Treasury Management Strategy

2023 to 2024

CHELTENHAM
BOROUGH COUNCIL

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1. Introduction

1.1 Treasury management is the management of the Council's cash flows, borrowing and investments, and the associated risks. Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2021 Edition (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

1.2 The Council's Treasury Management Strategy forms a key part of our overall Corporate Planning Framework. It provides a mechanism by which our treasury management decisions can be aligned with our over-arching corporate priorities and objectives over a medium term planning horizon.

1.3 The Strategy has direct links to the Council's Asset Management Strategy, Commercial Strategy, Capital Strategy and Investment Strategy and forms a key part of the Council's Medium Term Financial Strategy (MTFS) as presented below:

2. Purpose of this strategy

2.1 Our 2023/24 Treasury Management Strategy has been developed, with a focus on working with our partner organisations to lead in future place shaping, investment and regeneration in Cheltenham.

2.2 The key aims of this document are:

- To outline how we invest our money to ensure we have the financial resources to support the key priorities outlined in the 2023-2027 Corporate Plan.
- To set out the key principles on which our borrowing and investment decisions are made, including how security and risk have been assessed in the development of our investments (See Section 5, page 5).

2.3 To present the arrangements for managing and monitoring our treasury management decisions, including assessment of outcomes and the continual alignment to our Corporate Plan (See Section 6, page 11).

3. Why we invest our money

2.1 The Council invests its money for three broad purposes:

- because it has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure (known as treasury management investments)
- to directly support local public services by lending to other organisations (service investments), and
- to invest in community led and sustainable place shaping, regeneration and economic development of our town (known as growth investments).

Our Investment Strategy outlines the principles and arrangements in place for the second two categories of investment. This strategy focuses on our approach to the first category.

4. How we borrow money

Our Borrowing

4.1 At 31 March 2023, we are forecast to hold £173.610m of borrowing. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while balance sheet resources are the underlying sums available for investment. The Council has an increasing CFR due to the capital programme especially within the HRA capital programme to deliver on our affordable housing target. With minimal investments the council will therefore be required to borrow up to £76m over the forecast period

4.2 CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Council's external borrowing should be lower than its highest forecast CFR over the following three years. The table below shows that the Council expects to comply with this recommendation during 2023/24.

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

4.4 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 total forecast net borrowing against the CFR and liability benchmark is set out in the table below for the period of the Medium Term Financial Strategy.

Table: 1

	31.3.22 Actual £m	31.3.23 Estimate £m	31.3.24 Forecast £m	31.3.25 Forecast £m	31.3.26 Forecast £m
General Fund CFR	103.597	112.410	114.506	116.692	119.313
Housing (HRA) CFR	78.404	84.616	96.758	116.989	139.867
TOTAL CFR	**182.002**	**197.026**	**211.264**	**233.681**	**259.180**
Less: External Borrowing	176.100	173.610	170.124	168.598	167.200
Internal (over) Borrowing	**5.920**	**23.416**	**41.140**	**65.083**	**91.980**
Less: Useable reserves	(20.957)	(13.520)	(14.243)	(14.243)	(14.243)
Less: Working Capital	(3.843)	(24.822)	(42.048)	(65.991)	(92.888)
Investments/ (New Borrowing)	**18.880**	**14.926**	**15.151**	**15.151**	**15.151**
Net Borrowing Requirement	157.200	158.684	154.973	153.447	152.049
Preferred year-end position (Invest)	10.000	10.000	10.000	10.000	10.000
Liability Benchmark (year-end)	**167.200**	**168.684**	**164.973**	**163.447**	**162.049**

Our Borrowing Strategy

4.5 The Council's chief 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.

4.6 Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead. However if long term rates prove more attractive, then the Council will switch to using the Public Works Loan Board (PWLB) or another lender in the market to fund past and future debt.

4.7 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 or short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Ongoing monitoring may determine whether the Council borrows additional sums at long-term fixed rates in 2023/24 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

4.8 Alternatively, the Council may arrange forward starting loans during 2022/23, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period. The Council may also borrow short-term loans to cover unplanned cash flow shortages.

Our Borrowing Strategy (continued)

4.9 The main sources of approved long-term and short-term borrowing for Cheltenham Borough Council are:

Sources of borrowing

HM Treasury's PWLB lending facility (formally the Public Works Loan Board):
The Council has previously raised the majority of its long-term borrowing from the PWLB but will consider long-term loans from other sources including banks, pensions and local authorities, and will 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. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Council intends to avoid this activity in order to retain its access to PWLB loans.

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 Cabinet.

LOBOs:
The Council holds £7m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. £2m of these LOBO's matures in 2024. The Council will take the option to repay LOBO loans at no cost if it has the opportunity to do so.

Short-term and variable rate loans:
These loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators. However the use of short term loans is currently very favourable as borrowing costs are still low compared with long term rates, and although rates are predicted to rise in 2022, Arlingclose forecast a slow increase in rates in 2022 and 2023.

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 loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

5. How we invest money

Our Treasury Management investments

5.1 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council's investment balance has averaged from as high as £34m and as low as £14m over the last twelve months. On 2nd February 2023, we held £25.824m of treasury investments which are outlined in the table 2 below.

Table: 2

	2nd February 2023 Actual Portfolio £m	31st March 2023 Actual Rate %
Treasury investments:		
Glos Airport – Revolving credit facility	1.150	6.00%
Glos Airport – Sub Station/ Radar loans	0.137	2.00%
Glos Airport – Working Capital Loan	5.410	5.00%
Cheltenham Borough Homes (St Georges Place)	1.556	2.40%
Money Market Funds	10.000	3.47%
Cheltenham Borough Homes (St Georges Place) Equity	0.535	1.033%
The Trustees of St. Margaret's Hall	0.036	3.00%
Other Pooled Funds		
CCLA Property Investment Management	3.000	3.89%
CCLA Diversified Income	2.000	2.57%
Schroders Unit Trusts Ltd	2.000	3.90%
Total Treasury investments	**25.824**	**3.74%**

5.2 By the end of the 2022/23 financial year, it is forecast that our investment balance will have reduced due to previous years Covid and Energy grants being received at year-end and due to some additional borrowing required in February 2023 to cover repayments of government grants. The table below shows the forecast between short and longer term holdings.

	31.3.22 Actual £m	31.3.23 Estimate £m	31.3.24 Forecast £m	31.3.25 Forecast £m	31.3.26 Forecast £m
Near-term investments	11.345	2.150	3.000	4.000	5.000
Longer-term investments	11.922	11.792	11.756	11.710	11.663
Total	**23.267**	**13.942**	**14.756**	**15.710**	**16.663**

Our Treasury Management investments

5.3 The Council's policy on treasury investments, in line with the CIPFA Code, is to prioritise security and liquidity over yield; that is to focus on minimising risk rather than maximising returns. Cash that is likely to be spent in the near term is invested securely, for example with the government, other local authorities or selected high-quality banks, to minimise the risk of loss. Money that will be held for longer terms is invested more widely, including in bonds, shares and property, to balance the risk of loss against the risk of receiving returns below inflation. Both near-term and longer-term investments may be held in pooled funds, where an external fund manager makes decisions on which particular investments to buy and the Council may request its money back at short notice. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested. The council aims to be a responsible investor and will consider environmental, social and governance (ESG) issues when investing.

5.4 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's ESG policy 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.

5.5 Under the new IFRS 9 standard, the accounting for certain investments depends on the Council's "business model" for managing them. The Council aims to achieve value from its treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

5.6 The Council may invest its surplus funds with any of the counterparty types in table 2 below, subject to the cash limits (per counterparty) and the time limits shown.

Sector	Time limit	Counterparty limit	Sector limit
The UK Government	50 years	Unlimited	n/a
Local authorities & other government entities	25 years	£5m	Unlimited
Secured investments *	20 years	£6m	Unlimited
Banks (unsecured) *	13 months	£5m	Unlimited
Building societies (unsecured) *	13 months	£3m	£10m
Registered providers (unsecured) *	5 years	£5m	£5m
Money market funds *	n/a	£5m	Unlimited
Strategic pooled funds	n/a	£5m	£10m

5.7 * 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.

Bank & Building Society 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. See below for arrangements relating to operational bank accounts.

Bank & Building Societies secured
Investments secured on the borrower's assets, which limits the potential losses in the 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, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. Investments with the UK Government are deemed to be zero credit risk due to its ability to create additional currency and therefore may be made in unlimited amounts for up to 50 years

Corporates
Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made either following an external credit assessment as part of a diversified pool in order to spread the risk widely.

Registered providers
Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing, formerly known as housing associations. These bodies are tightly regulated by the Regulator of Social Housing (in England) 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. They 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 Council 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 that 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. Because 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.

Real estate investment trusts
Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.

Operational bank accounts
The Council banks with Lloyds (Lloyds Banking Group). On adoption of this Strategy, it will meet the minimum credit criteria of A- (or equivalent) long term. It is the Councils intention that even if the credit rating of Lloyds Bank falls below the minimum criteria A- the bank will continue to be used for short term liquidity requirements (overnight and weekend investments) and business continuity arrangements.

Policy investments
Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made either following an external credit assessment as part of a diversified pool in order to spread the risk widely.

- Cheltenham Festivals £100k up to one year duration
- Gloucestershire Everyman Theatre £100k up to one year duration
- Gloucestershire Everyman Theatre £303k Non-specified duration
- Ubico Limited £500k up to one year duration
- Cheltenham BID £100k up to one year duration
- The Cheltenham Trust £100k up to one year duration
- Publica Group £100k up to one year duration
- Cheltenham Borough Homes £97m Non-specified duration[1]
- Cheltenham Borough Homes £10m Equity Non- Specified duration[2]
- Cheltenham Borough Homes £500k up to one year
- Gloucestershire Airport Limited £9m up to one year
- Gloucestershire Airport Limited £7.250m Non-specified duration
- Folk2Folk (Peer to Peer lending) £575k Non-specified duration[3]

[1] Cheltenham Borough Homes is looking to borrow £90m and a further

[2] £10m Equity Investment from the council to assist in three areas over the coming years to provide substantial new housing in the town by providing Private Rented Sector (PRS) housing, purchasing 106 sites and building new homes. The drawdown of the loans will be over a period of 40 years.

[3] Folk2Folk is a peer to peer lending platform in which the council can lend to support local, rural and entrepre¬neurial businesses £575,000 with a capped limit of £100,000 per loan application, up to a maximum of 5 years. Interest rates earned can be between 4.5% and up to 9% per annum.

Renewable Energy investments

Over recent years significant investments from Local Authorities in the Renewable Energy markets has occurred by way of investing in an energy bond. Currently the council has approved the use of Corporate Bonds and has used them on a regular basis but only for a maximum of two years previously. To be able to potentially invest in Green Renewable energy recommendation was made following consultation with members of the Treasury Management Panel on the 5th June 2017 and approved by Council on 24 July 2017 that up to £2m in relation to Green Investment bonds can be invested up to five years.

Within our treasury management investments, it is critical to get the right balance between social, environmental and financial factors when assessing the investments we make. Full Council noted in December 2022 that our exposure to gas and oil investments currently stands at £173k down from £280k this time last year. This is part of the Schroder Income Maximiser Fund and makes up 2.5% (4% in 2022) of the £7m we have invested in Pooled Funds. However the current capital value of the fund is valued £419k less than the original £2m invested. Given our current climate priorities, assurance was provided to Council that we are looking to take steps to ensure our investments are contributing to these goals. We are committed in the longer term to divesting from oil and gas but need to balance these priorities with ensuring we are making the right financial decisions to safeguard our residents, businesses and communities. We will continue to closely monitor the performance of this fund and when it is financially prudent to do so, will consider the climate implications of how we invest this money in the future.

Monitoring our Treasury Management Investments

5.8 Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. The credit rating agencies in current use are listed in the Treasury Management Practices document. 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.

5.9 Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "negative watch") so that it may fall below the approved rating criteria, then only investments that can be withdrawn (on the next working 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.

5.10 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 and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

5.11 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, this 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 investment returns to fall but will protect the principal sum invested.

5.12 In order to monitor this, we have set cash limits on the credit quality of the investments.

	Cash limit
Total long-term investments	**£20m**
Total investments without credit ratings or rated below A- (except UK Government and local authorities)	**£10m**
Total investments (except pooled funds) with institutions domiciled in foreign countries rated below AA+	**£10m**

Investment Limits

5.13 The Council's revenue reserves available to cover investment losses are forecast to be £13.520 million on 31st March 2023. In order that no more than 35% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £5 million. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. 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.

Table 4: Investment limits

	Cash limit
Any single organisation, except the UK Central Government	£5m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£5m per group
Any group of pooled funds under the same management	£5m per manager
Foreign countries	£4m per country
Registered providers	£5m in total
Unsecured investments with building societies	£5m in total
Loans to unrated corporates – Renewable Energy	£4m in total- £2m max in each
Money Market Funds	£5m per MMF

5.14 The Council uses purpose-built cash flow forecasting to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium term financial plan and cash flow forecast.

6. Treasury Management Indicators

6.1 The Council measures and manages its exposures to treasury management risks using the following indicators.

Security
The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	Target
Portfolio average credit rating	A -

Interest rate exposures
This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest exposures, expressed as the proportion of net principal borrowed will be:

	2022/23	2023/24	2024/25
Upper limit on fixed interest rate exposure	100%	100%	100%
Upper limit on variable interest rate exposure	75%	75%	75%

Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate.

Maturity structure of borrowing
This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	Upper	Lower
Under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and within 20 years	100%	0%
20 years and within 30 years	100%	0%
30 years and within 40 years	100%	0%
40 years and above	100%	0%

Principal sums invested for periods longer than 364 days
The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

	2023/24	2024/25	2025/26
Limit on principal invested beyond one year	£20m	£20m	£20m

7. Related Matters

7.1 There are a number of additional items that the Council is obliged by CIPFA or MHCLG to include in its Treasury Management Strategy.

Policy on the use of financial derivatives
Local authorities have previously made use of financial derivatives embedded into loans and investments 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 1 of the Localism Act 2011 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.

Policy on apportioning interest to the HRA
On 1st April 2012, the Council notionally split each of its existing long-term loans into General Fund and HRA pools. In the future, new long-term loans borrowed will be assigned in their entirety to one pool or the other. Interest payable and other costs/ income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged/ credited to the respective revenue account. Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. This balance will be measured each year and interest transferred between the General Fund and HRA at the Council's average interest rate on investments, adjusted for credit risk.

Markets in Financial Instruments Directive
The Council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the Chief Financial Officer believes this to be the most appropriate status.

Investment advisers
The Council recently re-appointed Arlingclose Limited as treasury management advisers for three years plus the option for a further two years after a full joint tender with Cotswold District Council, Forest of Dean District Council and West Oxfordshire District Council. The new contract will commence from 1st March 2023.

Investment of money borrowed in advance of need

The Council may, from time to time, 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.

The total amount borrowed will not exceed the authorised borrowing limit of £287m. The maximum period between borrowing and expenditure is expected to be two years, although the Council is not required to link particular loans with particular items of expenditure.

Financial Implications

The budget for investment income in 2023/24 is forecast to be £887,300 based on an average investment portfolio of £19.860 million at an interest rate of 4.46%. For the purpose of setting the budget, it has been assumed that new treasury investments will be made at an average rate of 4 to 4.5%.

On top of this interest received on third parties loans amounts to £288k.The estimated budget for debt interest to be paid in 2023/24 is forecast to be £5.656 million, based on an average debt portfolio of £179.509m at an average interest rate of 3.15% (2.21% 22/23).The HRA will reimburse the General Fund £2.199m for its share of the debt it holds as at 1 April 2023. If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different.

8. Alternative options

The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Financial Officer, having consulted the Cabinet Member for Finance and Assets, 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 a 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

Appendix 1 - Arlingclose Limited Economic & Interest Rate Forecast February 2023

Economic background:

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

The Bank of England (BoE) increased Bank Rate by 0.50% to 4% in February 2023. This followed a 0.50% rise in December 2022 which was the largest single rate hike since 1989 and the tenth successive rise since December 2021. The February decision was voted for by a 7 2 majority of the Monetary Policy Committee (MPC), with two dissenters voting for a no-change at 3.50%.

The November quarterly Monetary Policy Report (MPR) forecast a prolonged but shallow recession in the UK with CPI inflation remaining elevated at over 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 remain higher for longer over the forecast horizon and the economic outlook remains 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 BoE forecasts Gross Domestic Product (GDP) 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 is expected to have peaked at around 11% in the last calendar quarter of 2022 and then fall sharply to 1.4%, below the 2% target, in two years' time and to 0% in three years' time if Bank Rate follows the path implied by financial markets at the time of the November MPR (a peak of 5.25%). However, the BoE stated it considered 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 MPR.

The labour market remains tight for now, with the most recent statistics showing the unemployment rate was 3.7%. 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 -2.7%. Looking forward, the November MPR shows the labour market weakening in response to the deteriorating outlook for growth, leading to the unemployment rate rising to around 6.5% in 2025.

Interest rates have also been rising sharply in the US, with the Federal Reserve increasing the range on its key interest rate by 0.5% in December 2022 to 4.25%-4.5%. This rise follows four successive 0.75% rises in a pace of tightening that has seen rates increase from 0.25%-0.50% in March 2022. Annual inflation has been slowing in the US but remains above 7%. GDP grew at an annualised rate of 3.2% (revised up from 2.9%) between July and September 2022, but with official interest rates expected to rise even further in the coming months, a recession in the region is widely expected at some point during 2023.

Inflation rose consistently in the Euro Zone since the start of the year, hitting a peak annual rate of 10.6% in October 2022, before declining to 10.1% in November. Economic growth has been weakening with an upwardly revised expansion of 0.3% (from 0.2%) in the three months to September 2022. As with the UK and US, the European Central Bank has been on an interest rate tightening cycle, pushing up its three key interest rates by 0.50% in December, following two consecutive 0.75% rises, taking its main refinancing rate to 2.5% and deposit facility rate to 2.0%.

Credit outlook:

Credit default swap (CDS) prices have generally followed an upward trend throughout 2022, indicating higher credit risk. They have been boosted 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 was higher in 2022 compared to 2021 and the divergence in prices between ringfenced (retail) and non-ringfenced (investment) banking entities has emerged 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 from 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 (February 2023):

The Authority's treasury management adviser Arlingclose forecasts that Bank Rate will rise in 2023 (March 2023) to 4.25% as the Bank of England attempts to subdue inflation which is still significantly above its 2% target. Then they believe the MPC will cut rates in the medium term to stimulate a stuttering economy.

Gilt yields will be supported by both significant new bond supply, quantitative tightening and hawkish central banks, offsetting the downward effects of declining inflation and growth. The likelihood of policy rates remaining higher for too long cannot be discounted, which will lead to more severe downturns than may have been warranted and therefore more significant monetary loosening over the medium term. Gilt yields face pressures to both sides. While there are growing fears of a global decline in economic activity and an expectation of falling inflation rates, these downward effects on gilt yields will be partly offset by hawkish-leaning central bankers, BoE bond sales and high government borrowing.

Please see Arlingclose's interest rate forecasts over the next two years

	Current	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Average
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	0.60
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	3.65
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	-0.69
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	0.60
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	3.96
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	-0.69
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	0.87
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	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	-0.85
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	0.87
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	3.23
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	-0.85
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	0.87
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	3.84
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	-0.85
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	0.87
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	3.59
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	-0.85

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