Treasury Management Strategy 2023/24

1. Introduction

Treasury management is the management of the Council's cash flows, borrowing and investments, and the associated risks. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Council's prudent financial management.

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 Authority to approve a treasury management strategy before the start of each financial year. This report fulfils the Authority's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

Investments held for service purposes or for commercial profit are considered in a different report, the Investment Strategy (see Appendix K).

The current investment strategy is to seek to ensure sufficient liquidity so that investment balances are available to fund all of the Council's approved capital schemes.

2. 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 Authority's treasury management strategy for 2023/24.

The Bank of England increased Bank Rate to 3.50% in December 2022, the largest rate hike since 1989 and the eighth successive rise since December 2021 when the Bank Rate was 0.25%.

The November quarterly Monetary Policy Report 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 previously forecast, due in part to the government's support package for household energy costs, inflation is expected to remain higher for longer over the forecast horizon and the economic outlook remains weak, with unemployment projected to start rising.

Interest rate forecast: the Bank Rate is forecast to increase again and peak at 4.25% in June 2023. Longer term investment yields and borrowing rates are forecast to remain broadly steady over the medium term although there may be continued volatility across shorter time periods.

Table 1 Arlingclose Interest Rate Forecast

Quarter Ending	Bank Rate %	Investment Rates		Borrowing Rates		
		3 month %	5 year %	5 year %	20 year %	50 year %
Mar 2023	4.00	4.40	3.60	4.40	4.65	4.40
Jun 2023	4.25	4.40	3.80	4.60	4.65	4.40
Sep 2023	4.25	4.40	3.80	4.60	4.65	4.40
Dec 2023	4.25	4.35	3.80	4.60	4.65	4.40
Mar 2024	4.25	4.30	3.70	4.50	4.65	4.40
Jun 2024	4.00	4.25	3.60	4.40	4.65	4.40
Sep 2024	3.75	4.00	3.50	4.30	4.65	4.40
Dec 2024	3.50	3.75	3.40	4.20	4.65	4.40
Mar 2025	3.25	3.50	3.30	4.10	4.65	4.40
Jun 2025	3.25	3.40	3.30	4.10	4.65	4.40
Sep 2025	3.25	3.40	3.30	4.10	4.65	4.40
Dec 2025	3.25	3.40	3.30	4.10	4.65	4.40

3. Treasury Balances Forecast

On 31st December 2022, the Authority held £12.3m of borrowing and £95.3m of investments. This is set out in further detail in Table 2.

Table 2 – Existing Investment & Debt Portfolio Position at 31.12.22	**Actual Portfolio £M**
External Borrowing:	
Public Works Loan Board	1.9
Bank Loans	10.4
Total External Borrowing	**12.3**
Treasury investments:	
Short Term	
Banks	4.7*
Local Authorities	22.0
Money Market Funds	31.5
HM Treasury	17.1
Long Term	
Other pooled funds	
- Cash Funds	16.5
- Bond Funds	3.5
Total Treasury Investments	**95.3**
Net Lending (Investments less borrowing)	**83.0**

*This includes £2M in a green deposit investment to finance environmentally sustainable initiatives like renewable energy projects.

Forecast changes in these sums are shown in the balance sheet analysis in Table 3.

Table 3 Treasury Balances Forecast

The forecast balances below in Table 3 show the impact on the treasury balances of the Council's existing approved Capital Programme.

	31.03.23 Forecast £M	31.03.24 Forecast £M	31.03.25 Forecast £M	31.03.26 Forecast £M	Notes
Capital Financing Requirement (CFR)	24.6	57.3	62.1	63.4	1
Less: External Borrowing already taken	(12.3)	(12.3)	(12.3)	(12.3)	2
Cumulative Borrowing Requirement	**12.3**	**45.0**	**49.8**	**51.1**	3
Usable Reserves and Provisions at 31st March	49.6	38.9	33.7	26.9	4
Working Capital	21.6	11.5	11.5	3.0	5
Less: Internal Borrowing	(12.3)	(45.0)	(49.8)	(51.1)	6
Treasury Investments by 31st March or (New Borrowing)	**58.9**	**5.4**	**(4.6)**	**(21.2)**	7

Notes to Table 3

1. The CFR is the amount the Authority needs to borrow for a capital purpose. The CFR increases when Prudential Borrowing is used to finance the capital programme. The Authority's capital expenditure plans are the key driver of treasury management activity and are summarised in the Capital Strategy Report. The CFR increases significantly during 2023/24 due to the capital expenditure that is being incurred on the Animate project.
2. This is the amount of debt that the Authority has already borrowed.
3. This is the cumulative amount of new borrowing that is required to finance the Capital Programme. The timing of new borrowing will be determined by the profile of capital expenditure and the availability of Internal Borrowing (Note 7).
4. This line represents the amount of usable reserves, balances and provisions which are available as cash. The forecast changes to the amount of usable reserves and provisions are determined by the drawdown of reserves, balances and provisions as estimated in the Financial Forecast Update 2022/23 to 2026/27 and the Capital Programme.
5. Working Capital is a temporary surplus in day to day cash. The current balance represents an estimate of cash held at 31st March 2023 and significant cash sums held on behalf of the Collection Fund (being the County Council, Preston City Council, the Police Authority and the Fire Authority).
6. Internal Borrowing occurs when the Authority uses its own cash resources to finance capital expenditure rather than new external borrowing. This is a prudent approach when investment returns are low. The amounts shown are the cumulative amount of borrowing required for each year. The forecast shows that using internal borrowing is not sustainable over the life of the forecast and during 2024/25 the Council will need to externally borrow.
7. This is the forecast amount of cash available for investment after allowing for the funding of Internal Borrowing and amounts in brackets indicate how much new external borrowing is required.

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Authority's current strategy in the short-term is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

The Authority has an increasing CFR due to the capital programme. The cash available for investing reduces as reserves are drawn down, working capital is depleted and internal borrowing is used to fund the Capital Programme. Based on current forecasts, the Authority will be required to borrow externally up to £21.2M over the forecast period.

CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Authority's total debt should remain lower than the highest forecast CFR over the next three years. Table 3 shows that the Authority expects to comply with this recommendation during 2023/24.

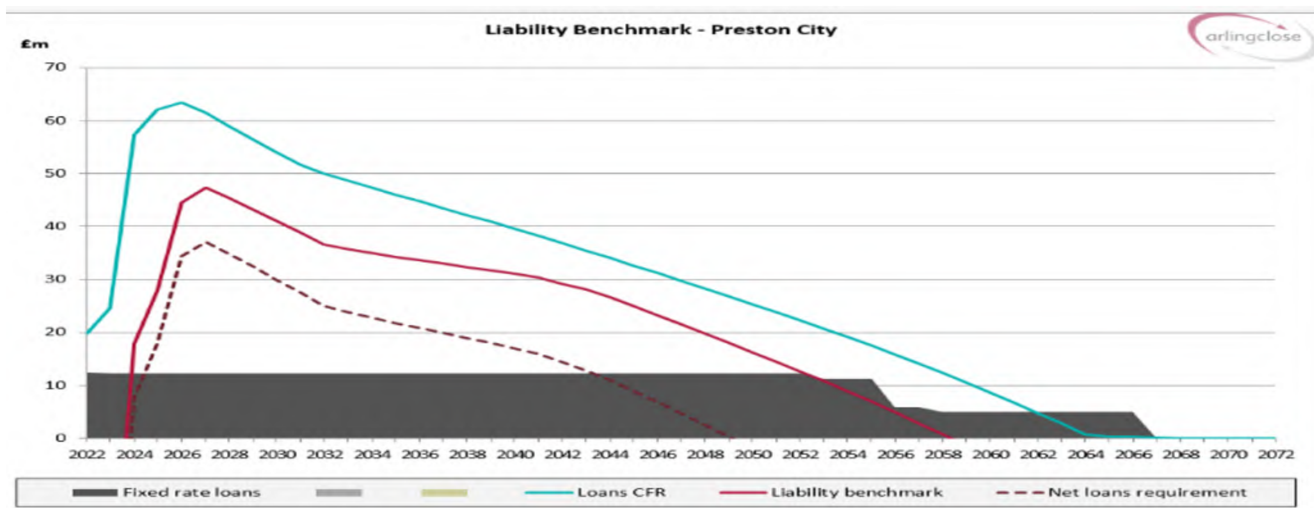
The CIPFA Prudential and Treasury Management Codes have introduced a new Prudential Indicator known as the **Liability Benchmark**. The liability benchmark is a measure of how well the existing loans portfolio matches the Authority's planned borrowing needs. It tells the Authority how much it needs to borrow, when, and the maturity of investments needed to match the planned borrowing needs. It is made up of four balances:

- Existing borrowing
- CFR – projected into the future
- Net loans requirement – a forecast of the Authority's net loan debt (net of investments for treasury management purposes)
- Liability benchmark – a forecast of the Council's gross loan debt

Table 4 Liability Benchmark

	31.03.22 Actual £m	31.03.23 Estimate £m	31.03.24 Estimate £m	31.03.25 Estimate £m	31.03.26 Estimate £m
Loans CFR	19.8	24.6	57.3	62.1	63.4
Less: Usable Reserves & Provisions / Balance Sheet Resources	(85.8)	(71.2)	(50.4)	(45.2)	(29.9)
Net loans requirement	**(66.0)**	**(46.6)**	**6.9**	**16.9**	**33.5**
Plus: Liquidity allowance	10.0	10.0	10.0	10.0	10.0
Liability benchmark	**(56.0)**	**(36.6)**	**16.9**	**26.9**	**43.5**

Using the forecasts in Table 4, the long-term liability benchmark includes capital expenditure that is funded by borrowing, the minimum revenue provision on capital expenditure, and includes expenditure and reserves (all increasing by inflation of 2.5% in the longer term from 2027). This is shown in the Arlingclose chart below over a 50-year period together with the maturity profile of the Authority's existing borrowing.



Any years where actual fixed rate loans are less than the liability benchmark indicate a future borrowing requirement. Any years where actual fixed rate loans exceed the benchmark represent an overborrowed position which will result in excess cash requiring investment. The liability benchmark suggest that the Authority will need to borrow from 2024 for a period of up to 30 years and the actual timing of this borrowing will depend on whether the Council's spending plans proceed as planned.

4. Borrowing Strategy

The Authority currently holds £12.3m of loans as part of its strategy for funding previous years' capital programmes. The Treasury Balances Forecast in Table 3 shows that the Authority expects to borrow to fund the Capital Programme. The Authority may however borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £53.1m in 2023/24.

Objectives: The Authority'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 in the event that the Council's long-term plans change is a secondary objective.

Strategy: Given the significant cuts to public expenditure and in particular to local government funding, the Authority's borrowing strategy continues to address the key issue of affordability. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. Arlingclose will assist the Authority with determining when to borrow with a view to keeping long-term interest costs low. The Authority may borrow short-term to cover unexpected cash flow movements.

The Authority has previously raised some 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 consider the possibility of issuing bonds and similar instruments in order to lower interest costs. PWLB loans are no longer available to local authorities who are planning to buy investment assets primarily for yield and the Authority intends to avoid this activity in order to retain its access to PWLB loans.

Alternatively, the Authority may arrange forward starting loans, 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 Authority is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year. In line with statutory guidance, a lower "operational boundary" is also set and is based on the Authority's estimate of most likely but not worst-case scenario and should equate to the maximum level of external debt projected by this estimate. The Operational Boundary and the Authorised Limit are increasing to allow sufficient headroom for new external borrowing for the approved Capital Programme which includes significant new borrowing for the Animate project.

Table 5 Prudential Indicators: Authorised limit and Operational Boundary for External Debt

	2022/23 Limit £M	2023/24 Limit £M	2024/25 Limit £M	2025/26 Limit £M
Authorised Limit – maximum external debt	22.3	53.2	53.2	56.5
Operational Boundary – total external debt	14.3	21.9	31.9	48.5

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

- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
- Any institution approved for investments (see below)
- Any other bank or building society authorised to operate in the UK
- Any other UK public sector body
- UK public and private sector pension funds (except Lancashire County Pension Fund as it is the Authority's own pension fund)
- Capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

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

- Leasing
- Hire purchase
- Private Finance initiative
- Sale and leaseback and similar arrangements

All decisions on borrowing will be reported to the Cabinet Member for Resources and Deputy Leader in the Quarterly Treasury Management Report.

5. Investment Strategy

The Authority holds significant invested treasury funds, representing income received in advance of expenditure, monies held on behalf of the Collection Fund (Lancashire County Council, the Police and Crime Commissioner for Lancashire and Lancashire Combined Fire Authority) plus balances and reserves held. At 31st December 2022 the Authority had treasury investments of £95.3m but these are expected to diminish in the forthcoming years as cash is required to fund the Capital Programme.

Objectives: The CIPFA Code requires the Authority to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. The Authority aims to be a responsible investor and will consider environmental, social and governance (ESG) issues when investing.

Strategy: The Council will continue to adopt a prudent approach to investment management to ensure that cash balances are readily available to fund capital projects and meet revenue needs.

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 Authority's ESG policy does not 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 Investment.

Approved counterparties: The Authority may invest its surplus funds with any of the counterparty types in Table 6 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 6: Approved investment counterparties and limits

Investment Type / Minimum Credit Rating (Note 1)	Banks Unsecured (Note 2)	Banks Secured (Note 3)	Government (Note 4)
UK Government	n/a	n/a	£ Unlimited 50 years
UK Treasury Bills	n/a	n/a	£18m in Total for 6 months
UK Local Authorities	n/a	n/a	£5m each for periods of up to 1 year £7m each for overnight/call deposits
Investment Rated A-	£2m each for 6 months	£4m each for 1 year	n/a
Building Societies (unsecured) (Note 2)	£1m each (maximum of £2m) for 3 months	n/a	n/a
Money Market Funds (Note 5)	£3.5m per Fund		
Cash Plus Funds (Note 5)	£6m per Fund (£20m in Total)		
Bond Funds (Note 5)	£5m in Total		
Registered Providers (Preston area) (Note 6)	£1m in Total for 5 years		
Any other organisation (Note 7)	£200k each for 5 years		

This table must be read in conjunction with the notes below.

Notes to Table 6

1. **Credit rating:** Investment limits are set by reference to the lowest published long-term credit rating from a selection of external rating agencies. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.
2. **Banks and building societies unsecured:** Includes accounts, deposits, certificates of deposit and unsecured bonds with banks and building societies. 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.
3. **Banks secured:** Includes covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's

assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits.

4. **Government:** Includes loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts as a contingency in the event of a crisis.
5. **Pooled Funds**: These Funds are shares in diversified investment vehicles which invest in any of the investment types above (Notes 2 to 4), plus equity shares and property. These funds provide wide diversification, together with the services of a professional Fund Manager. The Money Market Funds offer same-day liquidity and very low volatility and are used as an alternative to instant access bank accounts. There is no sector limit applying to Money Market Funds although the Council will take care to diversify its liquid investments over a variety of providers to ensure The Cash Plus and Bond Funds may be used for investments for a longer period and the value of these investments may change in line with market prices but offer enhanced returns over the longer term. These funds have no defined maturity date but are available for withdrawal after a short notice period.
6. **Registered providers:** These are longer term loans or bonds that are secured or guaranteed on the assets of Registered Providers of Social Housing. These bodies are highly regulated by the Homes and Communities Agency and are likely to receive government support if needed.
7. **Other organisation:** This is subject to an external credit assessment and specific advice from the Council's treasury management adviser.
8. **Foreign Countries**: Investments with institutions domiciled in foreign countries rated AA+ or higher will be limited to £2m per foreign country. This limit does not apply to Pooled Funds as these funds spread their investments over many countries in order to reduce risk.
9. **Operational bank accounts:** The Council's own bank account which is used for all of the Council's operational activities will have a minimum credit rating of BBB- and assets greater than £25 billion. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity. The balances in the Council's own bank account will ideally be kept below £2m. Due to cash flow fluctuations this limit may be exceeded on occasion and if the limit is exceeded for more than three working days the Section 151 Officer will review.
10. **Risk assessment and credit ratings**: Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. Where a credit rating agency announces that a counterparty of the Council is on review for a possible credit rating downgrade (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 until the outcome of the review is announced. This policy will not apply to credit rating 'negative outlooks' which indicate a long-term trend rather than an imminent change of credit rating.
11. **Other information on the security of investments**: Credit ratings are not the only predictors of investment default. Other information is also used to assess the credit quality of counterparties. This information includes credit default swap prices, financial statements, potential government support and reports in the financial press. This information is analysed by the Council's treasury advisors and no investments will be made with an organisation if there are doubts about its credit quality, even though it may meet the credit rating criteria.

    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 Authority's cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned but will protect the principal sum invested.

12. **Liquidity management**: The Council uses a detailed daily cash flow forecast 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. The Council spreads its liquid cash over a number of providers (e.g., Bank accounts and money market funds) to ensure that access to cash is maintained in the event of operational difficulties at any one provider.

6. Treasury Management Prudential Indicators

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

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

Table 7 Maturity Structure of Debt

Refinancing Risk Indicator	Lower Limit	Upper Limit
Under 12 months	0%	40%
12 months to 2 years	0%	50%
2 years to 5 years	0%	85%
5 years to 10 years	0%	90%
10 years and above	0%	100%

No lower limit is set in order to allow flexibility when managing the debt portfolio in the current economic conditions. Time periods start on the first day of each financial year.

Long Term Treasury Management Investments: The Council's only investment that can be considered as long term for Prudential Indicator purposes is a historic £3.5M investment in the Payden bond fund. The following indicator is set to control the Authority's exposure to the risk of incurring losses by seeking early repayments of this investment. The monies in the bond fund are forecast to reduce as cash is required to fund the capital programme. The timings of any withdrawals will be planned based on cash flow forecasts and in conjunction with treasury advisors. The prudential limit on the long-term treasury management investments will be:

Table 8 Price Risk Indicator

Price Risk Indicator	2023/24	2024/25	2025/26
Limit on principal invested beyond year end	£3.5m	£2.5m	£1.5m

- **Security** – the Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio with a target rating of A-.
- **Liquidity** – the Authority will continue to manage its cashflow so as not to go overdrawn.
- **Yield** – the benchmark for returns on investments is the Sterling Overnight Index Average (SONIA) and actual investment returns are monitored against budget.

Table 9 Interest Rate Risk Indicator

Interest rate exposures: The following indicator shows the sensitivity of the Authority's existing investments and borrowing to a change in interest rates.

Interest rate risk indicator Sums subject to variable interest rates:	**£m**	**Impact of a 1% rate rise**			**Impact of a 1% rate fall**		
		2023/24 £m	**2024/25 £m**	**2025/26 £m**	**2023/24 £m**	**2024/25 £m**	**2025/26 £m**
Investments	67.7	(0.41)	(0.64)	(0.67)	0.41	0.64	0.67
Borrowing	n/a	All existing borrowing is at a fixed rate.					

There are a number of additional items that the Authority is obliged to include in the Treasury Management Strategy. These are:

- **Policy on Use of Financial Derivatives** – the Authority will only use financial derivatives (such as swaps, forwards, futures and options) where it can be clearly demonstrated to reduce the level of financial risks that the Council is exposed to. 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. In line with the CIPFA Code, the Council will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.
- **Markets in Financial Instruments Directive –** the Authority has opted up to professional client status with its providers of financial services allowing it access to a greater range of services but with the greater regulatory protections afforded to individuals and small companies. This is the most appropriate status given the size and range of the Council's treasury management activities.

Financial Implications

The budget for investment income in 2023/24 is £0.61m based on an average inhouse investment portfolio of £10m at 3.5% and an external investment portfolio of £20M (for the first four months after which time cash may be redeemed to fund the capital programme) at an interest rate of 3.5%. The budget for debt interest payable in 2023/24 is £1.0m based on an existing debt portfolio of £12.3m at an average fixed interest rate of 4.8% and new borrowing of up to £8.5m at an interest rate of 4.9%. If actual levels of investments and borrowing, or actual interest rates, differ from those forecast, performance against budget will be correspondingly different.

Where investment income exceeds budget or debt interest paid falls below budget then the revenue savings will be transferred to a treasury management earmarked reserve to cover the risk of higher interest rates payable in future years for the Council's capital projects.

Other Options Considered

The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Section 151 Officer, having consulted the Cabinet Member for Resources and Deputy Leader, 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 and reduced liquidity
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	Penalties for repaying debt early will significantly impact on Revenue budgets	Long-term interest costs may be less certain