READING BOROUGH COUNCIL

REPORT BY DIRECTOR OF FINANCE

TO:	**POLICY COMMITTEE**		
DATE:	**20 FEBRUARY 2023**		
TITLE:	**TREASURY MANAGEMENT STRATEGY STATEMENT (2023/24); MINIMUM REVENUE PROVISION POLICY (2023/24); ANNUAL INVESTMENT STRATEGY (2023/24)**		
LEAD COUNCILLOR:	**COUNCILLOR BROCK**	**PORTFOLIO:**	**LEADER OF THE COUNCIL**
SERVICE:	**FINANCE**	**WARDS:**	**BOROUGHWIDE**
LEAD OFFICER:	**STUART DONNELLY**	**TEL:**	**01189 373468**
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1. PURPOSE OF REPORT AND EXECUTIVE SUMMARY

1.1 In accordance with the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2021 and the CIPFA Prudential Code for capital finance in local authorities (2021), the Council is required to approve a Treasury Management Strategy before the start of each financial year. This report fulfils that obligation.

1.2 The Council's Treasury Management Strategy Statement (TMSS), attached at Appendix A, sets out the parameters for the Council's planned treasury activity during 2023/24 under which the Council's Treasury Team will manage day to day activity. The TMSS reflects the Council's Draft Capital Programme 2023/24 – 2025/26.

1.3 The successful identification, monitoring and control of financial risk are central to the Strategy.

1.4 The CIPFA 2021 Prudential Code also requires the Council to prepare a Capital Strategy report which sets out the Council's capital requirements arising from policy objectives, as well as the associated governance procedures and risk appetite.

1.5 The Capital Strategy is reported separately from the Treasury Management Strategy Statement and includes non-treasury investments. The CIPFA Treasury Management Code 2021 further breaks down non-treasury investment into:

- Investments for service purposes – taken or held primarily for the provision and for the provision and for the purposes of delivering public services (including housing, regeneration, and local infrastructure), or in support of joint working with others to deliver such services.
- Investment for commercial purposes - taken or held primarily for financial return and are not linked to treasury management activity or directly part of delivering services.

1.6 This report has been prepared with reference to the following documents:

- CIPFA Code of Practice for Treasury Management in the Public Services 2021
- CIPFA The Prudential Code 2021
- MHCLG Statutory Guidance on Local Government Investments (February 2018)
- CIPFA Bulletin Treasury and Capital Management Update (October 2018)

2. RECOMMENDED ACTION

That Policy Committee endorse and recommend that Full Council approve:

2.1. The Treasury Management Strategy Statement for 2023/24 as set out in Appendix A section 2;

2.2. The Capital Prudential Indicators as set out in Appendix A section 3;

2.3. The Minimum Revenue Provision (MRP) Policy for 2023/24 as set out in Appendix A section 4;

2.4. The Borrowing Strategy for 2023/24 as set out in Appendix A section 5;

2.5. The Annual Investment Strategy for 2023/24 as set out in Appendix A section 6; and

2.6. The Prudential and Treasury Management indicators as set out in Appendix A Annex 1.

That Policy Committee note:

2.7. The requirement within the Prudential Code 2021 for quarterly reporting on the Council's Treasury Management activities from 2023/24. These reports will be presented to Audit & Governance Committee in line with the current delegation.

Appendices:

Appendix A - Treasury Management Strategy Statement 2023/24 (including the Borrowing & Investment Strategy, Treasury Management Indicators and Prudential Indicators); Treasury Management Policy (2023/24); Minimum Revenue Provision Policy (2023/24); Annual Investment Strategy (2023/24).

3. ECONOMIC BACKGROUND

3.1 Following the Bank of England Monetary Policy Committee (MPC) meeting on 2 February 2023 the bank rate was increased from 3.50% to 4.00%. The Council's Treasury Management advisors, Link Group, Link Treasury Services Limited are forecasting that bank rate will peak at 4.5% in June 2023 before starting to reduce in December 2023.

3.2 CPI inflation peaked in October at a 41-year high of 11.1% and fell to 10.7% in November and 10.5% in December. Goods price inflation, which is driven largely by global factors, has peaked. The sharp rises in energy prices in 2022 should result in energy price inflation falling sharply in 2023. Additionally, the large fall in agricultural prices since May means that food price inflation should start to decline soon and upward pressures on goods price inflation from global supply shortages is expected to fade quickly.

3.3 Domestic inflation pressures also eased in Q4. The 0.2% month on month rise in core CPI inflation in November was the smallest monthly gain since August 2020 and drove a fall in core CPI inflation from 6.5% in October to 6.3% in November. Services CPI inflation was stable at 6.3% in November despite the resilience of wage growth. And the easing of price expectations in the Bank of England's Decision Maker Panel survey in November suggests that inflation may become less persistent.

4. BORROWING

4.1 Under the Prudential Code, the Council can borrow to fund capital expenditure if such borrowings are sustainable, affordable, and prudent. In order to comply with the Prudential Code, an authority must not borrow to invest primarily for financial return.

4.2 The underlying need to borrow (the net borrowing requirement) for capital purposes is measured by the Capital Financing Requirement (CFR). Usable reserves and working capital are the underlying resources available for investment.

4.3 Historically the Council has borrowed to pay for new assets including schools, roads, housing and community facilities etc. The value of the Council's assets is circa £1.1bn. As at 31st December 2022, the Council had £376.010m of loans outstanding in respect of General Fund and Housing Revenue Account (HRA) assets.

4.4 The Council has not taken out any borrowing (short or long-term) in 2022/23 to 31st December 2022.

4.5 Market projections, per Table 11 in Appendix A, indicate that long-term borrowing costs will continue to rise for the first two quarters of 2023 before starting to reduce again. Consequently, the Council intends to use lower cost temporary borrowing in the coming year where required. This strategy will be kept under review with the Council's Treasury Management Advisors. Longer term borrowing will not be taken out until necessary, thereby avoiding the "cost of carry" (the difference between the cost of borrowing and return on investing the funds until such time as the borrowing is required to fund the capital expenditure incurred).

4.6 The Capital Programme 2023/24-2025/26 totals £339.349m (£188.045m General Fund and £151.304m HRA) as set out in Table 1 of Appendix A. The Programme aims to improve the infrastructure, asset base and effectiveness of service provision for the residents of Reading.

4.7 After accounting for specific grants, s106 contributions and capital receipts, the total borrowing requirement is £127.669m per Table 2 of Appendix A (£61.869m General Fund and £65.800m HRA). The cost of borrowing together with any associated revenue savings is included within the Council's Medium-Term Financial Strategy 2023/24 – 2025/26.

4.8 All schemes included in the approved Capital Programme, including those planned to start in 2023/24 shall remain subject to spending approval in detail by the responsible Committee or Policy Committee or Council, as appropriate, for schemes over £2.5m, with the exception of expenditure on rolling programmes of routine capital expenditure.

4.9 After reducing the borrowing requirement by a total Minimum Revenue Provision charge of £37.313m across the period, the Council has a projected increase in its CFR of £90.356m, as set out in Table 3 of Appendix A.

4.10 The Director of Finance has delegated responsibility for borrowing and works closely with the Council's Treasury Management Team and advisors, Link Group, on borrowing decisions taking into account several factors including:

- The cost of borrowing short or long-term
- Anticipated changes in the cost of borrowing
- The level of cash balances held under investment
- The return on invested balances

4.11 The Council's long-term borrowing (loans over 12 months in length) is from two sources: The Public Works Loans Board (PWLB) and private banks for debt relating to Lender Option Borrower Option loans (LOBO loans currently stand at £15m). For short term borrowing the Council will continue to use other sources of finance, e.g. loans from other local authorities that it can borrow from at lower rates of interest than PWLB.

4.12 The framework for taking borrowing decisions in the coming year is set out in the Council's TMSS, attached at Appendix A section 5. The Council may increase its longer term borrowing to cover new capital project expenditure in advance of need to minimise the risk of interest rate fluctuations. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates and will be considered carefully to ensure that value for money can be demonstrated, that the costs of borrowing can be met and that the Council can ensure the security of such funds.

4.13 The Council's self-imposed limits on sustainable, affordable and prudent borrowing and investment, the Prudential and Treasury Management Indicators that need to be approved by Council are set out in Appendix A.

5. INVESTMENTS

5.1 The Council's investments for Treasury Management purposes seek to manage fluctuations in cash-flow. Treasury investments can be called on at short-notice and in the main are held in Money Market Funds or short-term fixed term deposits. These are low-risk investments and give higher rates of interest compared to leaving balances in the Council's bank account. The long-term treasury investment held by the Council is in the CCLA property fund.

5.2 The level of investments fluctuates throughout the year dependent on cash balances. The balance of treasury investments was £67.746m at the end of December 2022 (per Table 6 in Appendix A). The average interest was 3.52% and the average weighted rate of return 3.59%.

5.3 The Council can legally invest in the following funds and instruments:

- Fixed Term Deposits (Government, public sector bodies, Banks and Building Societies)
- Callable deposits (Banks and Building Societies)
- Money Market Funds
- Certificates of Deposit (tradable term deposits)
- Governments Gilts and Treasury Bills
- Corporate Bonds
- Derivatives (where used for risk management)

5.4 The Department for Levelling Up, Housing and Communities (DLUHC) published updated guidance on investments in February 2018. The previous edition covered treasury investments only, but the latest edition focuses on non-treasury investments. These are commercial investments such as the purchase of investment properties, investments in subsidiaries or investments for service objectives including regeneration.

5.5 The revised PWLB borrowing terms announced in November 2020, prevent Local Authorities from borrowing from the PWLB for any purpose should their ongoing Capital Programme contain commercial schemes that are primarily investments to generate a financial yield. Consequently, Policy Committee approved the removal of the Capital budget for the Purchase of Commercial Property from its Capital Programme at its meeting in December 2020.

6. APPROVED INVESTMENTS AND COUNTERPARTIES

6.1 The counterparty criteria are kept under regular review and are detailed in annexe A of the appendix to this report. The criteria set out the value and duration limits which are applied in the day to day investment of the Council's cash balances.

6.2 The value and duration limits as well as the minimum credit ratings required of individual institutions seek to minimise the Council's exposure to counterparty risk, i.e. limit any potential loss due to the failure of any single institution or group.

6.3 The credit ratings agencies' criteria are relative measures of financial strength, any changes are notified to the Council's Treasury Team on the same day by our treasury advisor, Link Group. Over recent years the agencies have downgraded many financial institutions by removing the implied sovereign support. However, financial institutions have responded by improving their capital ratios to meet new regulatory standards to enable them to withstand market shocks like that experienced during the financial crisis in 2008. This requirement for increased resilience is designed to give higher assurance that institutions will be going concerns in the medium to long term.

6.4 In addition, central banks such as the Bank of England and European Central Bank provide financial support to financial institutions through Term Funding Schemes (TFS) that ensures they have access to enough liquidity at low rates. The TFS was launched in 2016 and provides funding to banks and building societies at rates close to Base Rate.

6.5 CIPFA's Treasury Management Code (2021) requires the Council to set out its policies and practices relating to environmental, social and governance (ESG) investment considerations within its credit and counterparty policies. The framework for taking investment decisions in the coming year is set out in the Council's TMSS, attached at Appendix A section 6 and includes the use of credit rating agencies' criteria, which incorporate Environmental, Social & Governance (ESG) risks alongside more traditional financial risk metrics, and the application of the Freedom House Global Freedom rating system.

6.6 The Freedom House Global Freedom rating system is a scored assessment of people's access to political rights and civil liberties in 210 countries and territories. In its annual Freedom in the World report, Freedom House assigns a numerical score and a Free/Partly Free/Not Free status to each country. The Council will only invest in organisations from countries with a 'Free' rating. Ratings will be regularly monitored to determine if ratings have changed.

7. MINIMUM REVENUE PROVISION (MRP) CONSULTATION

7.1 The Department for Levelling Up, Housing and Communities launched a consultation on 30th November 2021 until 8th February 2022, seeking views on proposed changes to regulations to improve enforcement of the duty on local authorities to make prudent Minimum Revenue Provision each year.

7.2 One of these proposals would, if implemented, require councils to provide MRP on any capital loans given to third parties and wholly owned companies. The Council's current MRP Policy would therefore need to be reviewed and additional budgetary provision made within the Council's revenue budget in order to comply with this change, should it materialise.

7.3 The latest information we have is that any changes will take effect from 2024/25 at the earliest; it is not the Government's intention that these changes are applied retrospectively.

8. RISK CONTROLS

Investment Risk

8.1 The main risk of investing is that the borrower or counterparty defaults on the loan and cannot repay it.

8.2 The main controls on investment risk are the application of counterparty criteria which limit the amount and duration of investments with both individual and groups of related counterparties. The criteria are generally based on rating agency evaluations as detailed in Appendix A section 6.

Borrowing Risk

8.3 The main risks when deciding to borrow is around the timing of the decision and ensuring affordability. There is a risk that interest rates will increase before any planned borrowing is taken. The Council receives regular interest rate forecasts which are used to inform decisions on the timing of external borrowing.

8.4 The latest guidance requires the use of other information as well as rating agency evaluations. When ratings change, the Treasury Team are notified on the same day by our treasury advisors. There are regular internal and external meetings the Treasury Team attend to keep abreast of latest topics. The monthly updates from Link Group include other market sources of information, such as the prices of financial instruments and shares. In addition, professional publications and sector specific reports are reviewed by the Team to ensure that any decision to borrow is based a broad array of available information.

8.5 The Treasury Management Policies deal with risk controls, decision making and reporting processes, along with high level administration of the Treasury Management activities.

9. CONTRIBUTION TO STRATEGIC AIMS

9.1 The Council's vision is to ensure that Reading realises its potential – and to ensure that everyone who lives and works in Reading can share the benefits of its success. The Council has three inter-connected themes which contribute to delivering this vision. The themes are:

- Healthy environment;
- Thriving communities;

- Inclusive economy.

9.2 Delivery of the Council's revenue and capital budgets is essential to ensuring the Council meets its strategic aims and remains financially sustainable going forward. The treasury management functions are crucial in ensuring that the Council has access to funds when required and in investing surplus funds in secure investments.

10. ENVIRONMENTAL AND CLIMATE IMPLICATIONS

10.1 There are no environmental implications arising directly from this report.

10.2 As set out in the Council's Annual Investment Strategy (Appendix A paragraph 6.18), the Council will not knowingly invest directly in businesses whose activities and practices pose a risk of serious harm to individuals or groups, or whose activities are inconsistent with the Council's Corporate Plan and values. This would include institutions with material links to environmentally harmful activities (e.g. pollution, destruction of habitat, fossil fuels).

11. COMMUNITY ENGAGEMENT AND INFORMATION

11.1 Budget-related communications and consultations will continue to be a priority over the next three years as we work to identify savings.

12. EQUALITY IMPACT ASSESSMENT

12.1 None arising directly from this report.

13. LEGAL IMPLICATIONS

13.1 This report assists the Council in fulfilling its statutory obligation to set out its Treasury Strategy for borrowing and to prepare an Annual Investment Strategy for the coming year setting out the Council's policies for managing its borrowing and investments and giving priority to the security and liquidity of those investments.

14. FINANCIAL IMPLICATIONS

14.1 Financial implications are set out within in the body of this report and within the appendix.

15. BACKGROUND PAPERS

15.1 None.