interest rates will be lower, reducing the risk of inflation falling too far below target. Market rates have fallen since the time of the November Monetary Policy Report.

The most recent labour market statistics, which include estimates of employment, unemployment and economic inactivity, showed a slight increase in the unemployment rate of 0.1% to 3.7% for the period August to October 2022. Earnings were up strongly in nominal terms by 6.1% for both total pay and for regular pay but factoring in inflation means real pay for both measures was a reduction of -2.7%. Forecasts suggest the labour market weakening in response to the deteriorating outlook for growth, leading to the unemployment rate rising to around 6.5% in 2025.

Credit outlook: Prices of Credit Default Swaps (CDS), which are financial products used to swap or offset risk, have followed an upward trend throughout the year, indicating higher credit risk. They have been affected by the war in Ukraine, increasing economic and political uncertainty and a weaker global and UK outlook, but remain well below the levels seen at the beginning of the Covid-19 pandemic.

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

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

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

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

Interest rate forecast: The Authority's treasury management adviser Arlingclose forecasts that the Bank of England's Bank Rate will rise by a further 0.25% to 4.25% in March 2023. While the Bank of England's Monetary Policy Committee (MPC) remains concerned that domestic inflationary pressure will remain elevated, the CPI rate is projected to fall below target in the medium term as monetary tightening takes effect on economic activity.

The MPC are likely to cut rates in the medium term to stimulate a stuttering UK economy but will be reluctant to do so until services inflation and wage growth eases. Arlingclose anticipate rate cuts in the first quarter of 2024 to a low of 3% by 2025, although the timing and extent of rate cuts remains highly uncertain.

A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix 1.

3.0 EXTERNAL DEBT AND INVESTMENT POSITION

At 31 December 2022, the Council held £99.80 million of Long Term Borrowing comprising:

- Public Works Loan Board (central government) at fixed rates and duration
- Lender's Option Borrower's Option which may be rescheduled ahead of their maturity of 22 January 2054,
- and £2.93 million of Salix interest-free loans on a repayment basis.

In addition, the Council had £94.05 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 2022

	Principal as at 31/12/2022 £m	Average Interest Rate 31/12/2022 %
External Long Term Borrowing		
Public Works Loan Board	77.62	4.70
Lender's Option Borrower's Option	19.25	4.65
Salix Loans (interest Free)	2.93	0.00
Total External Long Term Borrowing	**99.80**	**4.55**
Other Long Term Liabilities		
Private Finance Initiative*	14.12	
Other Long Term Liabilities	0.27	
Total Other Long Term Liabilities	**14.39**	
Total Gross Debt	**114.19**	
Treasury Investments		
Debt Management Office	29.50	1.40
Local Authorities	33.00	0.61
Banks	11.05	1.27
Money Market Funds**	20.50	1.66
Total Treasury Investments	**94.05**	**1.16**
Net Debt	**20.14**	

* (PFI) arrangement for the provision of a Secondary School in Maesteg 11.25 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. The table assumes that the Public Works Loan Board and Lender's Option Borrower's Option loans will be repayable on their maturity date. However, although shown as maturing in 2054 the £19.25 million of Lender's Option Borrower's Option loans may be rescheduled ahead of their maturity date of 22 January 2054.

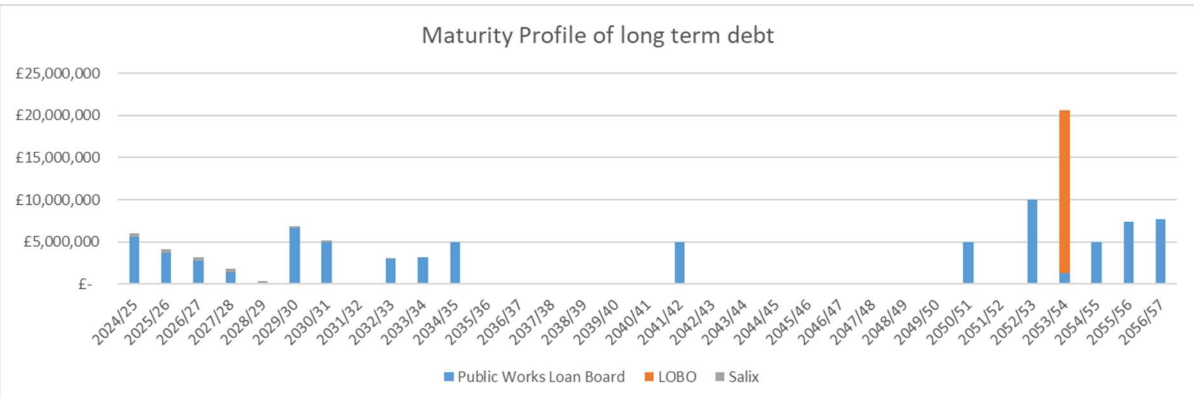


Table 2 below shows forecast changes in borrowing and investments and has been produced using estimates of capital spend and forecasts on usable reserves for the current and next three financial years. The Table shows that the Loans Capital Financing Requirement (CFR), which is the Council's need to borrow to fund capital expenditure, is anticipated to increase from current levels moving forward as opportunities to use cash set aside for earmarked reserves (internal borrowing) reduce.

Table 2: Balance sheet summary and forecast

	31/12/22 Actual £m	31/03/23 Estimate £m	31/03/24 Estimate £m	31/03/25 Estimate £m	31/03/26 Estimate £m
Capital Financing Requirement	176.22	181.46	184.81	182.91	179.89
Less: Other Debt Liabilities	(14.76)	(13.90)	(12.97)	(11.97)	(10.89)
Loans Capital Financing Requirement	**161.46**	**167.56**	**171.83**	**170.94**	**169.00**
Less: External Borrowing *	(99.80)	(99.48)	(99.16)	(93.27)	(89.24)
Internal Borrowing	**61.66**	**68.08**	**72.67**	**77.67**	**79.76**
Less: Usable Reserves	(146.03)	(119.64)	(74.58)	(52.34)	(49.92)
Plus: Working Capital	(9.56)	(9.56)	(9.56)	(9.56)	(9.56)
(Treasury investments) / new borrowing	**(93.93)**	**(61.12)**	**(11.47)**	**15.78**	**20.27**

*Shows only loans to which the Council is committed and excludes forecast new borrowing or refinancing

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). This is the amount of capital expenditure which is not funded via grants, capital receipts or contributions from revenue and earmarked reserves, so represents the need to borrow. 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 relatively low and the Council has resources in the short term it can use and can delay borrowing until necessary. The Council is forecasting an increased CFR due to the increased level of prudential borrowing in the capital programme. It is currently anticipated that the Council may need to borrow during the next 3 years. However, this position can change should capital schemes not progress as anticipated, or conversely further schemes be added to the Capital Programme that are not fully funded by grant or revenue contributions, or new schemes added which require additional debt financing. It may be necessary to borrow short term to manage the Council's day-to-day cash flow requirements.

CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Authority's total debt should be lower than its highest forecast Capital Financing Requirement (CFR) over the next three years. Table 2 shows that the Authority expects to comply with this recommendation over this period.

IFRS 16 – Accounting for Leases

As a result of a change to the method for accounting for leases under International Financial Reporting Standard (IFRS) 16, operating leases will be required to be 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 recognise the lease liability that was previously not included, within the Council's total liabilities. A further impact of the change to the treatment of leases 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 revenue budgets. The overall interest charge will not change, only its presentation within the financial statements. The implementation of the new accounting requirements is from April 2024. The impact of these changes are not reflected within this Strategy but will be included within the 2024-25 Strategy

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. In other words, what is the minimum amount the Council needs to borrow by using available cash balances to fund capital expenditure in the short term. 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 and the chart 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.

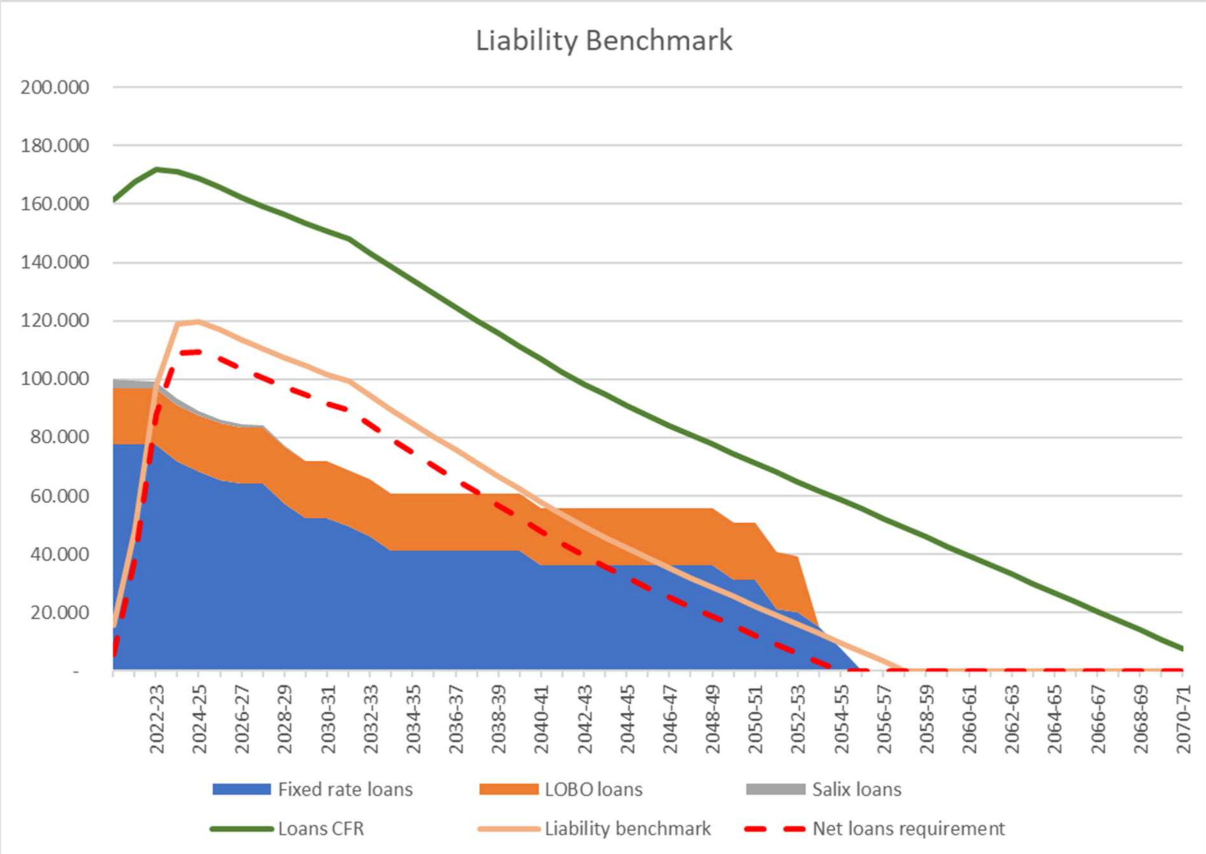
Table 3: Liability benchmark

	31/03/22 Actual £m	31/03/23 Estimate £m	31/03/24 Estimate £m	31/03/25 Estimate £m	31/03/26 Estimate £m
Loans Capital Financing Requirement	**161.46**	**167.56**	**171.83**	**170.94**	**169.00**
Less: Balance Sheet resources	(155.59)	(129.20)	(84.14)	(61.90)	(59.49)
Net Loans Requirement	**5.87**	**38.36**	**87.69**	**109.04**	**109.51**
Add: Liquidity allowance	10.00	10.00	10.00	10.00	10.00
Liability Benchmark	**15.87**	**48.36**	**97.69**	**119.04**	**119.51**

The liability benchmark is an important tool to help establish whether the Council is likely to be a long-term borrower or long-term investor in the future, and so shape its strategic focus and decision making. The liability benchmark itself represents an estimate of the cumulative amount of external borrowing the Council must hold to fund its current capital and revenue plans while keeping treasury investments at the minimum level required to manage day-to-day cash flow.

The forecasts in Table 3 above are on the basis that the long-term liability benchmark assumes capital expenditure funded by existing long-term borrowing of £99.8 million, as set out in Table 1.

The Liability Benchmark is shown in the chart below.



4.0 BORROWING STRATEGY

The Council currently holds £99.80 million of Long-Term Borrowing, £96.87 million of which is fixed long term loans as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in Table 2 above shows that the Council is expected to have a new borrowing requirement in 2024-25 of £15.78 million with a further requirement in the following year as detailed in Table 4. In addition to this the Council will need to hold £10 million for liquidity purposes, and so the forecast total borrowing requirement in 2024-25 is £25.78 million. Similarly the total forecast borrowing requirement for 2025-26 is £20.27 million plus the liquidity allowance of £10 million, a total requirement of £30.27 million. The incremental borrowing from 2023-24 is therefore £4.49 million, as shown in Table 4 below.

Table 2 above identifies a forecast need to borrow over the 3 years 2023-24 to 2025-26. The actual need to borrow will be affected by actual spend within the capital programme and the use of reserves. Should there be slippage in either the capital programme expenditure and/or the use of reserves, the need to borrow will also be delayed. The table blelow estimates the incremental forecast borrowing need. It is anticipated the Council will need to borrow long term during 2024-25.

Table 4: New Borrowing

	31/03/22 Actual £m	31/03/23 Estimate £m	31/03/24 Estimate £m	31/03/25 Estimate £m	31/03/26 Estimate £m
New borrowing	**0.00**	**0.00**	**0.00**	**25.78**	**4.49**

The requirement to borrow will need to 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 2023-24 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 increased pressures on public expenditure, 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 through short-term loans instead if necessary.

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 borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Council with any assessment of the need to borrow.

The Council has previously raised the majority of its long-term borrowing from the Public Works Loan Board (PWLB). This was the source of funding the last time the Council took long term borrowing of £5 million in March 2012. The Council will however consider long term loans from other sources including banks, pension funds and other local authorities if appropriate. 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.

The Council has loans from PWLB maturing within the next 3 years that it will need to repay. Depending on the level of reserves available these could be repaid or, if insufficient reserves are available, there will be a need to refinance these loans. The value of the loans over the next 3 years are:

	2023-24 £ million	2024-25 £ million	2025-26 £ million
Value of maturing debt	Nil	5.580	3.709

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 held for commercial purposes. Further information regarding the Council's investment assets is included at section 7.

The Council can arrange forward starting loans during 2023-24 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:

- HM Treasury PWLB lending facility (formerly the Public Works Loan Board)
- 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
- UK Municipal Bonds Agency and other 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 Model
- sale and leaseback

The Council has previously raised the majority of its long-term borrowing from the PWLB (80.13%) 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.

Municipal Bonds Agency: UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It issues bonds on the capital markets and lends the proceeds to local authorities. This is a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to Council.

LOBOs: The £19.25 million (19.87%) 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 2023-24 being in July and January each year. With interest rates having risen recently, there is now a reasonable chance that lenders will exercise their options thus an element of refinancing risk remains. In this case the Council would take the option to repay these loans at no cost if it has the opportunity to do so in the future. At present total borrowing via LOBO loans will be limited to the £19.25 million which has currently been accrued.

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 older, 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. The recent rise in interest rates means that more favourable debt rescheduling opportunities should arise than in previous years.

Treasury Management Prudential 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 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. Only long term fixed maturity debt has been included as the Salix loans are subject to repayments throughout the duration of the loans. The upper and lower limits on the maturity structure of borrowing are:

Table 5: Treasury Management Indicator Maturity Structure of Borrowing 2023-24

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 TREASURY INVESTMENT STRATEGY

The preparation each year of a Treasury Investment Strategy is central to the Welsh Government Statutory Guidance on Local Authority Investments and the CIPFA code. 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 investments representing income received in advance of expenditure plus balances and reserves as shown in Table 1 in Section 3 above. During 2022-23 the Council's investment balances were £84.07 million at the start of the year and were £94.05 million at 31 December 2022, and it is expected to be around this level at 31 March 2023. This is on the assumption of the use of Earmarked Reserves and Capital Receipts in the final quarter of 2022-23 and does not make any provision for any additional funding received from Welsh Government to 31 March 2023. It is anticipated that the Council's investment balances in 2023-24 will range between £40 million to £80 million with an average investment rate of between 3.5% and 4.0%, depending on the Bank Rate and investment types, based on Arlingclose's interest rate forecast at Appendix 1, which will be reviewed at the half year stage and reported to Council. 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 2022, the Council held investment properties valued at £5.585 million, with an expected return of £0.454 million per annum excluding any vacant or rent-free periods, providing a return of approximately 8.13%. The lessees are responsible for maintenance of these assets detail is shown in Table 11.

Both the CIPFA Code and the Welsh Government Guidance require the Council to invest its funds prudently, have regard to the security and liquidity of its investments whilst also 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 objectives of the Council in order of priority 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

Strategy: The Council's investments have historically been placed in mainly short-term bank unsecured deposits and with local and central government. Investments can also be made with any building society or public or private sector organisations that meet the credit criteria detailed below.

As demonstrated by the liability benchmark in Table 3, the Council anticipates to continue to maintain its borrowing and new treasury investments will therefore be made primarily to manage day-to-day cash flows using short-term low risk instruments.

Given the risk of short-term unsecured bank investments, the Council will consider further diversifying into more secure and/or higher yielding asset classes as appropriate, in consultation with the Council's treasury management advisers. The majority of the Council's surplus cash is currently invested with the Debt Management Office (DMO), 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.

Although short term interest rates have risen recently, they are still currently lower than long-term rates, which are expected to rise modestly, 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.

ESG Policy: Environmental, social and governance (ESG) considerations are increasingly a factor in global investors' decision making, but the framework for evaluating investment opportunities is still developing and therefore the Council does not currently include ESG scoring or other real-time ESG criteria at an individual investment level. When investing in banks and funds, the Authority will prioritise banks that are signatories to the UN Principles for Responsible Banking and funds operated by managers that are signatories to the UN Principles for Responsible Investment, the Net Zero Asset Managers Alliance and/or the UK Stewardship Code.

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
Other government entities	25 years	£12,000,000	Unlimited
Local Authorities	2 years	£10,000,000	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

This table must be read in conjunction with the notes below

***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.

Secured Investments: These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments.

Government: Loans to, 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 a method which rescues a failing financial institution by cancelling some of its deposits and bonds, the impact of which could result in a reduction in the amount of the deposit and a loss to the investor. Investors may suffer a reduction in their investment but may be given shares in the bank as part compensation. 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.

Local Authority to Local Authority: These are loans made to other Local Authorities throughout the UK normally for a duration of less than a year, though can be for longer. Despite concern over the volatility of funding such organisations receive, the level of risk associated with default is thought to be extremely low, however, to ensure that the Council's exposure to risk is balanced, the TMS sets a maximum amount per authority of £10m and 2 years duration. The Council also receives regular updates from our Treasury Management Advisors and will not make any new loans to a Local Authority which would be contrary to the Treasury Management Advisor's advice.

Other Investments: These are loans, bonds and commercial paper issued by companies that are not covered above. These investments cannot be bailed-in, but are exposed to the risk of the company going insolvent, placing any investment in them at risk. Loans to unrated companies will only be made following an external credit assessment and consultation with the Council's treasury management advisers.

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

Money market funds: Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. These funds have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the Authority will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

Strategic pooled funds: 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. As set out in Table 6 - Approved investment counterparties and limits, the maximum we would hold in our operational bank account is £3 million. 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, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty

Where a credit rating agency announces that a 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 immediately or the next day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

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 district, 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. The Council has set this 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 only a **maximum of £20 million** could be invested in these non-specified investments.

Table 7: Non-specified investment limits

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

	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	**2023-24 £m**	**2024-25 £m**	**2025-26 £m**	**No fixed date £m**
Limit on principal invested beyond financial year end	15	10	10	NIL

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
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

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 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 16.67% of the maximum amount of investments that the Council anticipates to have at any one point in time in 2023-24 of £95 million.

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.

Table 10: Treasury Management Indicator Interest Rate Exposures

The following Table is based on investments at 31 December 2022.

Interest rate risk indicator	£'000
One year revenue impact of a 1% rise in interest rates	(732)
One year revenue impact of a 1% fall in interest rates	924

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

This category covers non-financial assets held primarily or partially to generate a profit, primarily investment property. These assets are valued on an annual basis, which provides security of their value and continued benefit to the Council.

Non-treasury investments	Fair Value £'000
Bridgend Science Park - Units 1 & 2	3,740
Waterton Cross Land	600
Brynmenyn Industrial Estate Plot 53	675
Village Farm Plots 32,119 & 120	370
Tyrewise Bridgend	200
Total	**5,585**

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 addition, the value of these investments has increased from previous year.

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

Borrower	£'000
Loans to third parties including wholly owned companies and/or joint ventures	3,000
Treasury management investments meeting the definition of a loan	Unlimited

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 until 31 March 2023. Any unrealised capital gains or losses arising from qualifying investments held as at 31 March are expected to be charged to the Comprehensive Income and Expenditure Statement, subject to any further extension of the statutory override as has happened in England.

10.0 REPORTING ARRANGEMENTS

Council will receive the following reports for 2023-24 as standard in line with the requirements of the Code of Practice:

- Annual Treasury Management Strategy
- Half-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 Resources 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: Derivatives embedded into loans and investments including pooled funds and forward starting transactions may be used both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in section 24 of the Local Government and Elections (Wales) Act 2021 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria, assessed using the appropriate credit rating for derivative exposures. An allowance for credit risk calculated using the methodology in the Treasury Management Practices document will count against the counterparty credit limit and the relevant foreign country limit.
In line with the CIPFA Code, the Authority will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.

Climate Change: The Authority's investment decisions consider long-term climate risks to support a low carbon economy to the extent that any investments that do not align with these priorities would not be undertaken if such information is available or known at the time of the investment.

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.

Member training was provided for all Members in February**,** in advance of Council meeting in March to provide Members with the relevant knowledge to support them in the review, discussion and approval of the Treasury Management Strategy.

Investment advisers: Following a re-tender exercise in August 2020 Arlingclose Ltd were re-appointed as the Council's treasury management advisers. Arlingclose was incorporated in 1993 and is regulated by the Financial Conduct Authority, reference number 417722. They were awarded a four-year contract which to August 2024, 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 2023 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 2023-24.

The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Officer – Finance, Performance and Change, having consulted the Cabinet Member for Resources, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

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

GLOSSARY

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 outstanding loans owed 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 made 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.
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.
SONIA	Sterling Overnight Index Average – SONIA is bases on actual transactions and reflects the average of the interest rates that banks pay to borrow sterling overnight from other financial institutions and other institutional investors.
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 1 – Arlingclose Economic & Interest Rate Forecast – December 2022

Underlying assumptions:

- The influence of the mini-budget on rates and yields continues to wane following the more responsible approach shown by the new incumbents of Downing Street.
- Volatility in global markets continues, however, as investors seek the extent to which central banks are willing to tighten policy, as evidence of recessionary conditions builds. Investors have been more willing to price in the downturn in growth, easing financial conditions, to the displeasure of policymakers. This raises the risk that central banks will incur a policy error by tightening too much.
- The UK economy is already experiencing recessionary conditions and recent GDP and PMI data suggests the economy entered a technical recession in Q3 2022. The resilience shown by the economy has been surprising, despite the downturn in business activity and household spending. Lower demand should bear down on business pricing power – recent data suggests the UK has passed peak inflation.
- The lagged effect of the sharp tightening of monetary policy, and the lingering effects of the mini-budget on the housing market, widespread strike action, alongside high inflation, will continue to put pressure on household disposable income and wealth. The short- to medium-term outlook for the UK economy remains bleak.
- Demand for labour appears to be ebbing, but not quickly enough in the official data for most MPC policymakers. The labour market remains the bright spot in the economy and persisting employment strength may support activity, although there is a feeling of borrowed time. The MPC focus is on nominal wage growth, despite the huge real term pay cuts being experienced by the vast majority. Bank Rate will remain relatively high(er) until both inflation and wage growth declines.
- Global bond yields remain volatile as investors price in recessions even as central bankers push back on expectations for rate cuts in 2023. The US labour market remains tight and the Fed wants to see persistently higher policy rates, but the lagged effects of past hikes will depress activity more significantly to test the Fed's resolve.
- While the BoE appears to be somewhat more dovish given the weak outlook for the UK economy, the ECB seems to harbour (worryingly) few doubts about the short term direction of policy. Gilt yields will be broadly supported by both significant new bond supply and global rates expectations due to hawkish central bankers, offsetting the effects of declining inflation and growth.

Forecast:

- The MPC raised Bank Rate by 50bps to 3.5% in December as expected, with signs that some members believe that 3% is restrictive enough. However, a majority of members think further increases in Bank Rate might be required. Arlingclose continues to expect Bank Rate to peak at 4.25%, with further 25bps rises February, March and May 2023.

- The MPC will cut rates in the medium term to stimulate a stuttering UK economy but will be reluctant to do so until wage growth eases. We see rate cuts in the first half of 2024.
- Arlingclose expects gilt yields to remain broadly steady over the medium term, although with continued volatility across shorter time periods.
- Gilt yields face pressures to both sides from hawkish US/EZ central bank policy on one hand to the weak global economic outlook on the other. BoE bond sales and high government borrowing will provide further underlying support for yields.

Official Bank Rate													
Upside risk	0.00	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Central Case	4.00	4.25	4.25	4.25	4.25	4.00	3.75	3.50	3.25	3.00	3.00	3.00	3.00
Downside risk	0.00	-0.25	-0.25	-0.25	-0.50	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
3-month money market rate													
Upside risk	0.00	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Central Case	4.20	4.40	4.40	4.40	4.35	4.15	4.10	4.00	3.75	3.50	3.40	3.40	3.40
Downside risk	0.00	-0.25	-0.25	-0.25	-0.50	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
5yr gilt yield													
Upside risk	0.00	0.70	0.80	0.90	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	3.06	3.20	3.20	3.20	3.20	3.10	3.10	3.10	3.00	3.00	3.00	3.00	3.10
Downside risk	0.00	-0.50	-0.70	-0.90	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
10yr gilt yield													
Upside risk	0.00	0.70	0.80	0.90	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	3.19	3.30	3.30	3.30	3.30	3.20	3.20	3.20	3.20	3.20	3.20	3.20	3.20
Downside risk	0.00	-0.50	-0.70	-0.90	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
20yr gilt yield													
Upside risk	0.00	0.70	0.80	0.90	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	3.71	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85	3.85
Downside risk	0.00	-0.50	-0.70	-0.90	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00
50yr gilt yield													
Upside risk	0.00	0.70	0.80	0.90	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Central Case	3.43	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60
Downside risk	0.00	-0.50	-0.70	-0.90	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00

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