Northumberland
County Council

AUDIT COMMITTEE

26 JANUARY 2022

TREASURY MANAGEMENT STRATEGY STATEMENT FOR THE FINANCIAL YEAR 2022-23

Report of Jan Willis, Interim Executive Director of Finance and Section 151 Officer

Cabinet Member: Councillor Richard Wearmouth – Deputy Leader and Portfolio Holder for Corporate Services

Purpose of Report

The Local Government Act 2003 requires the Council to set out its Treasury Strategy for borrowing and to prepare an Annual Investment Strategy, which sets out the policies for managing investments and for giving priority to the security and liquidity of those investments. The Council nominates Audit Committee to be responsible for ensuring effective scrutiny of the Treasury Management Strategy and Policy.

This report sets out the Treasury Management Strategy, Treasury Management Policy Statement, the Annual Investment Strategy for the Financial Year 2022-23, Prudential Indicators 2022-23 to 2025-26 and the Minimum Revenue Provision Policy 2022-23.

Recommendations

- Members consider the report and recommend that County Council approves the Treasury Management Strategy Statement which includes the Treasury Management Policy Statement, the Annual Investment Strategy and Borrowing Strategy for the Financial Year 2022-23.
- Members recommend that County Council approves the Prudential Indicators (Appendix 4) for four years 2022-23 to 2025-26 to ensure that the Council's capital investment plans are affordable, prudent and sustainable.
- Members recommend that County Council approves the Minimum Revenue Provision Policy (Appendix 5) 2022-23.

Link to Corporate Plan

This report supports the “We want to be efficient, open and work for everyone” priority included in the Council’s Corporate Plan 2018-21.

Key issues

The Local Government Act 2003 (the Act) and supporting regulations requires the Council to ‘have regard to’ the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code and the CIPFA Treasury Management Code of Practice (which were adopted by Northumberland County Council in February 2010), to set Prudential and Treasury Indicators for the next four years to ensure that the Council’s capital investment plans are affordable, prudent and sustainable.

The Act requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act).

The Treasury Management Strategy Statement details the proposed activities of the Treasury Management function for the financial year 2022-23 and is based upon the treasury management officers’ views on interest rates, supplemented with leading market forecasts provided by the Council’s treasury management advisors, Link Asset Services.

TREASURY MANAGEMENT STRATEGY STATEMENT 2022-23

1. INTRODUCTION

1.1. Background

This Treasury Management Strategy Statement details the expected activities of the Treasury Management function for the financial year 2022-23. Its production and submission to full Council is a requirement of the CIPFA Code of Practice on Treasury Management.

Part of the treasury management operation is to ensure that cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low/medium risk counterparties or instruments commensurate with the Council's risk appetite, providing adequate liquidity initially before considering investment return.

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

The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue expenditure or for larger capital projects. The financial cost of these activities - i.e. the balance between the interest cost of debt and the investment income arising from cash deposits - has a significant impact on the overall revenue budget. In addition, since cash balances are mostly generated from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will result in a loss to the General Fund Balance.

Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities, (arising usually from capital expenditure), and are separate from the day-to-day treasury management activities.

CIPFA defines treasury management as:

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

1.2. Statutory and Regulatory Requirements

The Local Government Act 2003 (the Act) and supporting Regulations requires the Council to 'have regard to' the Chartered Institute of Public Finance and Accountancy's (CIPFA) Prudential Code 2017, and the CIPFA Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes 2017.

The codes define the manner in which capital spending plans are to be considered and approved. They require the Council to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable. In conjunction with this, they also require the Council to set out its Treasury Strategy for borrowing and to prepare an Annual Investment Strategy, as required by the (revised) Investment Guidance issued by the former Ministry of Housing, Communities and Local Government (MHCLG) which came into effect 1 April 2018.

With effect from 2019-20 there was a requirement that the report included a Capital Strategy, to provide a longer-term focus to the capital plans, and an extension of the meaning of 'investments' to include both financial and non-financial investments or commercial activity undertaken under the Localism Act 2011. The Capital Strategy is reported to County Council for approval with the annual budget report and Medium Term Financial Plan in February each year.

Non-financial investments, especially in property, do not generally form part of the treasury management activities carried out by the treasury management team of a local authority.

Treasury management investments represent the placement of cash in relation to the s12 Local Government Act 2003 Act investment powers: namely residual cash resulting from the authority's day to day activities.

Non-financial, or non-treasury investments tend to relate to s1 expenditure powers under the Act and be either of the following:

- Policy type investments, whereby capital or revenue cash is advanced for a specific council objective. This may be an advance to a third party for economic regeneration, or to enable care facilities etc.
- Commercial type investments, whereby the objective is primarily to generate capital or revenue resources. The resources generated would then help facilitate Council services.

This report deals solely with financial investments. Non-financial investments, which from the Council's perspective relate to the loans provided to third parties, are covered in the Capital Strategy report.

1.3. Basis and Content of Treasury Management Strategy for 2022-23

The proposed strategy for 2022-23 in respect of the following aspects of the treasury management function is based upon officers' views on interest rates, supplemented by

leading market forecasts provided by the Council's treasury advisors, Link Asset Services. The strategy covers:

- Current portfolio position.
- Economic outlook and prospects for interest rates.
- Borrowing Strategy for 2022-23.
- Annual Investment Strategy for 2022-23.
- Housing Revenue Account (HRA) treasury costs.
- Treasury management limits and Prudential Indicators.
- Minimum Revenue Provision Policy Statement.
- Policy on use of external service providers; and,
- implementation of the Treasury Management Strategy, scheme of delegation, reporting and training requirements.

1.4. Balanced Budget Requirement

It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, revised under Section 31 of the Localism Bill 2011, for the Council to produce a balanced budget. In particular, Section 31 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This means that the impact of increases in capital expenditure, such as interest charges associated with any new borrowing, and any increases in running costs from these capital projects, must be limited to a level which is affordable within the projected income of the Council for the foreseeable future.

The Council also has a statutory duty under S.3 of the Local Government Act 2003, and supporting regulations, to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Affordable Borrowing Limit". The Council must have regard to the Prudential Code when setting its Affordable Borrowing Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits.

The Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving best value in treasury management within the context of effective risk management, and to employing suitable performance measurement techniques, for example comparison with other members of the CIPFA and Link benchmarking clubs.

2. THE PORTFOLIO POSITION AT 30 NOVEMBER 2021

2.1. Current Borrowing

The Council's borrowing at 30 November 2021 is shown below:

	General Fund £m	HRA £m	Total Principal 30 Nov 2021 £m	Weighted Average Rate %
Public Works Loan Board Loans	413.844	40.704	454.548	2.65
LOBOs	153.500	23.000	176.500	3.95
Market / Local Authority (>1 year)*	131.000	8.100	139.100	2.55
Salix	0.015	-	0.015	-
Short Term loans* (<1 year)	32.034	-	32.034	0.33
TOTAL EXTERNAL BORROWING	**730.393**	**71.804**	**802.197**	**2.83**

* Note: above figures are based on the term of loans at their inception

Total external borrowing has decreased by £10.275 million from £812.472 million at the start of year to £802.197 million at 30 November 2021. Following further repayments and an assumed £50.000 million new borrowing later in the year, the year-end figure is expected to be around £806.893 million.

2.2. Current Investments

The table below summarises the investment position at 30 November 2021:

	Total Principal 30 Nov 2021 £m	Weighted Average Rate %
Money Market Funds and Call Accounts	117.000	0.02
Fixed Term Investments – Short Term (<1 year)*	80.014	0.17
Fixed Term Investments – Long Term (>1 year)*	30.000	3.24
TOTAL EXTERNAL INVESTMENTS	**227.014**	**0.50**

* Note: above figures are based on the term of investments at their inception

3. FORECAST FOR INTEREST RATES AND ECONOMIC OUTLOOK

The Council has appointed Link Asset Services (Link) as its treasury advisor and part of its service is to assist the Council to formulate a view on interest rates. The following table gives Link's central view of rates for 2022-23 (at 09 November 2021). A longer view and more detailed forecast are included at Appendix 1.

	Quarter 1 (Q/E Jun 2022)	Quarter 2 (Q/E Sep 2022)	Quarter 3 (Q/E Dec 2022)	Quarter 4 (Q/E Mar 2023)
Bank Rate	0.50%	0.50%	0.50%	0.75%
5-year PWLB	1.60%	1.60%	1.70%	1.70%
10-year PWLB	1.90%	2.00%	2.00%	2.10%
25-year PWLB	2.30%	2.40%	2.40%	2.40%
50-year PWLB	2.10%	2.20%	2.20%	2.20%

3.1. Economic Outlook (at November 2021)

The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at all of its subsequent meetings.

It is not expected that Bank Rate will go up fast after the initial rate rise as the supply potential of the economy is not likely to have taken a major hit during the pandemic. It should therefore be able to cope well with meeting demand after supply shortages subside over the next year, without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the MPC's 2.00% target after the spike up to around 5.00%.

However, it is likely that these forecasts will need changing within a relatively short timeframe for the following reasons:

- There are increasing grounds for viewing the economic recovery as running out of steam during the summer and now into the autumn. This could lead into stagnation which would create a dilemma for the MPC as to whether to focus on combating inflation or supporting economic growth through keeping interest rates low.
- Will some current key supply shortages spill over causing economic activity in some sectors to take a significant hit?
- Rising gas and electricity prices in October and next April, and increases in other prices caused by supply shortages, as well as increases in taxation next April are already going to deflate consumer spending power without the MPC having to take any action on Bank Rate to cool inflation.
- On the other hand, consumers are sitting on over £160.000 billion of excess savings left over from the pandemic so when will they spend this sum, in part or in total?
- It is estimated that there were around 1 million people who came off furlough at the end of September; how many of those would not have had jobs on 01

October and would therefore be available to fill labour shortages which are creating a major headache in many sectors of the economy? So, supply shortages which have been driving up both wages and costs, could reduce significantly within the next six months or so and alleviate one of the MPC's key current concerns.

- It is also recognised that there could be further surprises on the Covid-19 front, on top of the flu season this winter, and even the possibility of another lockdown, which could all depress economic activity.
- If the UK invokes article 16 of the Brexit deal over the dislocation in trading arrangements with Northern Ireland, this has the potential to end up in a no deal Brexit.

In summary, with the high level of uncertainty prevailing on several different fronts, it is likely that these forecasts will be revised again over the next few months.

3.2. Forecast for Treasury / Guilt Yields and PWLB Rates

As the US financial markets are, by far, the biggest financial markets in the world any trends in the US invariably impact and influence financial markets in other countries. And there is a strong correlation between movements in US treasury yields and UK gilt yields, and hence PWLB borrowing rates.

At its November meeting the US central bank, the Federal Reserve (or Fed), decided to start tapering its monthly Quantitative Easing (QE) purchases. If the run-down continues at its current pace, the purchases would cease entirely next June – although the Fed has reserved the ability to adjust purchases up or down. These purchases are currently acting as downward pressure on treasury yields and so it would be expected that US Treasury yields would rise as a consequence over the taper period, all other things being equal.

With wage growth at its strongest since the early 1980s, inflation expectations rising and signs of a breakout in cyclical price inflation, particularly rents, the Federal Open Market Committee's (FOMC) insistence that this is still just a temporary shock "related to the pandemic and the reopening of the economy", does raise doubts which could undermine market confidence in the Fed and lead to higher treasury yields.

As the interest forecast table for PWLB certainty rates above shows, there is likely to be a steady rise over the forecast period, with some degree of uplift due to rising treasury yields in the US.

3.3. Significant Risks to the Forecasts

- Labour and supply shortages prove more enduring and disruptive and depress economic activity.
- Mutations of the virus render current vaccines ineffective, and tweaked vaccines to combat these mutations are delayed, resulting in further national lockdowns or severe regional restrictions.

- The Monetary Policy Committee acts too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- The Monetary Policy Committee tightens monetary policy too late to ward off building inflationary pressures.
- The Government acts too quickly to cut expenditure to balance the national budget.
- UK / EU trade arrangements – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.
- German general election in September 2021. Germany faces months of uncertainty while a new coalition government is cobbled together after the indecisive result of the election. Once that coalition is formed, Angela Merkel's tenure as Chancellor will end and will leave a hole in overall EU leadership.
- Longer term US treasury yields rise strongly and pull gilt yields up higher than forecast.
- Major stock markets, for example the US, become increasingly judged as being over-valued and susceptible to major price corrections. Central banks become increasingly exposed to the "moral hazard" risks of having to buy shares and corporate bonds to reduce the impact of major financial market selloffs on the general economy.
- Geopolitical risks, for example in Iran, North Korea, but also in Europe and Middle Eastern countries; on-going global power influence struggles between Russia/China/US. These could lead to increasing safe-haven flows.

3.4. The Balance of Risks to the UK

The overall balance of risks to economic growth in the UK is now to the downside, including residual risks from Covid-19 and its variants - both domestically and their potential effects worldwide.

4. THE BORROWING STRATEGY 2022-23

4.1. Introduction

The Council borrows to fund the Capital programme, including loans to third parties for policy reasons (such as those to Advance Northumberland and Northumbria Healthcare NHS Foundation Trust etc.). Its capital expenditure plans are therefore the key driver of treasury management activity.

The output of capital expenditure plans is reflected in the Prudential Indicators, as set out in Appendix 4.

4.2. Borrowing Need – Capital Financing Requirement

The Council's long-term borrowing requirement is measured by the Capital Financing Requirement ("CFR"). The CFR represents total historic outstanding capital expenditure which has not yet been paid for from either revenue or cash-backed capital resources (such as grants and capital receipts). The CFR is repaid over time by an annual charge to revenue, known as the Minimum Revenue Provision (MRP). This charge, which is equivalent to depreciation, effectively spreads the cost of debt associated with capital expenditure over the useful economic life of the underlying assets.

At the same time the Council has significant levels of 'cash-backed' balances that are available for investment. Accordingly, the capital financing requirement (or borrowing requirement) need not always be met or funded externally from physical loans: At least in the short term, investment balances can be 'used' in lieu of borrowing externally; by withdrawing investments (in turn foregoing investment income) and instead using the cash to fund part of the borrowing requirement. This is often referred to as 'internal' or 'under' borrowing. Such an approach also has the added benefit of reducing 'counter-party' credit risk in terms of investments; because it reduces the need to place investments with external institutions.

The following tables summarise the forecast CFR movements for the next three financial years (based on the latest capital expenditure plans) along with the anticipated external borrowing over this period; assuming a significant degree on internal borrowing as proposed further below:

CFR Forecast (exc. PFI)	**2022-23 £m**	**2023-24 £m**	**2024-25 £m**	**2025-26 £m**
Opening CFR (exc. PFI)	1,047.270	1,114.755	1,189.825	1,246.103
Increase in CFR (exc. PFI)	67.485	75.070	56.278	-9.796
Closing CFR (exc. PFI) [Need to Borrow]	**1,114.755**	**1,189.825**	**1,246.103**	**1,236.307**

External Borrowing Forecast (exc. PFI)	2022-23 £m	2023-24 £m	2024-25 £m	2025-26 £m
Opening External Borrowing (exc. PFI)	806.893	890.349	993.805	1,061.512
Increase / (Decrease) in External Borrowing (exc. PFI)	83.456	103.456	67.707	(11.048)
Closing in External Borrowing (exc. PFI)	**890.349**	**993.805**	**1,061.512**	**1,050.464**
Under / (Over) Borrowing	224.406	196.020	184.591	185.843

4.3. Proposed Borrowing Strategy

With investment returns anticipated to remain low (at least in the short term), it is proposed to continue with the practise adopted in recent years of wherever possible using investments in lieu of external borrowing – i.e. operating an under-borrowing position.

Whilst the principal strategy of maintaining an under-borrowing position will reduce short term revenue costs, consideration will also be given to weighing the short-term advantage of internal borrowing against potential long-term costs.

As identified above, by the end of 2022-23, 20.13% (£224.406 million) of the Council's borrowing requirement is proposed to be covered by internal borrowing. The effective cost of this 'borrowing' is the foregone investment income. For 2022-23 this is estimated at 0.50% or around £1.162 million (based on the average mid-year internal borrowing position). Taking into consideration the forecast average cost for external borrowing (i.e. average interest rate on actual loans) for 2022-23 of 2.76%, this equates to a notional saving of 2.26% or around £5.243 million (or alternatively the notional cost of externalisation).

However, it is important to point out that this element of the borrowing requirement is subject to interest rate movements and therefore not without risk. Clearly if investment returns were to increase, or the borrowing had to instead be externalised (and funded by actual loans), the costs associated with this would increase accordingly. In order to identify and quantify this risk a local indicator is included in the Council's Prudential Indicators (see Appendix 4), identifying the level of internal borrowing and the impact of interest rate movements on this proportion of the borrowing requirement.

Despite utilising investments balances to support the borrowing need, as identified above a significant amount of external borrowing will still be required during 2022-23 (estimated at around £185.000 million, after taking into consideration maturing loans of £101.544 million) and going forward to fund the proposed capital programme.

Against the above backdrop that interest rates are projected to remain low over the next few years, and the risks within the economic forecast, it is envisaged the external borrowing requirement will be met primarily from shorter term / temporary borrowing

(up to 2 years). However medium to longer term borrowing may also be considered to provide a degree of longer-term certainty, and in particular if rate increases start to materialise earlier than projected (due to increased optimism in the economy etc.).

The Section 151 Officer will continue to monitor the interest rate market and scrutinise all lending opportunities to ensure borrowing is taken at the most advantageous time and limit the risk of exposure to increased borrowing costs in the future.

In line with the scheme of delegation set out in the Treasury Management Practices (TMP's, section 10), The Section 151 Officer will continue to approve all borrowing.

4.4. Policy on borrowing in advance of need

While not expected to happen due to the internal/under borrowing policy, the Council does have flexibility to borrow funds this year for use in future years. Where there is a clear business case for doing so, borrowing may be undertaken to fund the approved capital programme or to fund future debt maturities. The Section 151 Officer may do this under delegated power where, for instance, a sharp rise in interest rates is expected, and so borrowing early at fixed interest rates will be economically beneficial. Risks associated with any advance borrowing activity will be subject to appraisal in advance and subsequent reporting through the mid-year or annual reporting mechanism.

4.5. Debt Rescheduling

As short-term borrowing rates are forecast to be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment and in particular the premiums incurred.

The reasons for any rescheduling to take place will include:

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

The Council will monitor the situation and seek advice from Link Asset Services before any rescheduling of debt. All rescheduling will be reported to the Council as part of the in-year treasury management updates.

4.6. Municipal Bond Agency and European Investment Bank

The Municipal Bond Agency, which is currently in the process of being set up, may be in a position to offer loans to local authorities in the near future; perhaps at rates lower than those offered by the PWLB. Consideration may therefore be given to making use of this new source of borrowing as and when appropriate.

Consideration will also be given to borrowing from the European Investment Bank (EIB), where rates can be forward fixed, if this represents better value of money.

5. ANNUAL INVESTMENT STRATEGY 2022-23

5.1. Introduction – Investment Policy

The Council has significant levels of 'cash-backed' balances that are available for investment, in the form of General Fund and HRA balances, and the numerous earmarked reserves and provisions.

5.2. Investment Returns Expectations

As outlined in section 3 above and Appendix 1, investment returns are expected to improve in 2022-23. Link Asset Services current forecast a first increase in Bank Rate in December 2021. However, while markets are pricing in a series of Bank Rate hikes, actual economic circumstances may see the MPC fall short of these elevated expectations.

Against this background, Link Asset Services suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows:

	2022-23	2023-24	2024-25	2025-26	2026-27
Budgeted Rate	0.50%	0.75%	1.00%	1.25%	2.00%

5.3. Investment Strategy

As proposed in section 4 above, it is expected that during 2022-23 a significant proportion of available investment balances will be used as 'internal borrowing' to support the financing of the CFR. As a result, external investments will be limited and may decrease further during the year.

All remaining funds will be invested in-line with the following Investment Policy, which has regard to the former MHCLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code").

The overall aim of the Investment Strategy is to provide security of capital and minimise risk while ensuring the Council has sufficient liquidity.

The Council will also aim to achieve the optimum return on its investments commensurate with desired levels of security and liquidity. The risk appetite of the Council is low/medium, therefore specified and unspecified investments (see below) will be considered. However, security and liquidity will continue to take precedence over yield. All investments will be placed only with organisations which meet the criteria and will always be scrutinised and approved in line with approved Treasury Management Practices (Appendix 3).

5.4. Investment objectives

The general policy objective for this Council is the prudent investment of its surplus cash balances, which includes monies borrowed for the purpose of expenditure in the reasonably near future (i.e. over the 4-year medium term planning cycle). The Council's investment priorities are:

- the security of capital,
- the liquidity of its investments; and,
- the achievement of optimum yield.

Security and liquidity of principal have always been the priority and will continue to be so. In CIPFA's view "The priority is to protect capital rather than maximise return. However, the avoidance of all risk is neither appropriate nor possible and a balance must be struck with a keen responsibility for public money." In times of budget constraints, making the Council's funds work and generate increased returns is becoming increasingly important. CIPFA encourages local authorities to look carefully at their Counterparty Lists to ensure return on investments is achieved.

CIPFA recommends that "Responsibility for local authorities investment decisions lies and must continue to lie with the local authorities themselves". The best authorities:

- explicitly balance risk and reward,
- review and scrutinise policies and procedures regularly,
- have well trained staff and engaged elected members; and,
- use a wide variety of information.

The Credit and Counterparty Criteria List (Appendix 2), which has not changed from last year, offers diverse counterparties and takes into account country, sector and group limits.

This list clearly sets out the minimum acceptable credit criteria for organisations with which the Council will place funds.

All investments will be placed only with organisations which meet the criteria and will always be scrutinised and approved in line with approved Treasury Management Practices (Appendix 3).

The borrowing of monies purely to invest or lend-on and make a return is unlawful and this Council will not engage in such activity.

5.5. Security of Capital and Creditworthiness (Credit and Counterparty Policy)

In accordance with the above guidance from the former MHCLG and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria when determining which organisations it can place investments with. The criteria are set out in Credit and Counterparty Policy which is attached at Appendix 2.

The Council regards a key objective of its treasury management activities to be the security of the principal sums it invests. Accordingly, it will ensure that its counterparty policy and limits reflect a prudent attitude towards organisations with which funds may be deposited.

The Council applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from Fitch and Moody's. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies,
- CDS* spreads to give early warning of likely changes in credit ratings; and,
- sovereign ratings to select counterparties from only the most creditworthy countries.

  * Credit default swaps (CDS) are a type of insurance against default risk by a particular company/financial institution. In the event of a default, the buyer receives the face value of the bond or loan from the insurer.

The Council is alerted daily of changes to ratings of both agencies. If a downgrade results in the counterparty no longer meeting the Council's minimum criteria, no new investment will be made. Consideration will also be given to whether or not existing investments will be withdrawn, which is dependent on whether the bank concerned is agreeable.

As with previous practice, ratings and the use of this external service will not be the sole determinant of the quality of an institution. It is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. In addition, the Council will also use market data and market information, information on government support for banks and the credit ratings of that government support.

The assessment will also take account of information that reflects the opinion of the markets. Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

5.6. Types of investments the Council may use

The Council may use various financial instruments for the prudent management of its treasury balances (as listed in the Credit and Counterparty Policy in Appendix 2).

The Credit and Counterparty Policy does not identify individual counterparty names in order to ensure that the Section 151 Officer has the flexibility to place investments with the most suitable organisations, which meet the agreed criteria, in a timely manner.

Treasury staff investigates various products and instruments as they become available to see if they meet the Council's investment priorities and criteria list.

In line with the former MHCLG Guidance, the Credit and Counterparty Policy categorises investments instruments between 'Specified' and 'Non-Specified' investments:

Specified Investments offer high security and high liquidity. All such investments are:

- in pounds sterling,
- due to be repaid within 12 months or which may be required to be repaid within 12 months,
- not capital expenditure,
- made with high credit quality organisations, (for the purpose of this strategy high credit ratings are "A-" and above for long term and "F2/P-2" and above for short term investments); or,
- made with the United Kingdom Government or local authority (including the North East Combined Authority), parish council or community council.

Non-Specified Investments are those which do not meet the criteria for specified investments and give greater potential risk. The former MHCLG does not discourage the use of non-specified investments but states that there is a need for these to be dealt with in more detail.

As in previous years, it is anticipated that the majority of investments will be specified but it is proposed to maintain a maximum of 25% of total Council investments being held in non-specified investments at any one time during the year. This is primarily to allow the use of large, non-rated, building societies as well investments beyond 1 year with other local authorities.

Investments will only be placed with organisations which meet the criteria set out in the approved Credit and Counterparty Policy. Individual investments or aggregate of investments to one organisation should comply with the monetary limits set out in Credit and Counterparty Criteria List.

Nationalised/part-nationalised banks in the UK have credit ratings which do not comply with the credit criteria used by the Council. However, due to significant Government ownership the Council feels more comfortable applying higher limits for investments.

Investments are to be arranged in line with Treasury Management Practices (Appendix 3) and all investments with new counterparties must be approved by the Section 151 Officer or the Deputy Section 151 Officer or in their absence the Finance Managers. There is currently no proposed change to this practice.

5.7. Forecast Investment Balances and Liquidity

Based on current reserves and balances forecast and allowing for the proposed strategy of using some of the investable balances as 'internal borrowing' to support the financing of the CFR (see Section 4), it is anticipated that in 2022-23 the Council's

external investment balances will fluctuate throughout the year within a range between £41.119 million and £82.502 million.

To ensure liquidity a minimum of 20.00% of overall investments, or £5.000 million, whichever is lower, will be held in liquid accounts. For cash flow generated balances, the Council will seek to utilise its money market funds, call accounts and short-dated deposits (overnight to six months).

As investment rates are forecast to remain low and there is a requirement for liquid funds to support the under-borrowing position, it is envisaged the Council will avoid locking into longer term deals. However, if exceptionally attractive rates are available then they will be considered. Close contact will be maintained with the money market to ascertain the most favourable interest rates on offer to achieve best value from the return on surplus monies available in line with the Counterparty Policy in Appendix 2.

Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates.

5.8. Non-Treasury Management Investments Defined as Capital Expenditure

In addition to the above standard treasury management activity, the Council also receives interest from two other 'non-treasury' activities; namely the investment shares NIAL Holdings (Newcastle Airport) [valued at £9.729 million as 31 March 2021] and Advance Northumberland [£4.338 million], and the loans to Newcastle Airport, Northumbria Healthcare NHS Foundation Trust, Advance Northumberland and other organisations.

These non-treasury activities are deemed by Statutory Regulations as capital expenditure and are provided to support Council service objectives and corporate priorities. They are not made or regarded as part of the 'core' treasury management activity - i.e. the investment of surplus cash flow balances, as made under the power to invest inferred by s12 of the Local Government Act 2003. As a result, these activities were previously outside of the scope of the Investment Strategy.

The former MHCLG's investment guidance recommends that these non-financial or non-core investments should be included within the Annual Investment Strategy.

Whilst it is entirely appropriate to highlight the scope of these activities, there is a view amongst some practitioners that it may be misleading to refer to items of expenditure in the context of an investment strategy, and that a more suitable mechanism to explain and cover these activities would be within the newly re-introduced Capital Strategy.

Due to their nature, it is difficult to assess and consider non-financial or non-core investments in the context of liquidity and security, which arguably does not apply to these activities, at least not in the same way as it does for standard cash investments. Beyond the terms of the underlying agreement, loans to third parties are not liquid and have no need to be. The expenditure is incurred in the support of service objectives and funded from capital resources, which is different to the requirements and policies

surrounding management of the Council's investments and cash flows. Similarly, whilst the return of the funds advanced is key, security for third party loans may need to be considered differently to the credit ratings modelling approach utilised for core-treasury investments.

For these reasons, the Council's policy on non-financial or non-core investments, specifically the loans to third parties, is covered separately within the Capital Strategy document which is considered and approved by Council at its budget setting meeting in February and is attached at Appendix 6 for information.

A summary of value of loans to third parties and the interest expected to be received is summarised below:

Borrower	**Estimated Balance at 1 Apr 2021 £m**	**Weighted Average Interest Rate**	**Forecast Interest Income 2022-23* £m**
Northumbria Healthcare NHS Foundation Trust	95.696	3.80%	3.606
Advance Northumberland Group	277.995	5.00%	15.099
Newcastle Airport	11.916	8.60%	-
North East Local Enterprise Partnership	12.759	3.83%	0.650
Northumberland College	6.164	4.40%	0.289
Northumberland Aged Miners	1.495	3.50%	0.112
Cramlington Town Council	0.299	4.00%	0.012
Active Northumberland	0.189	3.30%	0.005
Newcastle City Council	0.190	5.00%	0.010
Alnwick Juniors	0.165	0.00%	-
Arts Groups (The Maltings, Alnwick Playhouse)	0.083	3.80%	0.003
Calvert Trust	0.089	2.10%	0.002
Alnwick Youth Hostel	0.089	2.10%	0.003
Haltwhistle Pool	0.044	2.10%	0.001
Northumberland Community Bank	0.050	2.54%	0.001
Other Parish/Town Councils and Housing Associations	0.065	11.90%	0.002
Alexa's Animal Charity	0.128	2.4%	0.003
Total	**407.416**	**4.77%**	**19.798**

*Note: the above includes forecast advances to be made.

**No interest payments are due from Newcastle International Airport in 2022-23.

The Medium-Term Capital Programme for 2022-23 to 2025-26 includes a provision of £56.432 million for further loans to Advance Northumberland and other third parties, plus an additional £7.240 million for loans to the North East Local Enterprise Partnership in respect of Enterprise Zone investments (which will ultimately be repaid by future business rate income).

Whilst the income from these advances is significant, the intention is largely only to cover the associated underlying borrowing costs to the Council. The loans are considered and approved to support the Council's service and policy objectives not to generate a financial return for the Council.

5.9. Provision for credit related losses

If any of the Council's investments appear at risk of loss due to default (i.e. a credit-related loss, and not one resulting from a fall in price due to movements in interest rates) the Council will make revenue provision of an appropriate amount.

6. HOUSING REVENUE ACCOUNT (HRA) TREASURY MANAGEMENT COSTS

6.1. Overview

Following implementation of the HRA self-financing reforms in April 2012, a separate pool of specific loans is now maintained for the HRA. The interest costs associated with these loans are charged direct to the HRA. This arguably negates the need for the former HRA Item 8 charge, which allocated a share of the Authority's overall borrowing costs to the HRA.

For the most part, the HRA will aim to ensure that new loans are taken out (or repaid) to match any anticipated movement in its borrowing requirement - known as the HRA Capital Financing Requirement (HRA CFR). There will however be instances during the year when the balance of the HRA loan pool - i.e. actual external borrowing charged to the HRA does not equate exactly to the HRA CFR. In such circumstances the HRA is borrowing from (or lending to) the General Fund and an additional charge (or credit) is necessary in order to reflect the notional cost of this imbalance. The Council's proposed policy for this arrangement is as follows, the policy remains unchanged from the previous year:

6.2. Policy for HRA Under and Over Borrowing

HRA Under-Borrowing

Where the weighted average balance of the HRA (external) loans pool is less than the weighted average HRA CFR for the same period, notional interest will be charged to the HRA at the average rate of interest for 30-year PWLB borrowing for the period.

HRA Over-Borrowing

Where the weighted average balance of the HRA (external) loans pool is greater than the weighted average HRA CFR for the same period, notional interest will be paid to

the HRA at the average 3-month SONIA (Sterling Overnight Index Average) rate for the period.

6.3. Other Treasury Management Charges to HRA

As under the former Item 8 arrangements, the HRA will continue to receive interest (or investment income) on its weighted average balances for the year, based on the Council's overall average investment rate.

The HRA will also continue to be charged a proportion of the authority's overall debt management expenses (based on the CFR proportions), as well its share of any historic premiums or discounts associated with the premature repayment of borrowing. Any future/new premiums or discounts will be met fully by the relevant fund of the underlying loan – i.e. premiums or discounts related to loans within the HRA loan pool will be charged fully to the HRA, and vice versa.

7. PRUDENTIAL INDICATORS and TREASURY LIMITS 2022-23 to 2025-26

The Council's capital expenditure plans are the key driver for treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members to overview and confirm capital expenditure plans.

Councils are required to approve a set of Prudential Indicators for the new financial year and adhere to these indicators during the course of that year. The indicators are to be set on a rolling basis, for the forthcoming financial year and three successive financial years. Prudential Indicators for 2022-23 to 2025-26 are set out in Appendix 4.

At the time of writing, CIPFA is consulting on revisions to the Treasury Management and Prudential Codes. The proposals include the potential introduction of two new indicators. On the assumption that the proposals are ultimately agreed, the two new indicators have been included in the Council's Prudential Indicators and Treasury Limits for 2022-23 to 2025-26 – as set out in Appendix 4.

The two new indicators are:

Liability Benchmark: The liability benchmark is a graphical projection of the amount of loan debt outstanding which the authority needs each year into the future, in order to fund its existing debt liabilities, planned prudential borrowing and other cash flows. In essence it compares the existing external borrowing against the future 'gross loans requirement' (i.e. need); with the gap representing the future need to borrow (externally). It is however important to point out that CIPFA's current draft guidance suggests the 'loans requirement' should be net of estimated investment balances. As a result, it assumes all available investment balances (except for a provision to cover day-to-day liquidity / cash flow requirements) will be used to support the borrowing need, in lieu of borrowing externally.

Net Income from Commercial and Service Investments as % of net revenue stream: to identify the authority's reliance on income of this nature, such as loans to Advance Northumberland, Northumbria Healthcare NHS Foundation Trust and Newcastle Airport etc.

8. THE ANNUAL MINIMUM REVENUE PROVISION POLICY STATEMENT

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision (MRP)), although it is also allowed to make additional voluntary payments if required.

Former MHCLG Regulations have been issued which requires Full Council to approve an MRP policy in advance of each year. A variety of options are provided to councils, with an overarching requirement there is a prudent provision.

Former MHCLG revised their MRP guidance in 2018. However, none of the amendments impact on the Council's current or proposed policy.

The 2022-23 policy is unchanged from that approved for 2021-22.

The Council is recommended to approve the Annual Minimum Revenue Provision Policy Statement including Additional Voluntary Provision as detailed within Appendix 5.

9. POLICY ON USE OF EXTERNAL SERVICE PROVIDERS

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon the services of our external service providers. All decisions will be undertaken with regard to all available information, including, but not solely, the Council's treasury advisers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of the appointment and the methods by which their value will be assessed are properly agreed and documented, and subject to regular review.

The Council uses Link Asset Services Ltd as its treasury management consultant. The company provides a range of services which include:

- Technical support on treasury matters, capital finance issues and templates of Member reports.
- Economic and interest rate analysis.
- Debt services which include advice on the timing of borrowing.
- Debt rescheduling advice surrounding the existing portfolio.

- Generic investment advice on interest rates, timing and investment instruments; and,
- Online up to date credit ratings.

10. IMPLEMENTATION OF THE TREASURY MANAGEMENT STRATEGY, SCHEME OF DELEGATION, TRAINING AND REPORTING REQUIREMENTS

10.1. Implementation of the Treasury Management Strategy

The continued implementation of the above strategy and procedures is the responsibility of the Section 151 Officer, who is authorised to arrange the necessary borrowings within the limits set out in the Prudential Indicators, and necessary investments as set out in the investment strategy.

Northumberland County Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to Cabinet.

The Council nominates Audit Committee to be responsible for ensuring effective scrutiny of the Treasury Management Strategy and policies.

There are no proposed changes to this methodology.

10.2. Treasury Management Practices (TMPs)

Treasury Management Practices (Appendix 3) set out the manner in which the Council will seek to achieve the treasury management policies and objectives. The Council has adopted the recommended form of words defining the Council's treasury management practices (TMPs), in compliance with CIPFA's Treasury Management in the Public Services: Code of Practice and the Prudential Code for Capital Finance in Local Authorities. These set out the specific details of the systems to be employed and the records to be maintained.

These practices are as follows:

TMP1 Credit and Counterparty Risk management

TMP2 Best value and performance measurement

TMP3 Decision-making and analysis

TMP4 Approved instruments, methods and techniques

TMP5 Organisation, clarity and segregation of responsibilities, and dealing arrangements

TMP6 Reporting requirements and management information

TMP7 Budgeting, accounting and audit arrangements

TMP8 Cash and cash flow management

TMP9 Money laundering

TMP10 Training and qualifications

TMP11 Use of external service providers; and,

TMP12 Corporate governance.

There are no proposed changes to these practices, other than the inclusion of three further companies for potential money broking services – Imperial Treasury Services Ltd, Munix Ltd and RP Martin Ltd (see Appendix 3, section 11.1.2).

10.3. Responsible Officers

Daily treasury management activities will be undertaken by a Senior Accountant within the Corporate Finance team, as set out in TMP5. If they are absent a Principal Accountant within the Corporate Finance team will undertake these activities.

The three annual Treasury Management reports submitted to Cabinet and Council will be produced by the Technical Accountant.

The Finance Manager will ensure all treasury management activities are made in accordance with agreed policies and practices.

10.4. Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. Members received training in October 2018 and further training will be arranged as required.

The training needs of treasury management officers are periodically reviewed. Each officer concerned will receive appropriate training and guidance on their duties and the constraints within which they operate.

10.5. Reports and Monitoring

To ensure that those with ultimate responsibility for the treasury management function appreciate fully the implications of treasury management policies and activities, and that those implementing policies and executing transactions have properly fulfilled their responsibilities, reports need to be submitted to full Council which need to be reviewed by Members of the Council in both Cabinet and Scrutiny functions.

The adequacy of the strategy statement will be monitored and reports requesting amendments to the statement will be produced when changes are thought to be necessary. The changes will be made in consultation with the Cabinet Portfolio holder for Corporate Services, whose role relates to the strategy and associated risks. Any strategy changes will be reported to the Audit Committee.

The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of polices, estimates and actuals. The following reports are required to be adequately scrutinised by Audit Committee before being recommended to the Council:

Treasury Management Strategy Statement

The first, and most important report covers:

- the capital plans (including prudential indicators),
- a Minimum Revenue Provision Policy (how residual capital expenditure is charged to revenue over time),
- the Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury indicators; and,
- an investment strategy (the parameters on how investments are to be managed).

A Mid-Year Treasury Management Report

This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury activity is meeting the strategy or whether any policies require revision.

An Annual Treasury Report

This provides details of prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

It is proposed that the Council follow reporting arrangements in accordance with the requirements of the revised Treasury Management Code of Practice.

Area of Responsibility	Council/ Committee/ Officer	Frequency
Scrutiny of treasury management strategy	Audit Committee or Risk Appraisal Panel	Annually before the start of the year
Treasury Management Strategy / Annual Investment Strategy / MRP policy and Treasury Management Practices	Cabinet / Full Council	Annually before the start of the year
Annual Treasury Outturn Report	Cabinet / Full Council	Annually by 31 July to Audit Committee and 30 September to Full Council
Treasury Management Budget Monitoring Reports	Incorporated within the Budget Monitoring report and reported separately to Scrutiny Committee	Quarterly
Scrutiny of treasury management performance	Audit Committee	As required
Updates or revisions to Treasury Management Strategy / Annual	Audit Committee / Cabinet / Full Council	Ad- hoc

Area of Responsibility	Council/ Committee/ Officer	Frequency
Investment Strategy / MRP policy		

The policies and strategies set out in this document will ensure that the management and administration of treasury management will be robust, rigorous, disciplined and help minimise risk.

The procedures for monitoring treasury management activities through audit, scrutiny and inspection will be applied with an openness of access to information and provide well-defined arrangements for review and implementation of changes.

Implications

Policy	The report sets out the Treasury Management Policy Statement for 2022-23, and is consistent with "We want to be efficient, open and work for everyone" priority included in the Council's Corporate Plan 2018-21.
Finance and value for money	The financial implications of the 2022-23 investment and borrowing transactions have been taken into account within the revenue budget for 2022-23 and Medium-Term financial Plan 2022-26. Northumberland County Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving best value in treasury management within the context of effective risk management, and to employing suitable performance measurement techniques, for example comparison with other members of the CIPFA and Link benchmarking clubs.
Legal	The Local Government Act 2003 (the Act) and supporting regulations requires the Council to 'have regard to' the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code and the CIPFA Treasury Management Code of Practice, 2017.
Procurement	There are no direct procurement implications for the County Council.
Human Resources	There are no direct staffing implications for the County Council.
Property	There are no direct property implications for the County Council.
Equalities (Impact Assessment attached) Yes ☐ No ☐ N/A ☐	Not applicable.

Risk Assessment	The report highlights the principal financial risks within the Treasury Management function. The identification, monitoring and control of risk are the prime criteria by which the effectiveness of the County Council's Treasury Management activities will be measured. Accordingly, the analysis and reporting of Treasury Management activities will focus on their risk implications for the Council. The investment priority is security and liquidity rather than yield, which is a secondary aim.
Crime & Disorder	There are no Crime and Disorder implications contained within this report.
Customer Consideration	There are no Customer Consideration implications contained within this report.
Carbon reduction	There are no specific Carbon Reduction implications within this report.
Health and Wellbeing	There are no Health and Wellbeing implications for the County Council.
Wards	All divisions.

Background Papers:

CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance notes 2017.

CIPFA Prudential Code for Capital Finance in Local Authorities 2017.

Guidance on Local Government Investments The Local Government Act 2003,

Local Authorities (Capital Finance and Accounting) Regulations 2012 (S.I.2012/265)

List of Appendices

Appendix 1 – Economic Forecasts

Appendix 2 – Credit and Counterparty Criteria Policy

Appendix 3 – Treasury Management Practices

Appendix 4 – Prudential Indicators

Appendix 5 – Minimum Revenue Provision Policy

Appendix 6 – Capital Strategy

Report sign off:

	Name
Monitoring Officer	Suki Binjal
Interim Executive Director of Finance & Section 151 Officer	Jan Willis
Relevant Executive Director	Jan Willis
Chief Executive	Daljit Lally
Portfolio Holder	Richard Wearmouth

Author and Contact Details

Alistair Bennett – Technical Accountant

(01670) 625504

Alistair.Bennett@northumberland.gov.uk